Additional Guidance for the audit of USAID funded projects

A chapter for the DAGP's "Guidelines for the audit of foreign aided projects"

(To be used by the Field Audit Offices of the DAGP for the audit of US AID funds)

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1. Perspective

1.1. The Department of the Auditor-General of Pakistan (DAGP), which is the Supreme Audit Institution (SAI) of the country, has signed a Memorandum of Understating (MOU) with the US AID on 26 April 2007 under which the office of the Regional Inspector General Manila (RIG Manila), the US AID and the SAI Pakistan have agreed that the SAI Pakistan will conduct the audit of the funds provided under USAID funding arrangement with the government of Pakistan. The MOU, Annexure 1, in its opening two clauses provides:

> 1. The audits shall be performed in accordance with the "Guidelines for Financial Audits Contracted by Foreign Recipients," issued by the USAID Inspector General, as required by Standard Audit Provisions contained in the respective agreements between USAID/Pakistan and the Government of Pakistan.
>
> 2. USAID/Pakistan and the SAI agree that the SAI will perform audits in accordance with the U.S. Government Auditing Standards or the Financial Audit Manual and the guidelines developed by SAI Pakistan.

1.2. This Chapter of the DAGP's Audit Guidelines for the Audit of Foreign Aided Projects (hereinafter referred to as DAGP's Guidelines) outlines the requirements of the US AID audit prescribed by the US AID Inspector General in the **Guidelines for Financial Audits Contracted by Foreign Recipients** (hereinafter referred to as OIG's Guidelines).

1.3. The DAGP's Guidelines are issued in pursuance of the Financial Audit Manual (FAM) of the Auditor-General of Pakistan (AGP), which derives its authority from the International Standards of Auditing for the Supreme Audit Institutions (ISSAIs). While various chapters of the DAGP's Guidelines provide comprehensive guidance about the auditing standards, methodology, audit planning, audit execution and audit reporting pertaining to the audit of foreign aided projects in Pakistan, **this chapter delineates the specific auditing and reporting requirements of the United States government regarding the audit of the US AID funds.**

1.4. This Chapter covers the audit objectives, the scope of audit, terms of engagement, and the audit reporting requirements along with the procedures for the closure of audit recommendations. It also defines the roles of the Field Audit Offices (FAOs) of the AGP, the Audited Entities and the US Aid mission in the audit.

2. Audit Objectives

2.1. According to the FAM, the SAI Pakistan's audits are carried out under ISSAIs. The ISSAIs, among other things, define the scope and objectives of the all the financial audits carried out by the SAIs.

2.2. The specific audit objectives of the financial audit of the US AID funds are defined in the OIG's Guidelines, which are available with the US AID mission in Pakistan and the FAOs dealing with audit of USAID fund must obtain a copy of these Guidelines before the commencement of audit. The Section 3.1 of the OIG's Guidelines specifies that

> *"The financial audit must include a specific audit of all the recipient's USAID-funded programs. The financial audit should also include an audit of the recipient's general purpose financial statements on an organization-wide basis (balance sheet, income statement, and cash flow statement)…. if the mission specifically requests such an audit.* ***The fund accountability statement is the basic financial statement to be audited that presents the recipient's revenues, costs incurred, cash balance of funds provided to the recipient by USAID, and commodities directly procured by USAID for the recipient's use.*** *The fund accountability statement should be reconciled to the USAID funds included in the general purpose financial statements by a note to the financial statements or the fund accountability statement. All currency amounts in the fund accountability statement, cost-sharing schedule, and the report findings, if any, must be stated in U.S. dollars. The auditors should indicate the exchange rate(s) used in the notes to the fund accountability statement."*

2.3. The Fund Accountability Statement is a critical document for the purposes of the financial audit of the USAID funds. A typical Fund Accountability Statement is attached for the ready reference of the FAOs at Annexure 2. For a comprehensive audit of the Fund Accountability Statement, the FAOs will be required to refer to Sections 4.3-4.7 of Chapter 4 of the OIG's Guidelines. For ease of reference, the FAOs may refer to Section IV of the **Annexure 3** where the OIG's requirements have been listed under the heading **Audit Scope**.

2.4. The specific audit objectives of the financial audit of the USAID funds, as defined in the OIG's Guidelines, are to

- Express an opinion on whether the fund accountability statement for the USAID-funded programs presents fairly, in all material respects, revenues received, costs incurred, and commodities directly procured by USAID for the period audited in conformity with the terms of the agreements and generally accepted accounting principles or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis).

- Evaluate the recipient's internal control related to the USAID-funded programs, assess control risk, and identify significant deficiencies including material weaknesses. This evaluation should include the internal control related to required cost-sharing contributions.
- Perform tests to determine whether the recipient complied, in all material respects, with agreement terms (including cost sharing/counterpart contributions, if applicable) and applicable laws and regulations related to USAID-funded programs. All material instances of noncompliance and all illegal acts that have occurred or are likely to have occurred should be identified. Such tests should include compliance requirements related to required cost-sharing contributions, if applicable.
- Perform an audit of the indirect cost rate(s) if the recipient has been authorized to charge indirect costs to USAID using provisional rates and USAID has not yet negotiated final rates with the recipient. (The OIG's Guidelines -section 3.2)

2.5. The OIG's Guidelines require that the Auditors must design audit steps and procedures in accordance with the applicable auditing standards, to provide reasonable assurance of detecting situations or transactions in which fraud or illegal acts have occurred or are likely to have occurred. If such evidence exists, the auditors must contact Office of the Inspector General and should exercise due professional care in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations or legal proceedings.

2.6. The methodology of financial audit defined in the DAGP's Guidelines adequately covers the specific audit objectives of the US AID. The FAOs may be required to adjust the Audit Programmes prescribed in the Chapter 6 of the DAGP's Guidelines for addressing the specific needs of the audit of US AID funds specified in **Annexure 3** and referred to in paragraph 2.3 above.

3. Scope of audit

3.1. The overall scope of the financial audit of foreign aided projects has been defined in Chapter 3 of the DAGP's Guidelines. Paragraph 1 of the Chapter 3 emphasizes that *"The audit team should also ensure that these Guidelines are applied in such a way that both the DAGP's standards and those of the donor or lending agency are met."*

3.2. For determining the specific scope of the financial audit of the US AID funds, the FAOs will be required to refer to clauses 5 & 6 of the MOU, which are reproduced below for ease of reference.

> Standard statements of the work provided by USAID, RIG/Manila as examples to be used in performing audits of governmental organizations are attached, and are an integral part of this MOU. The statements of work cover audit requirements for revenue producing governmental organizations and non-revenue producing governmental organizations. USAID/Pakistan shall approve the audit cost proposal and the statement of work before audit work begins. USAID/Pakistan may expand the scope of work to allow the review of specific areas that may be of particular interest to USAID/Pakistan for ensuring proper accountability over resources provided to the recipient, and may meet with the SAI at the beginning of the audit to explain any financial or compliance areas of concern contained in the statement of work that USAID/Pakistan wants to emphasize.
>
> The scope of audit of both revenue producing and non-revenue producing governmental organizations shall require a report on the Fund Accountability Statement for the USAID funded programs and a report on Internal Controls related to the USAID funded programs and a report on compliance with agreement terms and applicable laws and regulations related to the USAID funded programs. In addition, the scope of audit for revenue producing governmental organizations shall require an audit of the financial statements of the recipient organization.

3.3. The Standard Statement of Work referred to in clause 5 of the MOU is an obligatory requirement of the audit of US AID funds. Annexure 3 to this chapter contains an updated version of the Statement of work, which the FAOs will be required to issue before the commencement of audit as part of the Entity Communication Letter referred to in Chapter 5 of the DAGP's Guidelines. The FAOs will be advised to note that the Standard Statement of Work attached as Annexure 3 duly incorporates the requirements of the various provisions of the OIG's Guidelines.(Also please see paragraph 2.3 above.)

3.4. Since the SAI Pakistan conducts it audits under the FAM, it may be noted that wherever the Standard Statement of Work refers to the US Government or other auditing standards, the FAOs will substitute such references with relevant references from the FAM which derives its authority from the ISSAIs.

3.5. The following paragraphs of this Chapter highlight the salient features of the scope of audit of the US AID funds.

3.6. General consideration: The DAGP's Guidelines expect the FAOs to conduct the audit of the foreign aided projects in such a way that the requirements of the donor agencies are met along with the requirements of the home country systems. The Chapter 2 (paragraph 2) of the DAGP's Guidelines clearly provides

> *"As the FAP are co-financed by the donors agencies along with the GOP, the donors have prescribed/recommended in their respective guidelines various rules and procedures relating to bidding, procurement, selection of consultants etc. Whereas, each FAP is governed through PC-I duly approved by the Central Development Working Party (CDWP or the Executive Committee of the National Economic Council (ECNEC), the GOP has expressly granted the donor guidelines precedence over the Governmental rules and regulations."*

3.7. The DAGP's Guidelines are also cognizant that

> *"Before providing funds, donor agencies sign formal agreements with the Government of Pakistan, stating therein the terms and conditions which should be complied with during the course of fund utilization. Therefore, in the audit of Foreign-aided Projects, the donor or funding agencies will often have their own reporting requirements for the audit of foreign aided projects. The audit team should ensure that these Guidelines are applied in such a way that both the DAGP"s standards and specific requirements of the donor or lending agencies are met."* (Chapter 2, paragraph 4).

3.8. The FAOs are therefore required to develop their audit plans and programmes keeping in view the overall expectations of the US AID and the GOP from the audit of US AID assisted projects.

3.9. Selection of projects and programmes: Under the agreements between the Government of Pakistan and the US AID, the annual audit of the US AID funds is mandatory. The FAOs are therefore required to include all the US AID projects in their annual plans for audit. The resources for such audits should be allocated in such timeframes that the deadlines agreed for the timing of the audit out-puts are met.

3.10. Section 4.1 The DAGP's Guidelines states "… *information about the entity's size and business helps in assessing materiality; understanding the entity's operations can help to determine what components to audit; and, knowing the types of transactions entered into by the entity helps to assess inherent risks to the entity. This information will be fairly consistent and relevant for at least a few years' audits."* The following three paragraphs briefly give a profile of the current US AID assistance in Pakistan.

3.11. In Pakistan, the US AID has provided over $2.8 billion in assistance since 2009. Energy, Economic growth, Stabilization, Education and Health were identified as long-term development areas of interest for the US AID. Recently, the USAID has chosen to implement over half of all funding through local organizations (both Government and Non-Government) in Pakistan.

- Government includes National and Sub-National Governments
- Non-Government includes CSOs/NGOs, for profit organizations etc.

3.12. The US AID also works extensively with local contractors and other indigenous institutions which is an approach that ensures that programs are aligned with local priorities and builds local capacity. Major sectors in which the US AID has assisted Pakistan are Education, Governance, Cash Transfer, Economic Growth, Health, Reconstruction, Social Assistance, Agriculture, Energy, FATA, and KPK.

3.13. Various implementation mechanisms used in providing assistance through Government to Government assistance are

- Budget Support Cash Transfer
- Sector Specific Budget Support Cash Transfer
- Sector Specific Budget Support with Special Currency
- Fixed Amount Reimbursements
- Cost Reimbursement Agreements
- Purpose Accomplished Upon Disbursement – proposed

3.14. For determining their approach to audit the US AID funds, the FAOs are required to consult the updated assistance profile available with the US AID Mission in Islamabad.

