AUDIT MANUAL
FOR
FOREIGN AIDED PROJECTS



DEPARTMENT OF THE AUDITOR GENERAL OF PAKISTAN

January 2018

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NOTICE TO THE READER

The Audit Manual should be kept in safe custody and made available only to the intended users of the manual. Original copy of the manual must be kept with the Audit Policy Wing and distribution thereof, whether in the form of a hard copy or an electronic copy is the responsibility of the Audit Policy Wing.

The contents of this manual are confidential and should not be copied (physically or electronically) or distributed outside the DAGP either in whole or in part without the prior written approval of DAG, SSA or DG of regional directorates. The Manual shall be returned by the outgoing employees.

Foreword

The Audit Manual for Foreign Aided Projects has been developed to provide guidelines to The Department of Audit General of Pakistan ("DAGP") and it's Field Audit Offices in undertaking audit of Foreign Aided Projects ("FAP[s]"). The Manual shall be applicable to the Department of Auditor General of Pakistan for the conduct of audits of Foreign-Aided-Projects. In this regard, all the Field Audit Offices and relevant sections at the Office of Auditor General of Pakistan shall adhere to the requirements of this manual for carrying out audits of Foreign-Aided-Projects.

The manual is intended to assist in meeting development partner expectations regarding audit of FAPs. These audit requirements are laid out in the relevant legal agreements underlying the FAP. These legal agreements include project agreement and related loan covenant/grant agreement.

The Manual is based on International Standards of Supreme Audit Institutions ("ISSAI") issued by the International Organization of Supreme Audit Institutions ("INTOSAI"), International Standards on Auditing ("ISA") issued by the International Federation of Accountants (IFAC), Financial Audit Manual ("FAM") of DAGP and specific audit requirements of various development partners.

The manual has been structured in a manner that allows systematic description of key processes, duly linked with the relevant process owners, timelines and frequency of the activities.

The manual does not override the specific arrangements stipulated in loan, grant and financing agreements and related manuals and guidelines. The manual is designed to allow for updates by chapter, the reader is advised to consult DAGP Head Office regularly to ensure they have the latest version of the manual.

I hope that the Manual will prove useful to the Field Audit Offices and will go a long way in ensuring improvement in Audit Reports.

Dated: January 2018

(Javaid Jehangir)
Auditor General of Pakistan

ABBREVIATIONS

ADB	Asian Development Bank
ADP	Annual Development Plan
AGP	Auditor General of Pakistan
AR	Audit Risk
CAAT	Computer Assisted Audit Techniques
CR	Control Risk
DAC	Departmental Accounts Committee
DAG	Deputy Auditor General
DAGP	Department of Audit General of Pakistan
DR	Detection Risk
DP	Development Partners
DG	Director General
EA/IA	Executing/ Implementing Agencies
EAD	Economic Affairs Division
EQCC	External Quality Control Check
FAM	Financial Audit Manual
FAO	Field Audit Offices
FAP	Foreign Aided Projects
IQCC	Internal quality control check
ISSAI	International Standards of Supreme Audit Institutions
IR	Inherent Risk
INTOSAI	International Organization of Supreme Audit Institutions
ISA	International Standard on Auditing
IFAC	International Federation of Accountants
IPSAS	International Public Sector Accounting Standards
MUS	Monetary Unit Sampling
PMU	Project Management Unit
PIU	Project Implementation Unit
QCC	Quality Control Check
RoMM	Risk of Material Misstatement
USAID	United States Agency for International Development
WB	World Bank

DEFINITIONS

Additional Auditor General: Apex governing authority for audit of Foreign Aided projects.

Analytical review: Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data.

Assertions: Assertions are representations by management, explicit or otherwise, that are embodied in the financial statements, as used by us to consider the different types of potential misstatements that may occur.

Audit Officer: Audit Officer is the Field Team Lead and mainly responsible for FAP audit execution. Audit Officer is supported by Assistant Audit Officers, Senior and Junior Auditors for carrying audit of FAPs.

Audit risk ("AR"): Audit risk ("AR") is the risk that the auditor expresses an inappropriate audit opinion when financial statements are materially misstated.

Audit Evidence: Audit evidence is information used by the auditor in arriving at the conclusions on which their opinion(s) is/are based.

Audit Plan: An audit plan is a record of the planned nature, timing and extent of risk assessment procedures, further audit procedures at the assertion level in response to the assessed risks, and other audit procedures.

Audit programs: Audit programs contain audit procedures designed to obtain sufficient and appropriate audit evidence commensurate with the audit risk determined by the auditor based on his assessment of the risk of material misstatement performed as part of the audit planning.

Co-financed projects. Projects financed through one or more multilateral or bilateral financiers.

Control risks: Control risk is the risk that a misstatement would not be prevented or detected by the internal control systems that the client has in operation.

Deputy/Assistant Director Audit: Deputy/Assistant Director Audit heads the FAO

Development Partner: The donor organization is referred to as the Development Partner

Detection risks: Detection risk is the risk of material/significant error or loss going undetected by the auditor's substantive audit procedures.

Director General Audit ("DG Audit"): Responsible for the overall supervision and management of an audit field office.

EA/IA's Principal Office: Refers to Department/Ministry under which the FAP's project management/implementation unit has been established.

EA/IA's Principal Office management: Refers to the principal accounting officer or otherwise head of the EA/IA's Principal Office and similar staff members, primarily responsible for project implementation and vested with the powers of governance over the project.

Entity Communication Letter: Entity communication letter indicate the team authorized to conduct the audit and the time of the audit, and explain about the nature and scope of audit before the commencement of audit work.

Entrance Meeting: Meeting conducted with the FAP management when beginning the audit.