3.15. **Types of audit:** Chapter 3 of the DAGP's Guidelines extensively deal with various types of audit that the FAOs are required to carry out in case of foreign aided projects. The types of audits specified in the DAGP's Guidelines are based on the ISSAIs and include **Financial Attest, Compliance with Authority** and **Performance** audits. The MOU and the OIG's Guidelines emphasize the Financial Attest and Compliance with Authority audits by the SAI Pakistan. Wherever required by the US AID, specifically in pursuance of the OIG's Guidelines, the FAOs will be required to carry out the Performance Audit according to the Performance Audit Manual prescribed by the DAGP.

3.16. Sections 3.3 and 3.4 of the DAGP's Guidelines deal with the Objectives and Methodologies of the Certification and Compliance with Authority audits, respectively. Section 3.6 generically profiles the scope of foreign funded projects and Section 3.7 emphasizes that an updated list of projects available at the DAGP's HQ must be consulted for audit before determining the scope of audit. Section 3.10 highlights the major components of the foreign aided projects with a view to underlining the possible audit risk areas. It may be useful to reproduce here the major components of foreign funded projects so that the auditors of the US AID funds can develop their audit risk profile with reference to programmes and projects.

3.17. The major areas of a typical foreign funded project susceptible to audit risk, highlighted by the DAGP's Guidelines, are

- Award of contract to unsuitable supplier/contractor.
- Time overrun leading to exorbitant cost overrun.
- Employment of unwanted work charge establishment.
- Completion and certification of work below specification
- Technical sanctions not awarded by the competent authority
- Repeated revisions of drawings/estimates and administrative approvals.
- Maintenance of stock without its actual requirement.
- Non-auction of unserviceable material/machinery.
- Non-maintenance of record relating to assets.
- Violation of provisions of the guidelines given by the donors in respect of procurement.
- Excess expenditure against one grant and under expenditure against another
- Lack of reconciliation
- Lack of disclosure of the terms and conditions attached to loans
- Need for improved accuracy in reporting
- Generation of accounts not timely
- Confirmation of expenditure from Principal Accounting Officers and reconciliation by the DDO not strictly enforced.

3.18. It needs to be noted that the risk areas identified in the preceding paragraph are only indicative and the FAOs are required to develop the overall audit risk profile in the light of various provisions of the DAGP's Guidelines given in Chapters 5 paragraphs 5.13-5.28.

3.19. Adjustment of audit programmes: Chapter 6 the DAGP's Guidelines, among others, specifies detailed audit programmes for the audit of foreign aided projects in the following areas:

- Project Verification
- Procurement

- Appointment of Consultant(s)
- Payroll
- Inventory Management
- Fixed Assets
- Accounts Compilation

3.20. The above listed audit programmes are only indicative and the DAGP's Guidelines duly recognize that

> *"The Audit Programmes given in this section cannot provide an exhaustive set of checks. Although in certain cases specific references to the current rules and regulations have been given in the audit programmes, it needs to be noted that the auditor should be familiar with the operations of the audit entity and should have a sound knowledge of the relevant laws, regulations and rules with which the transactions must comply. This will allow him/her to make appropriate adjustments to the audit Programme guides. Furthermore, if the audit programmes do not cover the auditor's requirements, he can add an audit work sheet on which he notes the details of transaction(s) (revenue/expense /investment etc), his audit procedure(s) and findings."* (Section 6.16 of the DAGP's Guidelines.)

3.21. In view of the above provisions of the DAGP's Guidelines, the FAOs responsible for the audit of the US AID funds will be required to develop additional Audit Programme Guides for areas not specified above, if required specifically by the US AID under the MOU. **It needs to be noted that the Audit Policy Wing of the DAGP has issued guidance in connection with Forensic Audit to the FAOs, which also applies to the audit of the US AID funds.**

4. Terms of engagement

4.1. In line with the provisions of the ISSAI 1220 ―Agreeing the Terms of Audit Engagement", both the DAGP's as well as the OIG's Guidelines require the auditors to issue an audit engagement letter to the audited entity. Chapter 5 of the DAGP Guidelines requires the FAOs to issue an Entity Communication Letter to the audited entity (Annexure 4). Section 5.6 of the Audit Guidelines, titled 'Entity communication letter', states :

"The Audit Working Papers Kit includes the template of a letter which needs to be issued to the management of the auditee. It sets out the terms of the audit and will include the issues that the auditor wants to bring to the attention of entity's management. This letter will clarify what is expected from auditors during the course of audit and leads to cooperation between both the parties."

4.2. The Audit Working Papers Kit recognizes the need that in some circumstances the auditors will be required to make adjustments to the recommended template of the Entity Communication letter. The Audit Working Papers Kit provides that "*If desired, the letter may be expanded to include such matters as:*

- *DAGP's current understanding of any specific entity requirements;*
- *The timetable for the audit work;*
- *Details of assistance required from internal audit and other entity staff; and*
- *Information to be provided by entity officials.*
- *Follow up matters from previous audits."*

4.3. Clause 4 of the MOU refers to a schedule of audit and indicates a possible format which may be kept in view by the FAOs while issuing the Entity communication letter. The MOU requires that the schedule of audit activities to be carried out by the SAI Pakistan, among others must include the following:

- Names of the governmental institutions to be audited;
- Identification numbers of USAID/Pakistan agreements to be covered by the audits;
- Fiscal year to be covered by the audit;
- Name of the auditors (SAI or public accounting firm).

4.4. An important element of the Entity Communication letter pertains to the review of the previous audit findings and the remedial measure initiated by the audited entity. Such a review enables the auditors to identify additional audit risks. Both during the planning and execution phases of audit, the auditors are required to review the outstanding audit observations from the previous years and bring all the unresolved matters to the notice of the US AID. Section 6 of this Chapter gives more details in this regard.

5. Audit reporting requirements

5.1. The audit reporting requirements from the audit of foreign aided projects are elaborately defined in the DAGP's Guidelines. The DAGP's Guidelines also provide standard templates of the audit report, which are based on formats recommended in the ISSAIs. Recognizing the need for the special reporting requirements of the donor agencies, Chapter 2 (page 6) of the DAGP's Guidelines provides:

> Before providing funds, donor agencies sign formal agreements with the Government of Pakistan, stating therein the terms and conditions which should be complied with during the course of fund utilization. Therefore, in the audit of Foreign-aided Projects, the donor or funding agencies will often have their own reporting requirements for the audit of foreign aided projects. The audit team should ensure that these Guidelines are applied in such a way that both the DAGP"s standards and specific requirements of the donor or lending agencies are met.

5.2. In order to facilitate the FAOs in meeting the reporting requirements of the audit of US AID funds, this Chapter of the DAGP's Guidelines primarily identifies the US AID audit reporting requirements which are based on the OIG's Guidelines.

5.3. Chapter 5 of the OIG's Guidelines adequately addresses the audit reporting requirements of the US Government from the audit of US AID funds. While these requirements are also stated in the Standard Statement of the Scope of Work at Annexure 3 of this Chapter, it may be appropriate to reproduce its salient features for ease of reference of the FAOs.

5.4. The OIG's Guidelines require a portable document format (PDF) copy of the audit report in English in the format and content of the illustrative audit reports given in Chapter 7 of the OIG's Guidelines. The audit report must specify the correct award number(s) of each award covered by the audit. The report must contain a title page, table of contents, transmittal letter, and a summary which includes:

- a background section with a general description of the USAID programs audited, the period covered, the program objectives, a clear identification of all entities mentioned in the report, a section on the follow-up of prior audit recommendations, whether cost sharing/counterpart contributions were required during the period audited, and whether the recipient has a USAID-authorized provisional indirect cost rate

- the objectives and scope of the financial audit and a clear explanation of the procedures performed and the scope limitations, if any
- a brief summary of the audit results on the fund accountability statement, questionable costs, internal control, compliance with agreement terms and applicable laws and regulations, indirect cost rates, status of prior audit recommendations, and, if applicable, the recipient's general purpose financial statements on an organization-wide basis
- a brief summary of the results of the review of cost sharing/counterpart contributions and
- a brief summary of the recipient's management comments regarding its views on the audit and review results and findings.

5.5. The auditor's report on the Fund Accountability Statement should identify any material questioned costs not fully supported with adequate records or not eligible under the terms of the agreements. The report must be in conformance with the standards for reporting in Chapter 5 of U.S. *Government Auditing Standards* and must include:

> The auditor's opinion on whether the fund accountability statement presents fairly, in all material respects, program revenues, costs incurred, and commodities directly procured by USAID for the year then ended in accordance with the terms of the agreements and in conformity with generally accepted accounting principles or other basis of accounting. This opinion must clearly state that the audit was performed in accordance with U.S. *Government Auditing Standards* or specific alternative standards if applicable. (**As the SAI Pakistan performs the audit under the FAM, the FAOs will refer to the ISSAIs).**

5.6. The auditor's report on the review of the schedule of cost sharing/counterpart contributions must include a review report on the cost sharing/counterpart contributions schedule. The report must identify material questioned costs related to the provision of, and accounting for, cost sharing/counterpart contribution funds, with a reference to the corresponding finding in the report on compliance if the questioned costs are material. It should show cost sharing/counterpart contributions that are unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related are ineligible. It should also show cost sharing/counterpart contributions that lack adequate documentation or do not have required prior approvals or authorizations are unsupported.

5.7. The auditor's report on internal control must include as a minimum: (1) the scope of the auditor's work in obtaining an understanding of internal control and in assessing the control risk, and; (2) the significant deficiencies including the identification of material weaknesses in the recipient's internal control. Any other matters related to internal control – such as suggestions for improving operational or administrative efficiency or internal control, or control deficiencies that are not significant deficiencies or material weaknesses – may be communicated through a separate management letter that should be referred to in the report on internal control and sent with the audit report.

5.8. **The auditor's report on the recipient's compliance with agreement terms and applicable laws and regulations related to USAID-funded programs** must include material instances of noncompliance Nonmaterial instances of noncompliance should be communicated to the recipient in a separate management letter that should be sent with the audit report. All material questioned costs resulting from instances of noncompliance must be included as findings in the report on compliance.

5.9. **The auditor's report must include all conclusions that fraud or an illegal act either has occurred or is likely to have occurred**. This report must include identification of all questioned costs, if any, as a result of fraud or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected and whether the recipient does or does not agree with the findings and questioned costs. Abuse that is material, either quantitatively or qualitatively, must also be reported.

5.10. **In reporting material fraud, illegal acts, or other noncompliance**, the auditors must place their findings in proper perspective. To give the reader a basis for judging the extent and seriousness of these conditions, the instances identified should be related to the universe or the number of cases examined and is quantified in terms of U.S dollar value, if appropriate. Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense.

5.11. **The recipient's general purpose financial statements on an organization-wide basis and the auditor's report** on them only apply to recipients with an indirect cost rate that needs to be audited, unless the mission specifically requests that the statements be audited.

5.12. The findings contained in the reports on internal control and compliance related to USAID-funded programs must include a description of the condition (what is) and criteria (what should be). The cause (why it happened) and effect (what harm was caused by not complying with the criteria) must be included in the findings. In addition, the findings must contain an actionable *recommendation* that corrects the cause and the condition, as applicable. It is recognized that material internal control weaknesses and noncompliance found by the auditors might not always have all of these elements fully developed, given the scope and objectives of the specific audit. The auditors must, however, at least identify the condition, criteria and possible effect to enable management to determine the effect and cause. This will help management take timely and proper corrective action.