Exit/Discussion Meeting: Meeting conducted with the FAP management to discuss information about the audit findings and provide the opportunity to management to respond and/or produce evidences regarding the audit findings.

FAPs: FAPs are projects either wholly financed through foreign assistance from a development partner or contain an element of counterpart funding wherein partial foreign assistance is from a development partner.

Field Audit Office: Audit of FAPs are executed by the Field Audit Offices/Sections ("FAO") of each of the audit field office.

Financial Audit Manual ("FAM"): The purpose of FAM is to provide DAGP auditors with a set of modern auditing standards, concepts, techniques, and quality assurance arrangements that are consistent with international standards, for auditing entities in the Government of Pakistan.

Final Audit Report: The audit report issued to the FAP management stating audit opinion and management letter containing all unsettled audit issues, after considering the auditee's responses and the evidence for the audit issues stipulated in the preliminary audit report.

General purpose financial statements: are financial statements that are prepared in accordance with a general purpose framework, which is a financial reporting framework designed to meet the common financial information needs of a wide range of users.

Grant: Funds extended by a development partner as aid under a legal agreement that need not be returned subject to conditions attached to the granted funds explicated in the underlying legal agreement.

International Standards of Supreme Audit Institutions ("ISSAI"): The Auditing Standards Committee (changed now to Professional Standards Committee) of the International Organization of Supreme Audit Institutions (INTOSAI) issued the auditing standards at the XIVth Congress in 1992 in Washington DC. The INTOSAI standards represent the best auditing practices among the SAIs of various countries.

International Standard on Auditing ("ISA"): The accounting bodies of various countries established the International Federation of Accountants (IFAC) in 1977 to develop and enhance worldwide accountancy profession. The auditing standards issued by the IFAC are known as International Standards on Auditing (ISAs). Though the ISAs provide the basis for internationally recognized auditing practices of private and public sector auditing, they are still not mandatory for the auditors of a Supreme Audit Institution (SAI). The ISAs do not override the statutory, regulatory or professional statutes of the countries.

Inherent risks: Inherent risk is the risk that significant misstatements, both intentional and unintentional, may occur, disregarding the effectiveness of internal control to prevent or detect and correct such misstatements.

Integrity: Integrity refers to acting honestly, reliably, in good faith and in the public interest. In the course of their work, AGP staff shall be trustworthy.

Independence: Independence-in-fact is a situation where individuals are able to perform activities without being affected by relationships that can influence and compromise professional judgment, allowing them to act with integrity and exercise objectivity and professional skepticism.

Internal Auditors: Internal auditors are those individuals who perform the activities of the internal audit function. Internal auditors may belong to an internal audit department or equivalent function.

Loans and credits: Amounts extended by the development partner, also the lender, under a legal agreement that need to be returned to the lender along with a capital charge over the funds.

Management Letter: It is a letter written by management that confirms the accuracy of an audit.

Management Bias: Management bias is a lack of neutrality by management, both intentional and unintentional, in the preparation and fair presentation of information.

Objectivity: Objectivity is the mental attitude where individuals are able to act in an impartial and unbiased manner, presenting or assessing things on the basis of facts rather than own feelings and interests, without subordinating judgment to others.

Preliminary Audit Report: The audit report issued to the management of FAP to communicate all significant issues found during audit and to provide management with an opportunity to respond, if they have not provided a response during the exit meeting.

Project financial statements: Financial Statements prepared by the Project to report loan/grant expenditure and receipts.

Reasonable Assurance: Reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. It is a high, but not absolute, level of assurance.

Regional Directorate: Audit of FAPs are executed by the Field Audit Offices/Sections ("FAO") of each of the Regional Directorate.

Risks: Risks are the set of circumstances that hinder achievement of objectives.

Risk of material misstatement*:* Risk of material misstatement refers to the condition where the financial statements may be materially misstated. The risk of material misstatement consists of two components, namely inherent risk and control risk.

RoMM: RoMM is the risk that an assertion relating to a significant account or disclosure could be materially misstated due to error (RoMM due to error) or fraud (RoMM due to fraud). RoMM consists of inherent risk and control risk.

Sampling: Audit Sampling involves applying audit procedures to less than 100 percent of items within a population.

Significant Risk: A significant risk is an identified and assessed risk of material misstatement that, in auditor professional judgment, requires special audit consideration.

Chapter 1:
INTRODUCTION

1.1. Purpose of the manual

The Foreign Aided Project audit manual has been developed to provide guidelines to The Department of Audit General of Pakistan ("DAGP") and it's Field Audit Offices in undertaking audit of Foreign Aided Projects ("FAP[s]") by the Executing/ Implementing Agencies ("EA/ IA").

The objectives of this audit manual are to:

- Document the policies and procedures relating to audit in order to ensure uniformity in audits performed by the DAGP
- Provide guidelines to ensure that audit activities are documented in a consistent manner
- Provide guidelines for preparation of documentation in conformity in the audit scope, nature, timing and extent of procedures performed and reporting thereon
- Provide guidelines on checking compliance with all the relevant laws and regulations, terms and conditions of loan/grant agreement, project agreement and other relevant development partner guidelines
- Strengthen the performance of audits of FAPs
- Reduce the cost of information development and sharing and to mitigate the institutional memory losses resulting due to staff turnover
- Make the audit of FAPs easy for new and current employees to learn by amalgamating all important rules and procedures in one place, making the process less time consuming.

1.2. Scope and Applicability of the Manual

The Manual shall be applicable to the Department of Auditor General of Pakistan for the conduct of audits of Foreign-Aided-Projects. In this regard, all the Field Audit Offices and relevant sections at the Office of Auditor General of Pakistan shall adhere to the requirements of this manual for carrying out audits of Foreign-Aided-Projects.

1.3. Foreign Aided Projects ["FAP(s)"]

FAPs are projects either wholly financed through foreign assistance from a development partner or contain an element of counterpart funding wherein partial foreign assistance is from a development partner.

Foreign assistance may entail any of the modes of funding either in the form of credits, loans or grants.

1.4. FAP Audit Requirements

The manual is intended to assist in meeting development partner expectations regarding audit of FAPs. These audit requirements are laid out in the relevant legal agreements underlying the FAP. These legal agreements include project agreement and related loan covenant/grant agreement.

General requirements pertaining to audit of various development partner funds are laid out in **Annexure A**.

The principle under which development partners require an audit of FAPs is to draw assurance over effective financial management for the achievement of program objectives. Therefore, using audit as a tool for oversight and consequently to increase the development partner's confidence in the financial information prepared and presented by the project. This confidence emanates from opinion issued by the auditor that is a reflection of reasonable assurance obtained about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

Opinion is part and parcel of audit report on the financial statements that communicates the results of the audit, in accordance with the auditor's findings.

Development partners ostensibly accept audits performed in accordance with the ISSAI and ISA. Audit methodology and requirements purported in the aforementioned auditing standards have also been adopted and aligned within the type of audits and underlying audit objectives defined in the FAM, i.e., regulatory audit that includes attestation of the project financial statements and performance audits. These two types of audit are purposed to achieve the following objectives that also conform to development partner audit requirements:

- Attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinion on financial statements;
- Attestation of financial accountability of the government administration as a whole;
- Audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;
- Audit of internal control and internal audit functions;
- Audit of the probity and propriety of administrative decisions taken within the audit entity; and
- Reporting of any other matters arising from or relating to the audit that AGP considers should be disclosed.
- Audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- Audit of the efficiency of utilizing of human, financial and other resources, including the examination of information systems, performance measures, monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies; and
- Audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of activities compared with the intended impact.

1.5. Scope of assurance work pertaining to FAPs

The material in this manual should be applied in auditing foreign aided projects. Keeping in view the requirements of the development partners and the objectives of audit already defined in FAM, the scope of audit of FAPs will mainly include the any or all of the following:

- Considerations pertaining to the applicable auditing framework, i.e. ISSAI or Government Auditing Standards of US. In case the auditor established that ISSAI's are applicable, the auditor may use relevant guidance in FAM which is derived from ISSAIs. Selection of the relevant framework is likely to have an impact on the reporting requirements of the audit.

- Audit for project financial statements or Fund Accountability Statement in case of USAID funded projects;
- Review of interim financial information submitted by the project to the development partner;
- Review of the financial systems in place at the project;
- Review of internal controls specific to reporting requirements of the development partner;
- Compliance with terms and conditions specific to agreements signed with the development partner; and
- Compliance with laws and regulation applicable to the project's operations and relevant to the development partner.

1.6. Overview of the Manual

1.6.1. Basis of Preparation

The contents of the manual have been assimilated from:

- International Standards of Supreme Audit Institutions ("ISSAI"):

  The Auditing Standards Committee (changed now to Professional Standards Committee) of the International Organization of Supreme Audit Institutions (INTOSAI) issued the auditing standards at the XIVth Congress in 1992 in Washington DC. The INTOSAI standards represent the best auditing practices among the SAIs of various countries.

  The INTOSAI auditing standards consist of four parts – basic principles, general standards, field standards and reporting standards. The basic principles for auditing standards are basic assumptions, consistent premises, logical principles and requirements, which help in developing auditing standards and serve the auditors in forming their opinions and reports, particularly in cases where no specific standards apply. The general standards describe the qualifications of the auditor and/or the auditing institution so that they may carry out the tasks related to field and reporting standards in a competent and effective manner. The field standards regulate the audit activity by establishing the framework for conducting and managing audit work. The reporting standards relate to the forming audit opinion after completing the audit works.

- International Standard on Auditing ("ISA"):

  The accounting bodies of various countries established the International Federation of Accountants (IFAC) in 1977 to develop and enhance worldwide accountancy profession. The auditing standards issued by the IFAC are known as International Standards on Auditing (ISAs). Though the ISAs provide the basis for internationally recognized auditing practices of private and public sector auditing, they are still not mandatory for the auditors of a Supreme Audit Institution (SAI). The ISAs do not override the statutory, regulatory or professional statutes of the countries.

  Requirements of the ISAs have been curtailed for adherence by the DAGP in the context of projects' being implemented by the public sector and in accordance with "ISSAI 1200: Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards of Auditing".

- Financial Audit Manual ("FAM"):

  The purpose of FAM is to provide DAGP auditors with a set of modern auditing standards, concepts, techniques, and quality assurance arrangements that are consistent with international standards, for auditing entities in the Government of Pakistan. In case the stipulations of this manual are not in conformity with FAM, relevant stipulations of FAM shall prevail.

- Various development partner requirements.