5.13. Audit Findings that involve monetary effect must:

- Be quantified and included as questioned costs in the fund accountability statement, the Auditor's Report on Compliance, and cost sharing/counterpart contributions schedule (cross-referenced).
- Be reported without regard to whether the conditions giving rise to them were corrected.
- Be reported whether the recipient does or does not agree with the findings or questioned costs.
- Contain enough relevant information to expedite the audit resolution process (e.g., number of items tested, size of the universe, error rate, corresponding U.S. dollar amounts, etc.).

5.14. The audit reports must also contain, after each recommendation, pertinent views of responsible recipient officials concerning the auditor's findings and actions taken by the recipient to implement the recommendations. If possible, the auditor should obtain written comments. When the auditors disagree with management comments opposing the findings, conclusions or recommendations, they must explain their reasons following the comments. Conversely, the auditors should modify their report if they find the comments valid.

6. Procedures for closure of audit recommendations

6.1. DAGP's Guidelines in section 6.15 specifically provides for Exit Interviews and requires the FAOs to adopt a structured approach in the following words:

> "Section 9.8 of FAM stresses the importance of keeping entity officials informed during the course of audit. In addition to open communications during audit, it is a

good practice to arrange a meeting with senior entity management at the end of the fieldwork at each location. The audit of decentralized sites, remote from the Audit Office (out of which the audit team operates), is complicated by the fact that briefing of the management at the site cannot be done after the senior audit management has reviewed the audit findings. This means that the team should provide feedback to management at the decentralized site prior to conducting a full review of findings. It is a good practice for the audit team leader to determine whether there are any sensitive issues that need to be brought to the attention of senior audit management prior to discussing with entity management at the site. Where potentially sensitive matters are involved, the audit team leader should get instructions from senior audit management before the exit briefing."

6.2. The OIG's Guideline also emphasize that auditors should

"Hold entrance and exit conferences with the recipient. The cognizant USAID mission should be notified of these conferences in order that USAID representatives may attend, if deemed necessary."

6.3. In any case, all the issues arising from the audit need to be resolved before the commencement of the next audit. The auditors must review the status of corrective measures taken on findings and recommendations reported in previous audits of USAID-funded programs. The Standard Statement of Work referred to in clause 5 of the MOU referring to the U.S. *Government Auditing Standards* states:

"Auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. When planning the audit, auditors should ask management of the audited entity to identify previous audits, attestation engagements, financial reviews, and other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives."

6.4. The Standard Statement of Work, as at Annexure 3, further provides that *"the auditors must describe the scope of their work on prior audit recommendations in the summary section of the audit report. The auditors should refer to the most recent recipient contracted audit report for the same award (for a follow-up audit) or other USAID awards (for an initial audit). When corrective action has not been taken and the deficiency remains unresolved for the current audit period the auditors need to briefly describe the prior finding and status and show the page reference to where it is included in the current report. If there were no prior findings and recommendations, the auditors must include a note to that effect in this section of the audit report."*

6.5. Experience has shown that when the exit meetings are properly structured and all the stakeholders, i.e. the recipient entity, the donor and the audit authorities, attend them, some of the audit findings can be resolved during exit meetings. It is therefore imperative that the audit reports are not finalized without exit meetings. **In cases where the audited entities do not respond to the auditor's requests for holding exit meetings on time, the FAOs will be well advised to bring the subject to the notice of the donors**. It is both cost-effective and efficient for all the stakeholders that audit findings are addressed as quickly as possible so that corrective measures can be taken in hand.

6.6. The Follow up Continuity Schedule, referred to in section 7.20 of the DAGP's Guidelines, provides practical guidance on a structured approach for resolution of outstanding audit issues. **In order to save time and effort, the FAOs are advised that before finalizing the final audit reports they may ensure that the management of the audited entity and the cognizant US AID mission become aware of the significant findings of the audit report. This can be ensured by properly scheduling all the audit activities, from the inception to the end of the audit process, with timelines that are duly communicated to the stakeholders**. (Also please see paragraph 7.2 a below.)

7. Roles and responsibilities

7.1. The Auditors' Role: The role and responsibilities of the auditors have been defined in the DAGP's and the OIG's Guidelines, which are in line with the ISSAIs. Chapter 4 of the DAGP's Guidelines highlights the importance of the creating a Permanent File for each audited entity. The audit planning requirements of the DAGP have been elaborately defined in the FAM and Chapter 5 of the DAGP's Guidelines. The list of audit planning documents, given in the Audit Working Papers Kit for the audit of the foreign aided projects is at Annexure 5.

7.2. For ease of reference, the main role and responsibilities of the auditors are given below. The auditors must perform the following functions:

a) **Hold entrance and exit conferences with the recipient**. The USAID mission should be notified of these conferences in order that USAID representatives may attend, if deemed necessary. In order to enhance the timeliness and effectiveness of the audit process, it may be appropriate for the FAOs to agree a schedule of activities with the US AID and the audited entities. The schedule of activities, among others, may include the timelines for entrance and exit conferences, the audit process, the finalization audit reports and closure of audit recommendations

b) **Obtain a Management Representation Letter** signed by the recipient's management as per the format given in the OIG's Guidelines. A sample of the Management Representation Letter is given at Annexure 6 for ready reference.

c) During the planning stages of an audit, **communicate information to the audited entity regarding the nature and extent of planned testing and reporting** on compliance with laws and regulations and internal control over financial reporting. Such communication should state that the auditors do not plan to provide opinions on compliance with laws and regulations and internal control over financial reporting. This communication should be in the form of an engagement letter.

d) **Use the Quality Management Framework (QMF) of the AGP** to ensure that sufficient appropriate evidence is obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit. It needs to be noted that the QMF of the DAGP, issued in line with ISSAI 40, emphasizes that quality of audit needs to be managed at all the stages of an audit process. The QMF distinguishes between the Quality Assurance, which deals with the audit process, and the Quality Control, which pertains to the audit output. In 2013 the DAGP decided that the QMF which is in vogue since 2010, will also be applicable to all foreign aided projects. Hence the FAOs responsible for the audit US AID funds must ensure that the requirements of the QMF are kept in view at all the stages of audit. While the auditors may use their standard procedures for ensuring quality control, those procedures must, at a minimum, ensure that:

- Audit reports and audit documentation are reviewed by an auditor, preferably at the partner level, who was not involved in the audit. This review must be documented.

- All quantities and monetary amounts involving calculations are footed and cross-footed.

- All factual statements, numbers, conclusions and monetary amounts are cross-indexed to supporting audit documentation.

7.3. **It is the responsibility of the auditor to perform audits pursuant to the FAM and the OIG's Guidelines and to present audit reports in a timely manner**. The schedule for conducting audits and the timelines for the submission of final reports should be agreed between the FAOs, the audited entities and the US AID mission.

7.4. **The auditors must ascertain**, before preparing their proposal for the audit engagement (or if this is not possible, at the earliest opportunity during the engagement itself), whether the recipient ensured **that audits of its sub-recipients were performed** to ensure accountability for USAID funds passed through to sub-recipients (see paragraph 1.6 of the OIG's Guidelines). If sub-recipient audit requirements were not met, the auditors should immediately notify the cognizant USAID mission consider whether they can audit the sub-recipient costs themselves. If, after consultation with the cognizant USAID mission the auditors conclude that a restriction on the scope of the audit exists and the restriction cannot be removed, then the auditors should consider modifying their opinion and any costs that have not been audited as required must be questioned as unsupported costs.

7.5. **The auditors must properly maintain and store the audit documentation** for a period of three years from the completion of the audit. During this three-year period the audit auditors shall immediately provide the audit documentation files when requested by the USAID mission and allow them full access and copies of their audit documentation.

7.6. **The Audited Entity's Role**: The responsibility for the preparation of the financial statements, including adequate disclosure, is that of the management of the audited entities as required under the Controller General of Accounts (Appointment, Functions and Powers) Ordinance, 2001]. This includes the maintenance of adequate accounting records and internal controls, application of accounting policies, and the safeguarding of the assets of the entity. As part of the financial audit process, the auditors will request from management written confirmation concerning representations made to the audit team in connection with the audit.

7.7. The audited entities must ensure that all records are available to the auditors, all accounting entries and adjustments are made, and all other necessary steps are taken to enable the auditors to complete their work.

7.8. The audited entities/the USAID mission should provide the following information to the auditors for the entrance conference:

- A list of all payments made for assets, equipment, materials, and commodities purchased by USAID from third parties for the period being audited with copies of vouchers with supporting documentation.
- A list of all advances and reimbursements made during the audit period.
- A list of all disbursements made to the recipient.
- A copy of the "Audit Report Desk Review Guidelines" that the auditors can use to evaluate their audit report.

7.9. The role of the US AID Mission: Since all audits of the US AID funds in Pakistan are regulated under the MOU and are to be carried out by the SAI Pakistan, the US AID Mission must ensure that audit plans of the respective offices of the SAI Pakistan include audits of the US AID funded programmes and project and that they contain a standard statement of work containing all the requirements of the OIG's Guidelines.

7.10. Although the OIG's Guidelines require that one annual audit must cover all the US AID funding to a recipient, given the spread of the US AID assistance in Pakistan, there may be several audit reports from the SAI Pakistan emanating from various FAOs of the DAGP. The US AID Mission must consolidate these reports according to the satisfaction of the OIG.

7.11. The US AID Mission must also ensure that, wherever applicable, agreements between recipients and independent auditors contain a standard statement of work containing all the requirements of the OIG's Guidelines. The US AID missions must monitor and ensure the independent auditor's submission of the required recipient-contracted audit reports.

7.12. The USAID mission may meet with the auditors at the beginning of the audit to explain any financial/compliance areas of concern that they want emphasized. The USAID mission may also attend the exit conference.

Annexure 1: Memorandum of Understanding between USAID & the AGP

MEMORANDUM OF UNDERSTANDING BETWEEN
THE UNITED STATES AGENCY FOR INTERNATIONAL DEVELOPMENT
AND
THE AUDITOR GENERAL OF PAKISTAN

The United States Agency for International Development (USAID/Pakistan), the Regional Inspector General/Manila (RIG/Manila), and the Auditor General of Pakistan (hereinafter referred to as the SAI) agree that the SAI will perform or contract for audits of funds provided under USAID funding agreements with the Government of Pakistan.

1. The audits shall be performed in accordance with the "Guidelines for Financial Audits Contracted by Foreign Recipients," issued by the USAID Inspector General, as required by Standard Audit Provisions contained in the respective agreements between USAID/Pakistan and the Government of Pakistan.

2. USAID/Pakistan and the SAI agree that the SAI will perform audits in accordance with the U.S. Government Auditing Standards or the Financial Audit Manual and the guidelines developed by SAI Pakistan.

3. The SAI shall normally accomplish the audit tasks with own sources. However, if the SAI considers and decides that there is a need for engaging an individual expert of an independent Public Accounting Firm, USAID/Pakistan and the SAI may contract such individual expert or an Independent Public Accounting Firm to perform audits of USAID funded programs. These contracted audits shall be performed in accordance with the auditing standards mentioned in paragraph 2 above and shall be supervised by the SAI. USAID/Pakistan will finance these audit contracts; however, contracts shall be approved by USAID/Pakistan before the contract is entered into. The contractor during the course of audit will be employed with SAI Pakistan and the working papers developed will be in the ownership of the SAI.

4. USAID/Pakistan and the SAI shall jointly prepare an annual schedule of audits to be performed or contracted by the SAI. The schedule of audits will contain the following information.

    - Names of the governmental institutions to be audited;
    - Identification numbers of USAID/Pakistan agreements to be covered by the audits;
    - Fiscal year to be covered by the audit;
    - Name of the auditors (SAI or public accounting firm).