  *General development partner requirements as used to tailor various audit requirements under this manual are laid out in **Annexure A**.*

1.6.2. Structure of the Manual

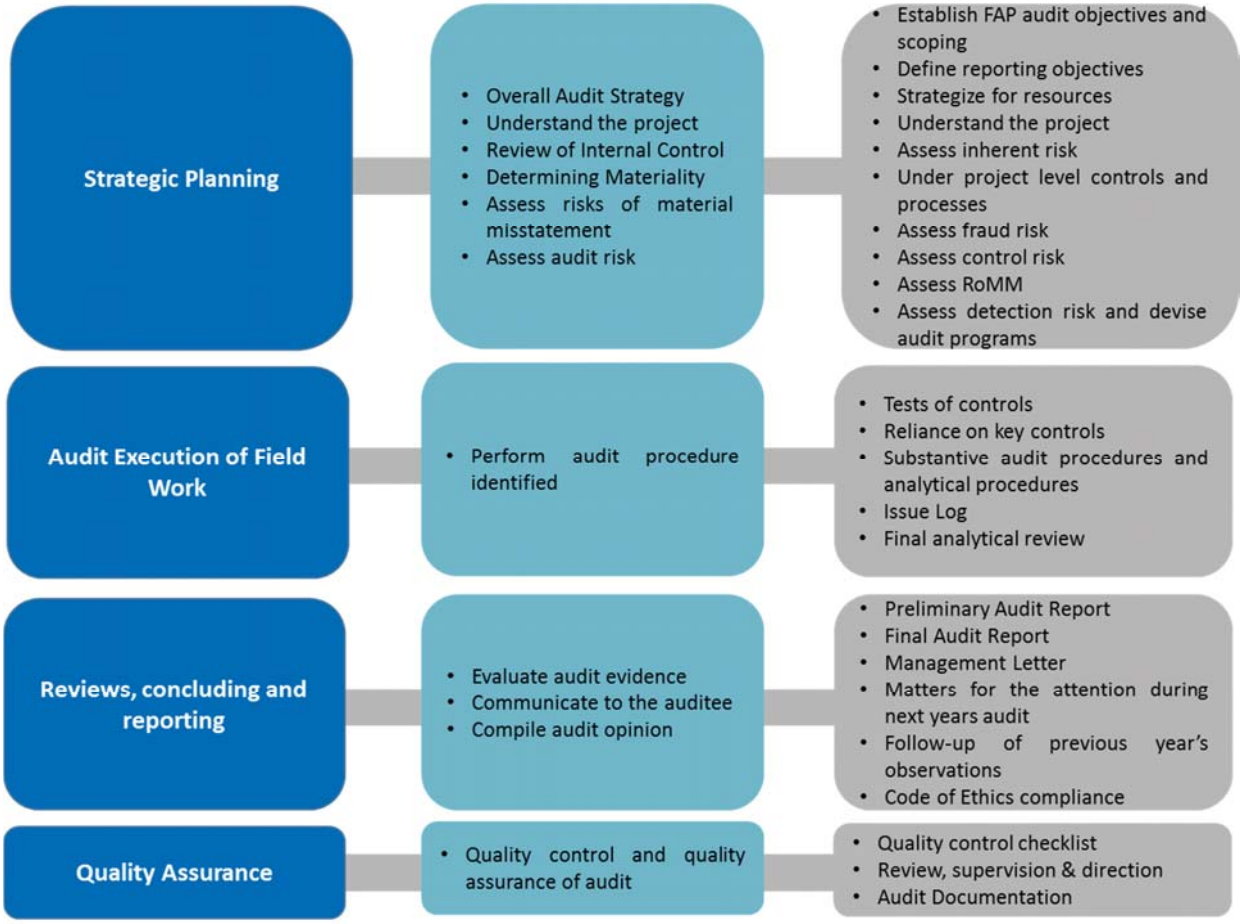
Below is a brief orientation of the Manual's contents:

Chapter Listing	Areas covered in the Manual
1 Introduction	• Explains applicability of the manual to audit of foreign aided projects that inculcates a hybrid methodology for various types of audits proposed by INTOSAI aligned with the development partner specific requirements for accountability, transparency and propriety. • Details the process for identification of auditable entities; • Outlines the manual structure to acclimatize the reader with reference to architecture of the document, development partner requirements for an audit of FAP, FAP audit scope and objectives, and version control.
2 Department Of The Auditor General Of Pakistan	• Explains role of the Auditor General of Pakistan as the prime authority for ratifying the contents of the manual and assignment of responsibilities for implementation of the material therein. • Delineates the expectations attached with the auditor in the form of relevant duties to be performed and the conditions of its employment. • Derives the code of conduct integral to the responsibilities of the auditor and articulated for adherence to ethical guidelines, and quality assurance over audit work as already laid out in FAM and ISSAI.
3 Planning and risk assessment – At the Desk level and Field level	• This section is split over 2 chapters that divides the tasks of audit planning into 2 phases, i.e., planning at the desk level, and planning carried out in the field. • Covers requirements for development of an overall strategy after consideration of projects to be audited, reporting objectives, nature of the work, resources available, significant areas including any highlighted in the previous year's audits whilst keeping in mind DAGP's current audit planning process. • Details procedures for development of an audit plan. • Complements procedures for development of an audit plan by explaining requirements for obtaining understanding of the project and its internal control structure, highlight risk areas, determine planning and performance materiality levels, define error conditions, and determine the nature, timing and extent of audit procedures. • Based on the risk-based approach, requires the auditor to decide on an optimum mix of procedures that require determining the extent of reliance on test of controls, and obtaining evident through substantive procedures. • Requires development of audit programs detailing audit procedures that can be customized to the requirements of the auditor in line with the optimum mix of procedures determined by the auditor. • Clearly specifies the documentation requirements arising from planning the audit and emphasize the need for documenting planning stage of audit.
4 Audit Execution	• Emphasizes the characteristics of audit evidence including the need for properly documented working papers, justified sampling methodology, and special considerations pertaining to specific items, opening balances, external confirmations, management representations, and analytical procedures.

	• Defines the category and types of procedures that may be used to gather appropriate audit evidence that corroborates the auditor's understanding developed during the planning phase of the audit. • Conclusions and recommendations become apparent when these are backed by adequately documented procedures and work done. The manual will include guidelines over the causal relationship of procedures, results, and recommendation thereon.
5 Completion	• Guides the process of informing the management of the results of the audit so that corrective measures may be taken, and appropriate opinion may be issued over the financial statements. • Reiterates the need for documenting and enlist outputs that should be available for perusal. Such documentation will highlight the results of procedures carried out during the field work and auditors evaluation of fraud risk, controls in place by the project specifically those relating to accounting and financial reporting, and need to revisit materiality assessments.
6 Reporting	• Elaborates reporting requirements of development partners for audit of projects. • Explains the types of audit opinion and will provide guidelines over the reporting templates to be used. This section will also cover specific audit reporting considerations necessary for inclusion by the auditor to develop greater understanding of the reader of the report as to the circumstances surrounding the audit and its performance. • Highlights specific considerations for conformity with development partners' requirements for an audit report that are not limited to opinion over the financial statements of the project.
7 Quality Assurance	• Explains the purpose of the quality assurance, identifying the need to implement the quality assurance in the conduct of audit; Elements of a system of quality controls implemented during audits; Ethical considerations and their significance in an audit of financial statements; Need to have a system of monitoring and a system of quality control review throughout the audit process; Significance of the review, supervision and setting the direction for an audit along with necessary guidelines for a comprehensive review, appropriate supervision and direction; Need to assess matters of complexity or otherwise that require consultation for appropriate action; and documentation that provides evidence of an audit performed in compliance with quality control requirements.
Annexures	• Templates for various auditing tools to assist the auditor in documenting the audit activities.

1.6.3. The Audit cycle

Summary of Audit Process



1.6.4. How to use the manual

The Manual allows the users a navigational text based interface. Wherever the user feels the need for further information, reference to relevant text in the source document is offered in the manual, making it a reference point for all the audit requirements of development partners for use by the DAGP on audit of FAPs.

Projects funded by Development Partners ("DP") are guided by rules and procedures of the Government of Pakistan and that of the DP. The DP being the administrator of funds has its policies and procedure that are applicable to the Projects. Therefore, there are two sets of procedures and reporting lines that come under the auditing framework for DP Funded Projects:

- For auditing funds from the DPs, the procedures of the specific DP need to be checked for compliance; whereas
- For government part funding is subject to government-based financial processes like budgeting, accounting, auditing, record keeping, the requirements of Government of Pakistan apply.

The manual gives details of auditing funds of the relevant DP, therefore, it relies on the DP guidelines and requirements for drawing assurance over the utilization of funds. In order to assist in manual implementation, annexures have been included containing indicative templates for applying the manual's

requirements. The templates are recommended to be used and modified according to circumstances surrounding a FAP audit.

The manual shall normally require changes on account of any of the following reasons:

- Suggestions from AGP staff, including any feedback obtained from the FAO by the Office of the AGP regarding implementation of the requirements of the manual;
- Additional policies and procedures consequent to introduction of new auditing standard, concentration of funding in a new socio-economic paradigm, the level of automation at FAP as well as DAGP, or requirements emanating from evolution in the current methodology of audit;
- Changes in applicable auditing framework, or in development partner requirements; and
- Restructuring the existing setup at DAGP.

Chapter 2:
DEPARTMENT OF THE AUDITOR GENERAL OF PAKISTAN

2.1. Legislative Authority

The authority under which the Auditor-General of Pakistan conducts audits is given by Article 169 of the Constitution of the Islamic Republic of Pakistan. In addition, Articles 168 to 171 also relate to the work of the Auditor-General.

Most of DAGP's audit work is performed under Articles 168 to 171 of the Constitution, and following two ordinances:

- Auditor-General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001 (Auditor-General Ordinance); and
- Controller General of Accounts (Appointment, Functions and Powers) Ordinance, 2001 (Controller General Ordinance).

Among other things, these ordinances elaborate on the functions, powers and responsibilities of the Auditor-General of Pakistan in line with the provisions of Article 169 of the Constitution.

Section 8 of the Auditor-General Ordinance mandates an audit of expenditures of the Federation and of each province and Section 12 of the Auditor-General Ordinance mandates an audit of the receipts of the Federal Government and of each Province and each district.

Moreover, authority for administering foreign assistance in Pakistan is vested with the Economic Affairs Division ("EAD") through appropriate legislation and regulation. FAPs are implemented by various government departments/ministries, also referred to as "Executing/Implementing Agencies" by various development partners through establishment of distinct PMU's.

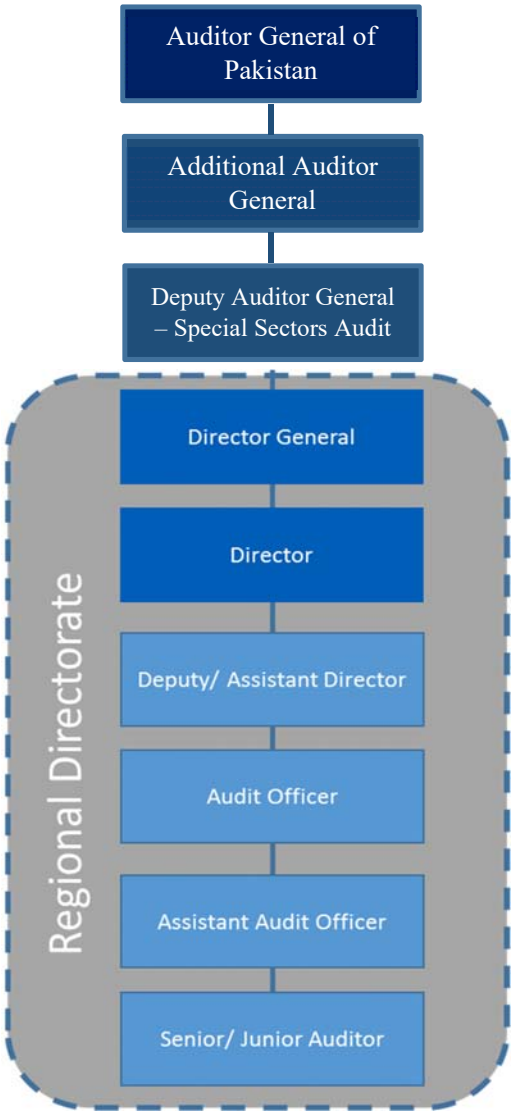
FAPs fall within the ambit of the Office of the AGP for the purposes of audit. Development partners willing to funnel funds through EAD accord acquiesce for audit by the DAGP.