4/26/17
JA, 4/26/17

5. Standard statements of the work provided by USAID, RIG/Manila as examples to be used in performing audits of governmental organizations are attached, and are an integral part of this MOU. The statements of work cover audit requirements for revenue producing governmental organizations and non-revenue producing governmental organizations. USAID/Pakistan shall approve the audit cost proposal and the statement of work before audit work begins. USAID/Pakistan may expand the scope of work to allow the review of specific areas that may be of particular interest to USAID/Pakistan for ensuring proper accountability over resources provided to the recipient, and may meet with the SAI at the beginning of the audit to explain any financial or compliance areas of concern contained in the statement of work that USAID/Pakistan wants to emphasize.

6. The scope of audit of both revenue producing and non-revenue producing governmental organizations shall require a report on the Fund Accountability Statement for the USAID funded programs and a report on Internal Controls related to the USAID funded programs and a report on compliance with agreement terms and applicable laws and regulations related to the USAID funded programs. In addition, the scope of audit for revenue producing governmental organizations shall require an audit of the financial statements of the recipient organization.

7. RIG/Manila is responsible for assuring that the work performed under this MOU complies with the audit guidelines and the applicable auditing standards. To accomplish this objective, RIG/Manila will provide technical advice, perform desk reviews of all audit reports, and perform quality control reviews (QCR) of the workpapers of a sample of audit reports. RIG/Manila will notify the auditee of the results of the desk reviews and QCR. If RIG/Manila has any comments on an audit report carried out by the SAI or its contractor, the auditors will perform any additional audit work requested by the RIG/Manila at no additional cost to USAID.

8. The SAI shall properly maintain audit working papers for the period of three years from the completion of the audit. During this three-year period, the SAI shall immediately provide the working papers when requested by USAID or RIG/Manila.

9. USAID/Pakistan and the SAI have agreed to audit the Program Assistance Grant (Budget support) with Ministry of Finance in FY 2005-2006 as a pilot audit. A detailed scope of work will be developed for the project.

10. Should experience in conducting audits, pursuant to this MOU, indicate the need to change the procedures for these audits, this MOU may be amended or modified through mutual written agreement of the Parties hereto.

11. This MOU shall enter into force on the date of signatures and remain valid unless terminated. Either Party may terminate this MOU at any time by giving a notice of three months to the other Party of its intention to terminate this MOU. The audit Projects initiated during the validity of this MOU shall continue to be governed by its provisions till their completion.

Done at Islamabad, Pakistan on twenty-six day of April, two thousand and seven

Signed ______
Date 26.4.07
Muhammad Yunis Khan
Auditor General of Pakistan

Signed ______
Date April 26, 2007
Jonathan Addleton
USAID/Pakistan Director

Signed April 27, 2007
Date Catherine Trujillo
Catherine M. Trujillo
USAID Regional Inspector General, Manila

Annexure 2: Fund Accountability Statement

(to be attached from the OIG's Guidelines Example 6.1)

Annexure 3: Standard Statement of Work for Financial Audits

OBJECTIVES AND GENERAL STATEMENT OF WORK

AUDIT OF USAID RESOURCES

MANAGED BY [*NAME OF RECIPIENT*]

I. BACKGROUND

On [*date*], the U.S. Agency for International Development (USAID), mission to [*Country*] (mission) approved the [*program name and number*] (program), which provided [*amount in U.S. Dollars*] in [*loan/grant*] funds to [*name of recipient*] (recipient) for [*describe in general terms the purposes of the program and the principal line items and amounts budgeted, including cost sharing contributions, direct payments and all related financial information of the program, as applicable*].

[*If recipient activities are financed by more than one program, include a similar paragraph for each program.*]

[*Include a brief history of the recipient, its principal purposes and goals, location(s) of activities to be audited, location(s) of accounting records and management.*]

[*The purpose of including complete data on the recipient and the program(s) involved is to provide the auditor with all necessary information for them to properly estimate their audit fees.*]

II. TITLE

Audit of the Fund Accountability Statement (or Audit of Financial Statements, if the audit includes an audit of the general-purpose financial statements) of USAID Resources Managed by [*name of recipient*] Under Program [*program number and name*] for the period from [*date*] to [*date*]. In the case of close-out audits,[1] the title must specify that it is a close-out audit, as in: Close-out Audit of the USAID Resources

[1]A close-out audit is an audit for an award that expired during the period audited.

Managed by [*name of recipient*] Under Program [*program number and name*] for the period from [*date*] to [*date*].

III. OBJECTIVES

The objective of this engagement is to conduct a financial audit of the USAID resources managed by the recipient under program [*program number and name*] from [*date*] to [*date*] in accordance with *U.S. Government Auditing Standards* issued by the U.S. Government Accountability Office (July 2007 revision) and the USAID Office of Inspector General *Guidelines for Financial Audits Contracted by Foreign Recipients* (*Guidelines*) dated February 2009.

The financial audit must include (1) a specific audit of all the recipient's USAID-funded programs, and (2) an audit of the recipient's general purpose financial statements on an organization-wide basis (balance sheet, income statement, and cash flow statement) if the recipient has been authorized to charge indirect costs, or if the mission specifically requests such an audit.

The fund accountability statement is the basic financial statement to be audited that presents the recipient's revenues, costs incurred, cash balance of funds provided by USAID, and commodities directly procured by USAID for the recipient's use. The fund accountability statement should be reconciled to the USAID funds included in the general purpose financial statements by a note to the financial statements or the fund accountability statement. All currency amounts in the fund accountability statement, cost sharing/counterpart contributions schedule, and the report findings, if any, must be stated in U.S. dollars. The auditors should indicate the exchange rate(s) used in the notes to the fund accountability statement.

A. Audit of USAID Funds

A financial audit of the funds provided by USAID must be performed in accordance with U.S. *Government Auditing Standards,* or other approved standards where applicable and accordingly includes such tests of the accounting records as deemed necessary under the circumstances. The specific objectives of the audit of the USAID funds are to:

- Express an opinion on whether the fund accountability statement for the USAID-funded programs presents fairly, in all material respects, revenues received, costs incurred, and commodities directly procured by USAID for the period audited in conformity with the terms of the agreements and generally accepted accounting principles or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis).

- Evaluate the recipient's internal control related to the USAID-funded programs, assess control risk, and identify significant deficiencies including material weaknesses. This evaluation should include the internal control related to required cost sharing/counterpart contributions.

- Perform tests to determine whether the recipient complied, in all material respects, with agreement terms (including cost sharing/counterpart contributions, if applicable) and applicable laws and regulations related to USAID-funded programs. All material instances of noncompliance and all illegal acts that have occurred or are likely to have occurred must be identified. Such tests must include the compliance requirements related to required cost sharing/counterpart contributions, if applicable.

- Perform an audit of the indirect cost rate(s) if the recipient has been authorized to charge indirect costs to USAID using provisional rates and USAID has not yet negotiated final rates with the recipient.

- Determine if the recipient has taken adequate corrective action on prior audit report recommendations.

Auditors must design audit steps and procedures in accordance with U.S. *Government Auditing Standards,* Chapter 4, to provide reasonable assurance of detecting situations or transactions in which fraud or illegal acts have occurred or are likely to have occurred. If such evidence exists, the auditors must contact the appropriate Regional Inspector General (RIG) office and should exercise due professional care in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations or legal proceedings.

B. Review of Cost Sharing Schedule

The audit should determine whether cost sharing/counterpart contributions were provided and accounted for by the recipient in accordance with the terms of the agreements, if applicable. The auditors will review the cost sharing/counterpart contributions schedule to determine if the schedule is fairly presented in accordance with the basis of accounting used by the recipient to prepare the schedule. The auditors should question all cost sharing/counterpart contributions that are either ineligible or unsupported costs. In addition, for audits of agreements that present a cost sharing/counterpart budget on an annual basis and for close-out audits of awards that present cost sharing/counterpart budgets on a life-of-project basis, the auditors will review the cost sharing/counterpart schedule to determine if cost sharing/counterpart contributions were provided by the recipient in accordance with the terms of the agreement.

C. Audit of General Purpose Financial Statements

A financial audit of the recipient's general purpose financial statements on an organization-wide basis must be submitted to USAID together with the audit of USAID funds if the recipient has been authorized to charge indirect costs, or if the mission specifically requests such an audit. The audit must be performed in accordance with generally accepted auditing standards of the American Institute of Certified Public Accountants (AICPA), auditing standards that have been prescribed by the laws of the country or adopted by an association of public accountants in the country, or auditing standards promulgated by the International Organization of Supreme Audit Institutions or International Auditing Practices Committee of the International Federation of Accountants. The objective of this audit is to express an opinion on whether those statements present fairly, in all material respects, the financial position of the recipient at year-end, and the results of its operations and cash flow for the year then ended, in conformity with generally accepted accounting principles.

IV. AUDIT SCOPE

The auditor should use the following steps as the basis for preparing audit programs. They are not considered all-inclusive or restrictive in nature and do not relieve the auditor from exercising due professional care and judgment. The steps should be modified to fit local conditions and specific program design, implementation procedures, and agreement provisions which may vary from program to program. Any limitations in the scope of work must be communicated as soon as possible to the USAID RIG/[*location*] office.

A. Pre-Audit Steps

Following is a list of documents applicable to different USAID programs. The auditor should review the applicable documents considered necessary to perform the audit:

1. The agreements between USAID and the recipient.

2. The subagreements between the recipient and other implementing entities, as applicable.

3. Contracts and subcontracts with third parties, if any.

4. The budgets, implementation letters, and written procedures approved by USAID.

5. USAID Automated Directives System Chapter 636 – "Program Funded Advances".

6. OMB Circular A-122 "Cost Principles for Nonprofit Organizations" (2 CFR Part 230).

7. OMB Circular A-21 "Cost Principles for Educational Institutions" (2 CFR Part 220).

8. Federal Acquisition Regulation (FAR), Part 31-Contract Cost Principles and Procedures.

9. USAID Acquisition Regulation (AIDAR), which supplement the FAR.

10. Mandatory Standard Provisions for Non-U.S. Nongovernmental Grantees (USAID Automated Directives System, Chapter 303 Internal Mandatory References).

11. Standard Provisions Annex for Agreements with Foreign Governments (USAID Automated Directives System, Chapter 350).

12. All program financial and progress reports; and charts of accounts, organizational charts; accounting systems descriptions; procurement policies and procedures; and receipt, warehousing and distribution procedures for materials, as necessary to successfully complete the required work.

13. Any previous audits, financial reviews, etc., that directly relate to the objectives of the audit.

B. Fund Accountability Statement

The auditor must examine the fund accountability statement[2] for USAID programs including the budgeted amounts by category and major items; the revenues received from USAID for the period covered by the audit; the costs reported by the recipient as incurred during that period; and the commodities directly procured by USAID for the recipient's use. The fund accountability statement must include all USAID assistance funds identified by each specific program or agreement. The revenues received from USAID less the costs incurred, after considering any reconciling items, must reconcile with the balance of cash-on-hand or in bank accounts. The fund accountability statement should not include cost sharing/counterpart contributions provided from the recipient's own funds or in-kind. However, a separate cost sharing/counterpart contributions schedule must be included and reviewed to determine whether cost sharing/counterpart contributions were provided and accounted for in accordance with the terms of the agreement (see section IV.C. of this statement of work).

[2] A "fund accountability statement" is a financial statement that presents a USAID recipient's revenues, costs incurred, cash balance of funds (after considering reconciling items), and commodities assistance directly procured by USAID that were provided by USAID agreements. The fund accountability statement must be presented in U.S. dollars and the exchange rate(s) used must be disclosed in a note to the fund accountability statement.