2.2. Conditions of Employment

The conditions of employment of auditors within DAGP have been formally and extensively documented in the "Auditor-General's Manual of Standing Orders" and other related paraphernalia. The aforementioned deals with matters of recruitment, trainings, promotions, transfers, leaves and areas ancillary to the HR administration of the department (DAGP). Additional requirements are laid down by the Government Servants (Conduct Rules) 1964 and the Establishment Code are also applicable on all DAGP staff.

2.3. Reporting Structure for FAP Audits

Following table reflects the execution and reporting structure for FAP audits in place at the DAGP:



2.4. Roles & Responsibilities

2.4.1 Auditor General of Pakistan

Auditor General is the apex governing authority for audit of Foreign Aided projects and is primarily responsible for ensuring that development partners' requirements and concerns are addressed and accounted for by the Office of Auditor General of Pakistan and appropriate considerations are given to terms of audit inclusion in accordance with the project implementation agreements for each of the FAPs.

2.4.2 Additional Auditor General

The Additional Auditor General is tasked with the quality review of audit reports before submission to the Auditor General of Pakistan. The audit reports finalized by the DAGP will be sent to the Additional Auditor

General who will review that the audit reports are in compliance with development partners' requirements and concerns are addressed and accounted for by the Office of Auditor General of Pakistan and appropriate considerations are given to terms of audit inclusion in accordance with the project implementation agreements for each of the FAPs.

2.4.3 Deputy Auditor General – Special Sectors Audit:

Deputy Auditor General is tasked with the portfolio of FAPs and is responsible for:

- Reconciliation of FAPs selected for audit by the audit field offices for the fiscal period;
- Liaison with relevant audit field offices for addressing development partner concerns over FAP audits;
- Prime facilitator for audit of FAPs at the EA/IA level so that any contentious matters are duly dealt with;
- External Quality Control review of designated offices as per government notification.

2.4.4 Audit Field Office

Audit of FAPs are executed by the Field Audit Offices ("FAO") of each of the audit field office. Each audit field office is headed by a Director General.

Director General Audit ("DG Audit") is responsible for the overall supervision and management of an audit field office. The position holder exercises all the designated relevant power as the head of the office and is responsible for the monitoring and overall performance of the FAO, give directions and exercise control over the resources of the office to ensure that FAP audits are made part of annual targets and achieved in an efficient and effective manner.

Moreover, DG Audit is the project lead for the audit of FAPs and is the ultimate authority for directing and approving all the activities pertaining to FAP audits.

DG Audit is supported by Director Audit for the purposes of review and supervision related of FAP audits.

Deputy Director Audit leads the FAO and is responsible for execution of FAP audit, mobilization of teams, medium for setting the direction of the audit in line with the requirements of Director General Audit, and assisting the Director in supervision and review of the audits conducted by the Field Team.

Audit Officer is the Field Team Lead and mainly responsible for FAP audit execution. Audit Officer is supported by Assistant Audit Officers, Senior and Junior Auditors for carrying out audit of FAPs.

Key task performed by the audit field offices in performance of FAP audits are:

- Include all active FAPs as part of the audit plan for the fiscal period;
- Determine the audit objective and related scope of work for each of the FAPs;
- Issue Entity Communication Letters to the management of FAP prior to field work;
- Approve the documented, audit planning checklist, and related audit procedures and audit programs;
- Ensure that the audit programs are customized to reflect procedures in line with development partner requirements emanating from project implementation agreements, loan/grant covenants, and procurement guidelines.
- Execute FAP audits according to the results of audit planning work performed at the start of the audit;
- Undertake appraisal of the basis for changes and updates in the audit plan, and related modifications to the audit procedures and audit programs;

- Review the audit evidence gathered, and appropriate and sufficiency thereof to cater to the pre-set audit risk;
- Review the results of audit procedures in the light of audit evidence gathered, conclusions drawn thereon.
- Finalize and approve the audit report including audit opinion along with management letter for onwards submission;
- Ensure that management comments are received and incorporated as part of the management letter;
- Ensure that the follow-up is triggered for each of the FAP audits through initiation of DAC proceedings;
- Ensure that the audit reporting pack is submitted for appropriate quality control reviews;
- Review, approve, and signoff of all the forms within the permanent audit file of FAP;
- Ensure that audit is completed in a timely manner for compliance with development partner timelines.

2.5. Code of Ethics

The material in this section has been derived from ISSAI 30 – Code of Ethics which is also the source for ethical guidelines included as part of AGP's Financial Audit Manual.

The INTOSAI Code of Ethics (the Code) intends to provide DAGP and the staff working for them with a set of values and principles on which to base behavior. Furthermore, it gives additional guidance on how to embed those values in daily work.

The Code is intended for all those who work for, or on behalf of DAGP. This includes the head of the DAGP, office bearers, executive management and all individuals directly employed by, or contracted to conduct business on behalf of the DAGP. The Code also applies to those in the governance structure of DAGP.