The auditors may prepare or assist the recipient in preparing the fund accountability statement from the books and records maintained by the recipient, but the recipient must accept the responsibility for the statement's accuracy before the audit commences.

The opinion on the fund accountability statement must comply with Statement on Auditing Standard SAS No. 62 (AU623). The fund accountability statement must separately identify those revenues and costs applicable to each specific USAID agreement. The audit must evaluate program implementation actions and accomplishments to determine whether specific costs incurred are allowable, allocable, and reasonable under the agreement terms, and applicable cost principles, and to identify areas where fraud and illegal acts have occurred or are likely to have occurred as a result of inadequate internal control. At a minimum, the auditors must:

1. Review direct and indirect costs billed to and reimbursed by USAID and costs incurred but pending reimbursement by USAID, identifying and quantifying any questioned costs. *All* costs that are not supported with adequate documentation or are not in accordance with the agreement terms must be reported as questioned. Questioned costs that are pending reimbursement by USAID must be identified in the notes to the fund accountability statement as not reimbursed by USAID.

   Questioned costs must be presented in the fund accountability statement in two separate categories. Ineligible costs that are explicitly questioned because they are unreasonable; prohibited by the agreements or applicable laws and regulations; or not program related. In addition if a recipient was required to place USAID funds in an interest-bearing account but did not, then the imputed interest that would have been earned is also classified as an ineligible cost. Unsupported costs are not supported with adequate documentation or did not have required prior approvals or authorizations. All material questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. Also, the notes to the fund accountability statement must briefly describe both material and immaterial questioned costs and must be cross-referenced to any corresponding findings in the report on compliance.

2. Review general and program ledgers to determine whether costs incurred were properly recorded. Reconcile direct costs billed to, and reimbursed by, USAID to the program and general ledgers.

3. Review procedures used to control funds, including their channeling to contracted financial institutions or other implementing entities. Review the bank accounts and the controls on those bank accounts. Perform positive confirmation of balances, as necessary.

4. Determine whether advances of funds were justified with documentation, including reconciliations of funds advanced, disbursed, and available. The auditors must ensure that all funding received by the recipient from USAID was appropriately recorded in the recipient's accounting records and that those records were periodically reconciled with information provided by USAID.

5. Determine whether program income was added to funds used to further eligible project or program objectives, to finance the non-federal share of the project or program, or deducted from program costs, in accordance with USAID regulations, other implementing guidance, or the terms and conditions of the award.

6. Review procurement procedures to determine whether sound commercial practices including competition were used, reasonable prices were obtained, and adequate controls were in place over the qualities and quantities received.

7. Review direct salary charges to determine whether salary rates were reasonable for that position, in accordance with those approved by USAID when USAID approval is required, and supported by appropriate payroll records. Determine if overtime was charged to the program and whether it is allowable under the terms of the agreements. Determine whether allowances and fringe benefits received by employees were in accordance with the agreements and applicable laws and regulations. The auditors must question unallowable salary charges in the fund accountability statement.

8. Review travel and transportation charges to determine whether they are adequately supported and approved. Travel charges that are not supported with adequate documentation or not in accordance with agreements and regulations must be questioned in the fund accountability statement.

9. Review commodities (such as supplies, materials, vehicles, equipment, food products, tools, etc.) whether procured by the recipient or directly procured by USAID for the recipient's use. The auditors should determine whether commodities exist or were used for their intended purposes in accordance with the terms of the agreements, and whether control procedures exist and have been placed in operation to adequately safeguard the commodities. As part of the procedures to determine if commodities were used for intended purposes, the auditors should perform end-use reviews for an appropriate sample of all commodities based on the control risk assessment (see section IV.D. of this statement of work). End-use reviews may include site visits to verify that commodities exist or were used for their intended purposes in accordance with the terms of the agreements. The cost of all commodities whose existence or proper use in accordance with the agreements cannot be verified must be questioned in the fund accountability statement. (The auditor should determine the cost of commodities based on supporting documentation available from the recipient or USAID, as appropriate.)

10. Review technical assistance and services procured by the recipient. The auditors should determine whether technical assistance and services were used for their intended purposes in accordance with the terms of the agreements. The cost of technical assistance and services not properly used in accordance with terms of the agreements must be questioned in the fund accountability statement.

    a. In addition to the above audit procedures, if technical assistance and services were contracted by the recipient from a non-U.S. contractor, the auditors must perform additional audit steps of the technical assistance and services, unless the recipient has separately contracted for an audit of these costs. When testing for compliance with agreement terms and applicable laws and regulations, the auditors must not only consider the agreements between the recipient and USAID, but also the agreements between the recipient and non-U.S. contractors providing technical assistance and services. The agreements between the recipient and the non-U.S. contractors should be audited using the same audit steps described in the other paragraphs of this section, including all tests necessary to specifically determine that costs incurred are allowable, allocable, reasonable, and supported under the agreement terms.

b. If the technical assistance and services were contracted by the recipient from a U.S. contractor, the auditors are still responsible for determining whether technical assistance and services were used for their intended purposes in accordance with the terms of the agreements. However, the auditors are not responsible for performing additional audit steps for the costs incurred under the technical assistance and services agreements, since either USAID or a cognizant U.S. Government agency is responsible for contracting for audits of these costs.

11. When indirect costs are charged to USAID using provisional rates, review the allocation method to determine that the indirect cost pool and distribution base include only allowable items in accordance with the agreement terms and regulations. The auditors should be aware that costs that are unallowable as charges to USAID agreements (e.g., fundraising) must be allocated their share of indirect costs if they represent activities that (1) include the salaries of personnel, (2) occupy space, and (3) benefit from the organization's indirect costs. Indirect costs must be calculated after all adjustments have been made to the pool and base. When indirect costs are charged to USAID using predetermined or fixed rates, verify that the correct rates are applied in accordance with the agreement with USAID

12. Review unliquidated advances to the recipient and pending reimbursements by USAID when performing final closeout audits. Ensure that the recipient returned any excess cash to USAID. Also, ensure that all assets (inventories, fixed assets, commodities, etc.) procured with program funds were disposed of in accordance with the terms of the agreements. The auditors should present, as an annex to the fund accountability statement, the balances and details of final inventories of nonexpendable property acquired under the agreements. This inventory must indicate which items were titled to the U.S. Government and which were titled to other entities. These closeout audit procedures must be performed for any award that expires during the period audited.

The fund accountability statement included as Example 6.1 of the *Guidelines* illustrates how to report the results of a single audit that covers more than one USAID agreement. In such cases, the fund accountability statement must separately disclose the financial information (revenues, costs, etc.) for each agreement, and must identify the USAID missions/offices that provided funding for each agreement. Questioned costs, and internal control and compliance findings of any audits of subrecipients must be reported in the recipient's financial audit using the same treatment and procedures as the recipient's own questioned costs and findings. This is particularly important in audits of recipients covering agreements from more than one USAID mission. Each mission can identify its agreements in the audit report for resolution of findings and recommendations with the recipient. The same reporting principles apply when only one USAID agreement is covered by the audit.

The auditors must generally express a single opinion on the fund accountability statement that includes more than one agreement with USAID. Auditors *must not* express separate opinions on fund accountability statements of each agreement or program unless specifically requested to do so by the USAID mission.

C. Cost Sharing/Counterpart Contributions Schedule

USAID agreements may require contributions by the recipient. Most agreements establish a life-of-project budget for such contributions; however, some agreements may establish annual budgets for those contributions. The review of the cost sharing/counterpart contributions schedule must be approached differently depending on whether the cost sharing/counterpart contribution budget is a life-of-project budget or an annual budget. In either case, the review consists principally of inquiries of recipient personnel and analytical procedures applied to financial data supporting the cost sharing/contributions schedule.

The auditors may prepare or assist the recipient in preparing the cost sharing/counterpart contributions schedule from the books and records maintained by the recipient. The recipient must, however, accept responsibility for the schedule's accuracy before the review commences.

C (1). Agreement with Life-of-Project Cost Sharing/Counterpart Contribution Budget

For an agreement with a life-of-project budget for cost sharing/counterpart contributions, it is not possible to determine whether the contributions have been made as required until the agreement ends. Nonetheless, USAID and the recipient need reliable information to monitor actual cost sharing/counterpart contributions throughout the life of the agreement.

Thus, for agreements with a life-of-project budget for cost sharing/counterpart contributions, for each year that an audit is performed in accordance with the *Guidelines*, the auditors will review the cost sharing/counterpart schedule to determine if the schedule is fairly presented in accordance with the basis of accounting used by the recipient to prepare the schedule. The auditors must question all cost sharing/counterpart contributions that are either ineligible or unsupported costs. An ineligible cost is unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related. An unsupported cost lacks adequate documentation or does not have required prior approvals or authorizations. All questioned costs must be briefly described in the notes to the cost sharing/counterpart contributions schedule. In addition, material questioned costs must be included as findings in the report on compliance. Notes to the cost sharing/counterpart contributions schedule must be cross-referenced to the corresponding findings in the report on compliance. Also, significant deficiencies in internal control related to cost sharing/counterpart contributions must be set forth as findings in the report on internal control. (See sample cost sharing/counterpart contributions schedule at Example 6.2.A, and sample reports at Examples 7.6.A and 7.6.B of the *Guidelines.*)

In addition, for closeout audits of agreements with a life-of-project budget for cost sharing/counterpart contributions, the auditors will review the cost sharing/counterpart contributions schedule to determine if the recipients provided such contributions in accordance with the terms of the agreement. If actual contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost sharing/counterpart contributions schedule. (See sample cost sharing/counterpart contributions schedule at Example 6.2.B, and sample reports at Examples 7.6.C and 7.6.D of the *Guidelines.*)

C (2). Agreement with Annual Cost Sharing/Counterpart Contributions Budget

For agreements with an annual budget for cost sharing/counterpart contributions, for each year that an audit is performed in accordance with the *Guidelines*, the auditors will review the cost sharing/counterpart contributions schedule to determine whether (1) the schedule is fairly presented in accordance with the basis of accounting used by the recipient to prepare the cost sharing/counterpart contributions schedule and (2) contributions were provided by the recipient in accordance with the terms of the agreement. The auditors must question all cost sharing/counterpart contributions that are either ineligible or unsupported costs. An ineligible cost is unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related. An unsupported cost lacks adequate documentation or does not have required prior approvals or authorizations. All questioned costs must be briefly described in the notes to the cost sharing/counterpart contributions schedule. In addition, questioned costs must be included as findings in the report on compliance. Notes to the cost sharing/counterpart contributions schedule must be cross-referenced to the corresponding findings in the report on compliance. Also, significant deficiencies in internal control related to cost sharing/counterpart contributions must be set forth as findings in the report on internal control. If actual cost sharing/counterpart contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost sharing/counterpart contributions schedule. (See sample cost sharing/counterpart contributions schedule at Example 6.2.B, and sample reports at Examples 7.6.C and 7.6.D of the *Guidelines.*)

D. Internal Controls

The auditors must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risk of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. In obtaining this understanding, the auditor must understand the design of the internal control related to USAID programs and determine whether they have been placed in operation. The U.S. Government Accountability Office's Standards for Internal Control in the Federal Government (GAO/AIMD-00-21.3.1; 1999) may prove helpful in assessing recipient internal control. The internal control must be described in the audit documentation.

The auditors must prepare the report required by the *Guidelines*, identifying any significant deficiencies or material weaknesses in the design or operation of internal control. A material weakness is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented or detected and corrected on a timely basis. A significant deficiency is a deficiency, or combination of deficiencies, in internal control that is less severe than a material weakness that is important enough to merit attention by those charged with governance. Any significant deficiencies or material weaknesses must be set forth in the report as "findings" (see paragraph 5.1.d of the *Guidelines*). Any other matters related to internal control – such as suggestions for improving operational or administrative efficiency or internal control, or control deficiencies that are not significant deficiencies or material weaknesses – may be reported in a separate management letter to the recipient and referred to in the report on internal control.

The major internal control components to be studied and evaluated include, but are not limited to, the controls related to each revenue and expense account on the fund accountability statement. The auditors must:

1. Obtain an understanding of the design of the internal control related to USAID programs and determine whether they have been placed in operation.

2. Assess inherent risk and control risk, and determine detection risk. Inherent risk is the susceptibility of an assertion, such as an account balance, to a misstatement that could be material, either individually or when aggregated with other misstatements, assuming there are no related controls. Control risk is the risk that a misstatement that could occur in a relevant assertion and that could be material, either individually or when aggregated with other misstatements, will not be prevented or detected on a timely basis by the entity's internal control. Detection risk is the risk that the auditor will not detect a material misstatement that exists in an assertion. Detection risk is based upon the effectiveness of an auditing procedure and the auditor's application of that procedure.

3. Summarize the risk assessments for each assertion in a single document included in the audit documentation. The risk assessments should consider the following broad categories under which each assertion should be classified: (a) classes of transactions and events for the period under audit (occurrence, completeness, accuracy, cutoff, and classification), (b) account balances at the period end (existence, rights, obligations, completeness, valuation, and allocation), and (c) presentation and disclosure (occurrence, rights, obligations, completeness, classification, understandability, accuracy, and valuation). At a minimum, the audit documentation should identify the name of the account or assertion, the account balance or the amount represented by the assertion, the assessed level of inherent risk (high, moderate, or low), the assessed level of control risk (high, moderate, or low), the combined risk (high, moderate, or low), and a description of the nature, extent, and timing of the tests performed based on the combined risk. Summary audit documentation should be cross-indexed to the supporting audit documentation that contains the detailed analysis of the fieldwork. If control risk is evaluated at less than the maximum level (high), then the basis for the auditor's conclusion must be described in the audit documentation.

If the auditors assess control risk at the maximum level for assertions related to material account balances, transaction classes, and disclosure components of financial statements when such assertions are significantly dependent upon computerized information systems, the auditors must describe in the audit documentation the basis for such conclusions by addressing (i) the ineffectiveness of the design and/or operation of controls, or (ii) the reasons why it would be inefficient to test the controls.

4. Evaluate the control environment, the adequacy of the accounting systems, and control procedures. Emphasize the policies and procedures that pertain to the recipient's ability to record, process, summarize, and report financial data consistent with the assertions embodied in each account of the fund accountability statement. This should include, but not be limited to, the control systems for:

   a. ensuring that charges to the program are proper and supported;

   b. managing cash on hand and in bank accounts;

   c. procuring goods and services;

   d. managing inventory and receiving functions;

   e. managing personnel functions such as timekeeping, salaries, and benefits;

   f. managing and disposing of commodities (such as supplies, materials, vehicles, equipment, food products, tools, etc.) purchased either by the recipient or directly by USAID;

   g. ensuring compliance with agreement terms and applicable laws and regulations that collectively have a material impact on the fund accountability statement. The results of this evaluation must be contained in the audit documentation section described in Section IV.E. of this statement of work and presented in the compliance report.

5. Evaluate internal control established to ensure compliance with cost sharing/counterpart contribution requirements, if applicable, including both provision and management of the contributions.

6. Include in the study and evaluation other policies and procedures that may be relevant if they pertain to data the auditor uses in applying auditing procedures. This may include, for example, policies and procedures that pertain to non-financial data that the auditor uses in analytical procedures.

In fulfilling the audit requirement relating to an understanding of the internal control and assessing the level of control risk, the auditor must follow, at a minimum, the guidance contained in AICPA SAS Nos. 109 (AU 314), entitled *Understanding the Entity and Its Environment* and *Assessing the Risks of Material Misstatement*, 115 (AU 325), entitled *Communicating Internal Control Related Matters Identified in an Audit*, and 117 (AU801) entitled *Compliance Auditing*.

E. Compliance with Agreement Terms and Applicable Laws and Regulations

In fulfilling the audit requirement to determine compliance with agreement terms and applicable laws and regulations related to USAID programs, the auditors must, at a minimum, follow guidance contained in AICPA SAS No. 117 (AU801) entitled *Compliance Auditing*. The compliance review must also determine-on audits of awards that present cost sharing/counterpart contribution budgets on an annual basis and on close-out audits of awards that present cost sharing/counterpart contribution budgets on a life-of-project basis--if cost sharing/counterpart contributions were provided and accounted for in accordance with the terms of the agreements. The auditor's report on compliance must set forth as findings all material instances of noncompliance, defined as instances that could have a direct and material effect on the fund accountability statement. Nonmaterial instances of noncompliance should be included in a separate management letter to the recipient and referred to in the report on compliance.

The auditor's report should include all conclusions that a fraud or illegal act either has occurred or is likely to have occurred. In reporting material fraud, illegal acts, or other noncompliance, the auditors should place their findings in proper perspective. To give the reader a basis for judging the prevalence and consequences of these conditions, the instances identified should be related to the universe or the number of cases examined and is quantified in terms of U.S. dollars, if appropriate. In presenting material fraud, illegal acts, or other noncompliance, auditors must follow the reporting standards contained in Chapter 5 of U.S. *Government Auditing Standards*. Chapter 4 of U.S. *Government Auditing Standards* discusses factors that may influence auditors' materiality judgments. If the auditor concludes that sufficient evidence of fraud or illegal acts exists, they must contact the USAID RIG/[*location*] office and exercise due professional care in pursuing indications of possible fraud and illegal acts to avoid interfering with potential future investigations or legal proceedings.

In planning and conducting the tests of compliance the auditors must:

1. Identify the agreement terms and pertinent laws and regulations and determine which of those, if not observed, could have a direct and material effect on the fund accountability statement. The auditors must:

    a. list all standard and program-specific provisions contained in the agreements that cumulatively, if not observed, could have a direct and material effect on the fund accountability statement;

    b. assess the inherent and control risk that material noncompliance could occur for each of the compliance requirements listed in 1.a. above;

    c. determine the nature, timing and extent of audit steps and procedures to test for errors, fraud, and illegal acts that provide reasonable assurance of detecting both intentional and unintentional instances of noncompliance with agreement terms and applicable laws and regulations that could have a material effect on the fund accountability statement. This must be based on the risk assessment in 1.b. above.

    d. prepare a single summary in the audit documentation that identifies each of the specific compliance requirements included in the review, the results of the inherent, control and (detection) risk assessments for each compliance requirement, the audit steps used to test for compliance with each of the requirements based on the risk assessment, and the results of the compliance testing for each requirement. The summary document should be cross-indexed to detailed audit documentation that adequately supports the facts and conclusions contained in the summary document.

2. Determine if payments have been made in accordance with agreement terms and applicable laws and regulations.

3. Determine if funds have been expended for purposes not authorized or not in accordance with applicable agreement terms. If so, the auditor must question these costs in the fund accountability statement.

4. Identify any costs not considered appropriate, classifying and explaining why these costs are questioned.

5. Determine whether commodities, whether directly procured by the recipient or directly procured by USAID for the recipient’s use, exist or were used for their intended purposes in accordance with the terms of the agreements. If not, the cost of such commodities must be questioned.

6. Determine whether any technical assistance and services procured by the recipient were used for their intended purposes in accordance with the agreements. If not, the cost of such technical assistance and services must be questioned.

7. Determine if the amount of cost sharing funds was calculated and accounted for as required by the agreements or applicable cost principles.

8. Determine if the cost sharing/counterpart contribution funds were provided according to the terms of the agreements and quantify any shortfalls.

9. Determine whether those who received services and benefits were eligible to receive them.

10. Determine whether the recipient's financial reports (including those on the status of cost sharing/counterpart contributions) and

claims for advances and reimbursement contain information that is supported by the books and records.

11. Determine whether the recipient held advances of USAID funds in interest-bearing accounts, and whether the recipient remitted to USAID any interest earned on those advances, with the exception of up to $250 a year that the recipient may retain for administrative expenses. If the recipient was required to place USAID funds in an interest-bearing bank account but did not, then the auditor should determine the amount of interest that was foregone by the recipient, and this amount should be classified as ineligible costs.

F. Follow-Up on Prior Audit Recommendations

The auditors must review the status of actions taken on findings and recommendations reported in prior audits of USAID-funded programs. Paragraph 4.09 of the U.S. *Government Auditing Standards* states: "Auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and recommendations from previous engagements that could have a material effect on the financial statements. When planning the audit, auditors should ask management of the audited entity to identify previous audits, attestation engagements, financial reviews, and other studies that directly relate to the objectives of the audit, including whether related recommendations have been implemented. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work, including determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives."

The auditors must describe the scope of their work on prior audit recommendations in the summary section of the audit report. The auditors should refer to the most recent recipient contracted audit report for the same award (for a follow-up audit) or other USAID awards (for an initial audit). When corrective action has not been taken and the deficiency remains unresolved for the current audit period the auditors need to briefly describe the prior finding and status and show the page reference to where it is included in the current report. If there were no prior findings and recommendations, the auditors must include a note to that effect in this section of the audit report.

G. General Purpose Financial Statements

Auditors should examine the recipient's general purpose financial statements on an organization-wide basis if an indirect cost rate needs to be audited,[3] or if the mission specifically requests that the general purpose financial statements be audited. The audit must be performed in accordance with generally accepted auditing standards of the American Institute of Certified Public Accountants (AICPA), auditing standards that have been prescribed by the laws of the country or adopted by an association of public accountants in the country, or auditing standards promulgated by the International Organization of Supreme Audit Institutions or International Auditing Practices Committee of the International Federation of Accountants.

The objective of this audit is to express an opinion on whether those statements present fairly, in all material respects, the recipient's financial position at year-end, and the results of its operations and cash flow for the year then ended, in conformity with generally accepted accounting principles.

H. Indirect Cost Rates

The auditors should determine the actual indirect cost rates for the year if the recipient has used provisional rates to charge indirect costs to USAID. The audit of the indirect cost rates must include tests to determine whether the:

1. Distribution or allocation base includes all costs that benefited from indirect activities.

2. Distribution or allocation base is in compliance with the governing USAID Negotiated Indirect Cost Rate Agreement, if applicable.

[3] Where indirect costs are authorized, an audit of the general purpose financial statements is needed to ensure that all costs have been correctly included in the indirect cost rate calculation.

3. Indirect cost pool includes only costs authorized by the USAID agreements and applicable cost principles.

4. Indirect cost rates obtained by dividing the indirect cost pool by the base are accurately calculated.

5. Costs included in this calculation reconcile to the total expenses shown in the recipient's audited general purpose financial statements.

The results of the audit of the indirect cost rate should be presented in a schedule of computation of indirect cost rate (see Example 6.3 the *Guidelines*). This schedule should contain: (1) a listing of costs included in each indirect cost pool, (2) the distribution base, and (3) the resultant indirect cost rate calculation. The costs in the schedule must reconcile to the total expenses shown in the recipient's general purpose financial statements. U.S. Office of Management and Budget (OMB) Circular A-122 (2 CFR Part 230) provides additional guidance on allocation of indirect costs and determination of indirect cost rates.