2.5.1 Risks and Controls

Risks (often also referred to as "threats" or "vulnerabilities") of non-compliance with the above values can be influenced by a number of risk factors. These include, but are not limited to:

- Political influence and external pressure from auditees or other parties;
- Personal interests;
- Inappropriate bias from previous judgments made by the DAGP or DAGP staff;
- Advocating the interests of auditees or other parties;
- Long or close relationships.

These risks can be either real or perceived.

Clear communication is necessary to increase staff's awareness and understanding of the code of ethics. This can include educating staff on promoting the AGP's values and addressing ethical dilemmas, by offering workshops and training, leadership engagement, and disseminating topics relating to ethics and good practices.

Monitoring controls help the DAGP mitigate ethics risks. DAGP may apply the following monitoring controls:

- Maintaining registers to track interests, gifts and hospitality. Such registers should be complemented by procedures that require the officers and staff of DAGP to divulge such information on an as-and-when basis duly backed by periodic written declarations that the relevant personnel has made such disclosures.

- Conducting self-assessment, internal and external reviews. Evaluations will have to consider that many ethical requirements refer to soft controls, which require the use of specific appropriate assessment methods. Tools available for these assessments include peer review guidelines, surveys, interviews and feedback questionnaires;
- Establishing and implementing policies on ethical misconduct and whistle-blowing: these include procedures for reporting cases of misconduct and for timely and adequate response, investigation and sanctioning.

2.5.2 Fundamental Ethical Values

a. Integrity

Integrity refers to acting honestly, reliably, in good faith and in the public interest. In the course of their work, AGP staff shall be trustworthy.

AGP staff shall take care to exercise responsibilities and use the powers, information and resources at their disposal solely for the benefit of the public interest. They shall not use their position to obtain favors or personal benefits for them or for third parties.

Integrity Vulnerabilities

DAGP staff needs to be alert to circumstances that might expose them to integrity vulnerabilities related to working for the DAGP and in the public sector environment, avoid such circumstances and disclose them if such circumstances arise.

These circumstances may relate to:

- Personal, financial or other interests or relationships that conflict with DAGP's interests;
- Acceptance of gifts or gratuities;
- Abusing power for personal gains;
- Involvement in political activities, participation in pressure groups, lobbying, etc.;
- Access to sensitive and/or confidential information;
- Access to, and use of, valuable resources of DAGP.

Staff need to know whom to consult with issues related to integrity, for example for advice or to report concerns or suspicions of integrity violations.

b. Independence and objectivity

Independence-in-fact is a situation where individuals are able to perform activities without being affected by relationships that can influence and compromise professional judgment, allowing them to act with integrity and exercise objectivity and professional skepticism.

Independence-in-appearance is the absence of circumstances that would cause a reasonable and informed third party, having knowledge of relevant information, to reasonably doubt the integrity, objectivity or professional skepticism of the auditor(s), or conclude that they have been compromised.

Objectivity is the mental attitude where individuals are able to act in an impartial and unbiased manner, presenting or assessing things on the basis of facts rather than own feelings and interests, without subordinating judgment to others.

AGP shall be independent as regards its status, mandate, reporting, and management autonomy. It shall discharge its functions in a fully discretional manner as prescribed by the constitutional, legal and regulatory framework.

AGP staff shall be free of impairments to independence and objectivity, whether real or perceived. For this purpose AGP staff shall:

- Maintain independence from political influence and be free from political bias;
- Not be involved in the auditee management's decision-making;
- Not audit their own work;
- Avoid auditing entities in which they have recently been employed, without appropriate safeguards;
- Avoid circumstances where personal interests could impact decision-making;
- Avoid circumstances where relationships with the management or personnel of the auditee or other entities could impact decision-making; and
- Refuse gifts, gratuities or preferential treatment that could impair independence or objectivity.

AGP staff shall identify possible threats and situations in which their independence or objectivity may be impaired and inform the Office of the AGP about any pre-existing relevant relationships and situations that may present a threat to independence or objectivity.

c. Competence

Stakeholders' trust in AGP's judgments, and the credibility of those judgments, rely on work being performed competently. Thus, AGP must assemble appropriate competences needed as well as provide support to continuing professional development. Working competently requires the AGP staff to:

- Perform their job in accordance with applicable standards and with due care;
- Act in accordance with the requirements of the assignment, and on a timely basis; and
- Maintain and develop their knowledge and skills to keep up with the developments in their professional environment in order to perform their job optimally.

d. Professional behavior

Office of the AGP shall be aware of the standard of professional behavior expected by the development partners, as well as those defined by the law, regulations and conventions of the society in which they operate, and conduct their work accordingly and in line with their mandate.

DAGP staff shall not engage in conduct that may bring discredit to the prestige and reputation of AGP as an institution as well as the individuals, office bearers making up the institution.

e. Confidentiality and transparency

AGP shall balance the confidentiality of audit-related and other information with the need for transparency and accountability. DAGP staff shall be aware of the legal obligations and DAGP's policies and guidelines concerning both confidentiality and transparency.
AGP shall provide that any parties contracted to carry out work for the DAGP are subject to appropriate confidentiality agreements.

AGP staff shall not use confidential information for personal gain or for gain of third parties. AGP staff shall be alert to the possibility of inadvertent disclosure to third parties of confidential information. AGP staff shall maintain professional confidentiality during and after termination of employment.

Chapter 3:
PLANNING AT DESK LEVEL

3.1. Introduction

This chapter deals with the auditor's approach to audit and auditor's responsibilities at the time of planning FAP audits. Since, audit team formations are deputed at a later completing, this chapter deals with planning procedures that can be performed on the information that is available at the FAO's. The chapter therefore entails:

- Audit approach under which the FAP audit is planned and performed;
- Communications required during the course of audit;
- Identification of relevant personnel responsible for different elements of planning an audit; and
- Development of an overall audit strategy for the FAP.