I. Other Audit Responsibilities

The auditors must perform the following steps:

1. Hold entrance and exit conferences with the recipient. The cognizant USAID mission should be notified of these conferences in order that USAID representatives may attend, if deemed necessary.

2. During the planning stages of an audit, communicate information to the auditee regarding the nature and extent of planned testing and reporting on compliance with laws and regulations and internal control over financial reporting. Such communication should state that the auditors do not plan to provide opinions on compliance with laws and regulations and internal control over financial

reporting.[4] This communication should be in the form of an engagement letter.

3. Institute quality control procedures to ensure that sufficient appropriate evidence is obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the financial statements under audit. While auditors may use their standard procedures for ensuring quality control, those procedures must, at a minimum, ensure that:

   - audit reports and audit documentation are reviewed by an auditor, preferably at the partner level, who was not involved in the audit. This review must be documented;

   - all quantities and monetary amounts involving calculations are footed and cross-footed; and

   - all factual statements, numbers, conclusions and monetary amounts are cross-indexed to supporting audit documentation.

4. The auditor must ascertain, before preparing its proposal for the audit engagement (or if this is not possible, at the earliest opportunity during the engagement itself), whether the recipient ensured that audits of its subrecipients were performed to ensure accountability for USAID funds passed through to subrecipients (see paragraph 1.6 of the *Guidelines*). If subrecipient audit requirements were not met, the auditors should immediately notify the cognizant USAID mission and RIG and consider whether they can audit the subrecipient costs themselves. If, after consultation with the cognizant USAID mission and RIG, the auditors conclude that a restriction on the scope of the audit exists and the restriction cannot be removed, then the auditors should consider modifying their opinion and any costs that have not been audited as required must be questioned as unsupported costs.

5. Obtain a management representation letter in accordance with AICPA SAS No. 85 (AU333) signed by the recipient's management. See Example 4.1 of the *Guidelines* for an illustrative management representation letter.

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[4] The auditors only express an opinion on the fund accountability statement, and the indirect cost rate and general purpose financial statements, if applicable, as indicated in Chapter 3 of the *Guidelines*.

V. AUDIT REPORTS

The recipient must submit to the cognizant USAID Mission a portable document format (PDF) copy of the audit report in English and a PDF copy of the report in the country's official language, if considered appropriate. The USAID mission will forward the report to the appropriate RIG for processing. The format and content of the audit reports should closely follow the illustrative reports in Chapter 7 of the *Guidelines*. The audit report must specify the correct award number(s) of each award covered by the audit. The report must contain:

A. A title page,[5] table of contents, transmittal letter, and summary which includes: (1) a background section with a general description of the USAID programs audited, the period covered, the program objectives, a clear identification of all entities mentioned in the report, a section on the follow-up of prior audit recommendations, whether cost sharing/counterpart contributions were required during the period audited, and whether the recipient has a USAID-authorized provisional indirect cost rate; (2) the objectives and scope of the financial audit, and a clear explanation of the procedures performed and the scope limitations, if any; (3) a brief summary of the audit results on the fund accountability statement, questionable costs, internal control, compliance with agreement terms and applicable laws and regulations, indirect cost rates, status of prior audit recommendations, and, if applicable, the recipient's general purpose financial statements on an organization-wide basis; (4) a brief summary of the results of the review of cost sharing/counterpart contributions; and (5) a brief summary of the recipient's management comments regarding its views on the audit and review results and findings.

B. The auditor's report on the fund accountability statement, identifying any material questioned costs not fully supported with adequate records or not eligible under the terms of the agreement. The report must be in conformance with the standards for reporting in Chapter 5 of the *U.S. Government Auditing Standards* and must include:

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[5] Closeout audits must specify they are closeout audits on the title page. A closeout audit is an audit for an award that expired during the period audited.

1. The auditor's opinion on whether the fund accountability statement presents fairly, in all material respects, program revenues, costs incurred, and commodities directly procured by USAID for the year then ended in accordance with the terms of the agreements and in conformity with generally accepted accounting principles or other basis of accounting. This opinion must clearly state that the audit was performed in accordance with U.S. *Government Auditing Standards* or specific alternative standards if applicable (see paragraph 2.9.d of the *Guidelines*). Any deviations from these standards, such as noncompliance with the requirements for continuing professional education and external quality control reviews, must be disclosed (See Example 7.1.A of the *Guidelines*).

2. The fund accountability statement identifying the program revenues, costs incurred, and commodities directly procured by USAID for the fiscal year. The statement must also identify questioned costs not considered eligible for reimbursement and unsupported, if any, including the cost of any commodities directly procured by USAID whose existence or proper use in accordance with agreements could not be verified. All material questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. Also, the notes to the fund accountability statement must briefly describe both material and immaterial questioned costs and must be cross-referenced to any corresponding findings in the report on compliance (see Example 6.1 of the *Guidelines*). All questioned costs in the notes to the fund accountability statement must be stated in U.S. dollars. The U.S. dollar equivalent must be calculated at the exchange rate applicable at the time the local currency was disbursed to the recipient by USAID.

3. Notes to the fund accountability statement, including a summary of the significant accounting policies, explanation of the most important items of the statements, the exchange rates during the audit period and foreign currency restrictions, if any.

C. A report on the auditor's review of the schedule of cost sharing/counterpart contributions. The report must follow the guidance in the AICPA Statements on Standards for Attestation Engagements, Attestation Standard (AT) for review reports AT100.64. The report must include:

1. A review report on the cost sharing/counterpart contributions schedule. This review report must state that the review was conducted in accordance with AICPA standards. It should also explain that a review is more limited in scope than an examination performed in accordance with AICPA standards, and state that an opinion on the schedule is not expressed. The report must identify material questioned costs related to the provision of, and accounting for, cost sharing/counterpart contribution funds, with a reference to the corresponding finding in the report on compliance if the questioned costs are material. The report must provide negative assurance with regard to the provision of, and accounting for, cost sharing/counterpart contributions for items not tested (see Examples 7.6.A through 7.6.D of the *Guidelines*).

2. The cost sharing/counterpart contributions schedule identifying questioned costs (see Examples 6.2.A and 6.2.B or the *Guidelines*). Cost sharing/counterpart contributions that are unreasonable, prohibited by the agreements or applicable laws and regulations, or not program related are ineligible. Cost sharing/counterpart contributions that lack adequate documentation or do not have required prior approvals or authorizations are unsupported.

3. The cost sharing/counterpart contributions schedule identifying the budgeted amounts required by the agreements,[6] the amounts actually provided, and any cost sharing/counterpart contribution shortfalls (see Example 6.2.B of the *Guidelines*).

4. Notes to the cost sharing/counterpart contributions schedule that briefly explain the basis for questioned costs and shortfalls, if applicable. The notes must be cross-referenced to the corresponding findings in the report on compliance.

D. The auditor's report on internal control. The auditor's report must include as a minimum: (1) the scope of the auditor's work in obtaining an understanding of the internal control and in

[6] This step is required for audits of agreements that present cost sharing/counterpart contribution budgets on an annual basis and for closeout audits of awards that present cost sharing/counterpart contribution budgets on a life-of-project basis. See paragraphs 4.12 and 4.13 of the *Guidelines.*

assessing the control risk, and; (2) the significant deficiencies, including the identification of material weaknesses in the recipient's internal controls. Significant deficiencies must be described in a separate section (see paragraphs 5.2 through 5.4 of the *Guidelines*). This report must be made in conformance with SAS No. 60 and the standards for reporting in Chapter 5 of U.S. *Government Auditing Standards.* Any other matters related to internal control – such as suggestions for improving operational or administrative efficiency or internal control, or control deficiencies that are not significant deficiencies or material weaknesses may be communicated through a separate management letter that should be referred to in the report on internal controls and sent with the audit report (see Examples 7.2.A and 7.2.B of the *Guidelines*).

E. The auditor's report on the recipient's compliance with agreement terms and applicable laws and regulations related to USAID-funded programs. The report must follow the guidance in SAS No. 117. Material instances of noncompliance must be described in a separate section (see paragraphs 5.2 through 5.4 of the *Guidelines*). Nonmaterial instances of noncompliance should be communicated to the recipient in a separate management letter that should be sent with the audit report (see Examples 7.3.A and 7.3.B of the *Guidelines*). All material questioned costs resulting from instances of noncompliance must be included as findings in the report on compliance. Also, the notes to the fund accountability statement that describe both material and immaterial questioned costs must be cross-referenced to any corresponding findings in the report on compliance.

The auditor's report must include all conclusions, based on evidence obtained, that a fraud or illegal act either has occurred or is likely to have occurred. This report must include an identification of all questioned costs, if any, as a result of fraud or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected and whether the recipient does or does not agree with the findings and questioned costs. Abuse that is material, either quantitatively or qualitatively must also be reported.[7]

[7] Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant. If during the course of the audit, auditors become aware of abuse that could be quantitatively or qualitatively material to the financial statements,

In reporting material fraud, illegal acts, or other noncompliance, the auditors must place their findings in proper perspective. To give the reader a basis for judging the extent and seriousness of these conditions, the instances identified must be related to the universe or the number of cases examined and is quantified in terms of U.S. dollar value, if appropriate. In presenting material fraud, illegal acts, or other noncompliance, auditors must follow the reporting standards contained in Chapter 5 of U.S. *Government Auditing Standards*. Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense. Chapter 4 of U.S. *Government Auditing Standards* provides guidance concerning factors that may influence auditors' materiality judgments. If the auditors conclude that sufficient evidence of fraud or illegal acts exist, they must contact the USAID RIG/[*location*] office and exercise due professional care in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations or legal proceedings.

F. The schedule of computation of indirect cost rate (see Example 6.3 of the *Guidelines*) and the auditor's report on the schedule of computation of indirect cost rate. This should be a separate report prepared in accordance with guidance set forth in SAS No. 29. (AU551), (see Example 7.4 of the *Guidelines*).

G. The recipient's general purpose financial statements on an organization-wide basis and the auditor's report on them. These statements and the report on them only apply to recipients with an indirect cost rate that needs to be audited, unless the mission specifically requests that the statements be audited.

H. The findings contained in the reports on internal control and compliance related to USAID-funded programs must include a description of the condition (what is) and criteria (what should be). The cause (why it happened) and effect (what harm was caused by not complying with the

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auditors should apply audit procedures specifically directed to ascertain the potential effect on the financial statements or other financial data significant to the audit objectives. After performing additional work, auditors may discover that the abuse represents potential fraud or illegal acts. Because the determination of abuse is subjective, auditors are not required to provide reasonable assurance of detecting abuse.

criteria) must be included in the findings. In addition, the findings must contain a *recommendation* that corrects the cause and the condition, as applicable. It is recognized that material internal control weaknesses and noncompliance found by the auditors may not always have all of these elements fully developed, given the scope and objectives of these elements fully developed, given the scope and objectives of the specific audit. The auditors must, however, at least identify the condition, criteria and possible effect to enable management to determine the cause and take timely and proper corrective action.

I. Firms are expected to exercise independent judgment throughout the audit engagement, including in reporting on questioned costs. Indications of a lack of independence may result in removal of firms from the list of firms eligible to conduct audits of USAID funds. Findings which involve monetary effect must:

1. Be quantified and included as questioned costs in the fund accountability statement, the Auditor's Report on Compliance, and cost sharing/counterpart contributions schedule (cross-referenced).

2. Be reported without regard to whether the conditions giving rise to them were corrected.

3. Be reported whether the recipient does or does not agree with the findings or questioned costs.

4. Contain enough relevant information to expedite the audit resolution process (e.g., number of items tested, size of the universe, error rate, corresponding U.S. dollar amounts, etc.).

The reports must also contain, after each recommendation, pertinent views of responsible recipient officials concerning the auditor's findings and actions taken by the recipient to implement the recommendations. If possible, the auditor should obtain written comments. When the auditors disagree with management comments opposing the findings, conclusions or recommendations, they should explain their reasons following the comments. Conversely, the auditors should modify their report if they find the comments valid.

Any evidence of fraud, or illegal acts that have occurred or are likely to have occurred must be included in a separate written report if deemed necessary by USAID RIG/[*location*]. This report must include an identification of all questioned costs as a result of fraud or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected or whether the recipient does or does not agree with the findings and questioned costs.

VI. INSPECTION AND ACCEPTANCE OF AUDIT WORK AND THE REPORT

USAID RIG/[*location*] is responsible for assuring that the work performed under this statement of work complies with U.S. *Government Auditing Standards* and the *Guidelines for Financial Audits Contracted by Foreign Recipients* dated February 2009. To accomplish this objective, USAID RIG/[*location*] will perform desk reviews on every final audit report and will perform quality control reviews of the audit documentation of a select sample of final audit reports received from the independent auditors.

For quality control reviews, the audit firm must ensure that all audit records related to USAID agreements are available to enable RIG auditors to complete and support their review. To this end, the RIG auditors must have access to all pertinent audit documentation and records of the recipient and their subrecipients and make excerpts, photocopies, and transcripts.

As no audit costs may be charged to a USAID agreement if audits are not performed in accordance with the *Guidelines*, it is incumbent upon the auditor to produce a final product that meets these requirements. If the RIG rejects the work of the audit firm due to noncompliance with the *Guidelines*, the audit costs may not be charged to the USAID agreements until the RIG finds the report to be acceptable. USAID must withhold final payment for any work determined to be substandard until acceptable corrective action is taken. Should the audit firm fail to make its report acceptable, either a different recipient-contracted audit firm or the RIG must perform another audit. In such case, the audit firm will not be considered acceptable to perform future audits until the RIG determines that it has undergone an external quality control review, implemented the resultant recommendations, and is capable of substantially improved performance.

VII. RELATIONSHIPS AND RESPONSIBILITIES

The client for this contract is the recipient. The USAID Regional Inspector General (RIG) is responsible to responding to inquiries on audit matters during the audit. The RIGs also monitor the quality of such audits as mentioned in the Section VI above. The Program Coordinator for the RIG office is [*name of person*].

Recipients must ensure that all records are available to the independent auditors, all accounting entries and adjustments are made, and all other necessary steps are taken to enable the auditors to complete their work.

USAID Missions ensure that audit agreements between recipients and independent auditors contain a standard statement of work containing all the requirements of the *Guidelines*. Accordingly, recipients **must** send all draft audit contracts to the cognizant USAID mission for approval **prior to finalization**. One annual audit must cover all USAID funding to a recipient. Recipients that have funding agreements with more than one USAID mission must send their audit contracts for approval to the nearest USAID mission with which they have an agreement. This USAID mission will act as the designated cognizant mission, unless the recipient is otherwise directed by USAID. The USAID mission may meet with the public accounting firm at the beginning of the audit to explain any financial/compliance areas of concern that they want emphasized. The USAID mission may also attend the exit conference. The USAID mission should provide the following information to the auditors for the entrance conference:

1. A list of all payments made for assets, equipment, materials, and commodities purchased by USAID from third parties for the period being audited with copies of vouchers with supporting documentation.

2. A list of all advances and reimbursements made during the audit period.

3. A list of all disbursements made to the recipient.

4. A copy of the "Audit Report Desk Review Guidelines" that the auditors can use to evaluate their audit report.

USAID missions monitor and ensure the audit firm's submission of required recipient-contracted audit reports.

It is the responsibility of the recipient-contracted audit firm to perform audits pursuant to the *Guidelines* and to present audit reports in a timely manner. The public accounting firm must properly maintain and store the audit documentation for a period of three years from the completion of the audit. During this three-year period the audit firm shall immediately provide the audit documentation files when requested by the USAID mission or the RIG and allow them full access and copies of their audit documentation. Public accounting firms that are nonresponsive or do not provide timely responses to questions raised by the USAID mission or RIG office shall be temporarily or permanently excluded from performing additional audits.

VIII. TERMS OF PERFORMANCE

The effective date of this contract and statement of work will be the date of the recipient Contracting Officer's signature.

The audit should begin as soon as possible after the signing of the audit contract. Recipients must submit final audit reports to the cognizant USAID mission, who will forward final reports to the USAID Regional Inspector General (RIG) office for review and release. The cognizant RIG must receive the audit report within nine months after the end of the audited period. To this end, interim audit work is likely to be needed except in the case of recipients with few transactions. This practice makes timely audit reporting possible, does not restrict the scope of certain audit procedures and should result in reduced audit costs.

Payment will be as follows: 20 percent on the date of this contract, 40 percent after approval of the draft report and 40 percent on the date the RIG approves the final report. *[Payment terms could differ. However, a significant percentage of the payment should be retained until the RIG approves the final report]*

Annexure 4: Sample Entity Communication Letter

DEPARTMENT OF THE AUDITOR-GENERAL OF PAKISTAN

[Date]

[Name of Principal Accounting Officer]
[Entity's Name and Address]

Dear *[Name of Principal Accounting Officer]*

Subject: External Audit Activities for *20xx-20yy*

The provisions of the Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 (The Auditor-General Ordinance), read with Articles 169 and 171 of the Constitution of the Islamic Republic of Pakistan, provide the Auditor-General of Pakistan with the mandate to audit the accounts of [name of entity]. As part of this mandate, we intend to perform the following work for the financial year *20xx-20yy:*

[List the audit activities to be performed.]

The Department of the Auditor-General of Pakistan (DAGP) will conduct these audits in accordance with DAGP's Auditing Standards, which are in conformity with International Auditing Standards.

Financial Audits (Audits of Financial Statements/Accounts):

For the audits of the financial statements listed above, DAGP's Auditing Standards require that it plans and performs the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. In this respect, a financial audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. A financial audit also includes assessing the accounting principles used and significant estimates made by the management, as well as evaluating the overall presentation of financial statements.

Because of inherent limitations of a financial audit, together with the inherent limitations of any accounting and internal control systems, there is an unavoidable risk that even some material misstatements may remain undiscovered.

In addition to the report of the Auditor-General on the financial statements, we expect to provide your [ministry/department/agency, etc.] with a separate report concerning any material weaknesses in accounting and internal control systems that come to our notice during the course of the audit. The more significant matters may be reported in a published audit report.

The responsibility for the preparation of the financial statements, including adequate disclosure, is that of the management as required under [list applicable ordinances, such as the Controller General of Accounts (Appointment, Functions and Powers) Ordinance, 2001]. This includes the maintenance of adequate accounting records and internal controls, application of accounting policies, and the safeguarding of the assets of the entity. As part of the financial audit process, we will request from management written confirmation concerning representations made to the audit team in connection with the audit.

Compliance with Authority Audit Work:

For the compliance with authority audits listed above … *[describe nature and extent of work, expected reports, etc.].*

Separate Audits of Internal Control:

Performance Audits:

Audits of foreign-aided projects:

Other functional, systems, programme and fraud audits:

Special assignments:

[Would follow same format as for compliance with authority audits.]

** ** **

This audit work is important to ensure effective management and governance across the Government of Pakistan.

We look forward to full cooperation from your staff and trust that they will make available to the audit team any accounts, books, papers and other documents which deal with, or form the basis of, or are otherwise relevant to the audit, as required under Section 14 of the Auditor-General Ordinance.

Yours truly,

Director General (Audit)

(Instructions follow)

Entity Communication Letter

A copy of the most recent entity communication letter, setting out the terms of the audit assignment, should be filed in this section of the Planning File.

Types of audits to be mentioned in the letter include:

1. *Annual financial audit of the entity's financial statements, or of the entity's portion of the financial statements of the Federation, one of the provinces, or one of the districts;*
2. *Compliance with authority audits;*
3. *Separate audits of internal controls;*
4. *Performance audits;*
5. *Audits of foreign-aided projects;*
6. *Other functional, systems, programme and fraud audits; and*
7. *Special assignments.*

The audits listed in (2) to (7) would be separated between those audits continuing from the previous year, and those that are being started in the current year.

A sample entity communication letter is attached.

If desired, the letter may be expanded to include such matters as:

1. *DAGP's current understanding of any specific entity requirements;*
2. *The timetable for the audit work;*
3. *Details of assistance required from internal audit and other entity staff; and*
4. *Information to be provided by entity officials.*
5. *Follow up matters from previous audits.*

Annexure 5: Documentation in Planning Phase (from the DAGP Guidelines)

Titles of various forms specified in the Audit Working Papers Kit are listed below:

1. Audit objectives and scope *
2. Points for attention at next audit (from last year) *
3. Entity communication letter *
4. Audit planning memorandum *
5. Memorandum on post-planning changes *
6. Important dates *
7. Tour programme *
8. Information requested from entity officials *
9. Materiality assessment form
10. Expected aggregate error and planned precision form
11. Audit risk assessment form
12. Inherent risk assessment form
13. Internal control questionnaire – control for overall environment
14. Internal control questionnaire – general computer controls
15. Internal control questionnaire – application controls
16. Control risk assessment form
17. Analytical procedures assurance form
18. Source of audit assurance form
19. List of applicable laws and regulations *
20. Sample selection checklist
21. High value item selection form *****
22. Key item selection form
23. Sample sizing for tests of internal control
24. Sample sizing for substantive tests of details
25. Checklist of accounting estimates to be reviewed
26. Points for attention at next audit *
27. Audit planning checklist *

> *Note: These forms recommended under FAM and Audit Working Papers Kit essentially meet the requirements of Certification Audit. However, some of these forms, marked with asterisks(*), can also be used for Compliance with Authority Audit.*

Annexure 6: Illustrative Management Representation Letter

Note: This letter is based on the OIG's Guidelines. The auditors may use the Management Representation Letter format prescribed under the ISSAIs.

(Date)

Addresses (which in this will be the concerned head of the FAO)

We are providing this letter in connection with your audit(s) of the (identification of financial statements) of (name of entity) as of (dates) and for the (periods) for the purpose of expressing an opinion as to whether the (consolidated) financial statements present fairly, in all material respects, the financial position, results of operations, and cash flows of (name of entity) in conformity with accounting principles generally accepted in the United States of America. We confirm that we are responsible for the fair presentation in the (consolidated) financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it possible that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, (as of date of auditor's report), the following representations made to you during your audit(s).

1. The financial statements referred to above are fairly presented in conformity with accounting principles generally accepted in the United States of America.

2. We have made available to you all:

    a. Financial records and related data.

    b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.

3. There have been no communications from regulatory agencies concerning non-compliance with or deficiencies in financial reporting practices.

4. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.

5. We believe that the effects of the uncorrected financial statement misstatements summarized in the accompanying schedule are immaterial both individually and in the aggregate, to the financial statements taken as a whole.

6. We acknowledge our responsibility for the design and implementation of programs and controls to prevent and detect fraud.

7.We have no knowledge of any fraud or suspected fraud affecting the entity involving (a) management, (b) employees who have significant roles in internal control, or (c) others where the fraud could have a material effect on the financial statements.

8.We have no knowledge of any allegations of fraud or suspected fraud affecting the entity received in communications from employees, former employees, analysts, regulators, or others.

9.We have complied with all aspects of contracts and agreements that could have a material effect on the fund accountability statement in the event of noncompliance.