3.2. Audit Approach: Risk Based Audit

Management sets both project-wide objectives and activity-level objectives, identifying and analyzing the risks that these objectives will not be achieved. All projects, regardless of size, structure, nature or sector are subject to operational risks. Operational risks affect each project's ability to survive, compete successfully, maintain positive public image and safeguard the overall quality of its program services delivery for the benefit of project beneficiaries.

Risks are the set of circumstances that hinder achievement of objectives. There are three components of risk which include: Risk Event, Probability of the Risk Event, and Impact of Risk Event (Risk Event Value). Risk Event is a discrete occurrence that may affect the project for better or for worse.

A Risk-based approach to accomplish the audit objectives involves identifying the monitoring and control activities specific to the audit objective and considering whether these activities are effective to prevent, or detect and correct, significant misstatements.

3.2.1. Audit risk

Audit risk ("AR") is the risk that the auditor expresses an inappropriate audit opinion when financial statements are materially misstated. Audit risk is a function of the risk of material misstatement (i.e. the risk that the financial statements are materially misstated prior to audit) and the risk that the auditor will not detect such misstatement (i.e. detection risk).

Audit risk is the product of the following risk factors:
Audit Risk ("AR") = Risk of material misstatement ("RoMM") x Detection Risk ("DR")*

**Risk of material misstatement ("RoMM") = Inherent Risk ("IR") x Control Risk ("CR")*

Auditor to manage the AR and bring it down to the acceptable level assesses IR and CR. IR and CR are beyond auditor's control to manipulate and manage. Therefore, auditor assesses those two risks and

manipulates DR. The way to minimize DR (to manage AR) auditor will change the nature, extent and timing of the audit.

a. Risk of material misstatement

Risk of material misstatement refers to the condition where the financial statements may be materially misstated. The risk of material misstatement consists of two components, namely inherent risk and control risk.

Inherent risks

Inherent risk is the risk that significant misstatements, both intentional and unintentional, may occur, disregarding the effectiveness of internal control to prevent or detect and correct such misstatements. The auditor cannot, in the short term, influence inherent risk: the main task of the audit is to assess the risk. Misstatements occur when there is a failure to capture process or report data correctly or misstatements are introduced into the data at any time. The number and size of misstatements depend on many conditions or events relating to the project's operations. These conditions or events can be divided between those that are:

- FAP level; and
- Specific to FAP financial statement assertions.

When assessing inherent risk, the auditor should consider the combined effect of both FAP level and specific conditions or events. The assessment of inherent risk is an audit judgment – the risk that significant misstatements may occur, disregarding internal control.

Control risks

The auditor should assess the effectiveness of internal control to provide reasonable assurance that significant misstatements are prevented, detected and corrected. The intrinsic limitations of internal control mean there is, even with the best internal control system, always a risk that some significant misstatements may occur and remain undetected. These limitations may be due to:

- Resource constraints and the need to consider the cost of internal control in relation to expected benefits;
- Limits of human judgment and such human failures as simple errors or mistakes due to carelessness, distraction, mistakes or the misunderstanding of instructions;
- Ability of management to override internal control;
- Possibility of collusion of two or more people inside or outside the project; and
- Reality that breakdowns may occur.

The internal control failure to prevent, detect and correct, material misstatements is to be considered as control risk. If the auditor considers internal control to be effective in preventing, detecting or correcting significant misstatements, the control risk is to be assessed as low. If the auditor finds some controls (but not all) to be effective, the control risk would be considered moderate. If the auditor considers internal control to be ineffective or the auditor considers that it would not be efficient to evaluate the effectiveness of internal control, the auditor should assess control risk as high. In such a case, the auditor would not be able to rely on the internal control system and will have to place increase reliance on substantive procedures.

b. Detection risks

Detection risk is the risk of material/significant error or loss going undetected by the auditor's substantive audit procedures. Detection risk expresses the extent of the audit evidence that must be procured through substantive tests. Tests of controls are carried out to confirm the assurance auditors ascribe to the internal

control system. If the internal control does not function as intended, detection assurance must be increased and the possible number of substantive tests should be raised.

3.3. Consolidated Annual Audit Plan for Audit of FAPs

The Policy Wing at the Economic Affairs Division ("EAD") – also termed as the "Front Office" is responsible for assessment of requirements, programming and negotiations of external economic assistance related to the Government of Pakistan and its constituent units, from foreign governments and multilateral agencies. Therefore, all formal aid negotiations and communications take place through the EAD.

Back Office at the EAD which includes an IT Center maintains a complete database of the funding and relevant stakeholders. Subsequently, reports are shared with the Office of The Auditor General of Pakistan ("AGP") that enlist FAPs that were active during the fiscal period. The enlistment is a tabulation of the title of the project, development partner, Executing Agency/ Implementing Agency ("EA/IA"), location of the EA/IA's principal office, and project outlay.

The enlistment provided by EAD is circulated to all the audit field offices by the Office of the AGP in order to ensure that FAPs are allocated to audit field offices for audit in accordance with their mandate and jurisdiction, and are therefore made part of the audit field offices' annual audit plan.

Office of the AGP ensures that all FAPs have been allocated to the audit field offices and any jurisdictional issues pertaining to audit of FAPs are resolved.

Annual audit plans of Field Audit Offices are consolidated by the Office of the AGP that includes list of all FAPs to be audited by the respective audit field offices. The consolidated audit plan contains the following:

- Strategic plan that defines the DAGP's mandate and scope of audit of the Government of Pakistan and its underlying entities, articulates an expectations and resource analysis that exhibits the strengths of the DAGP and overall challenges it may face in execution of the audits, and proposes a strategy to deal with the challenges in performing the audit;
- Plan for the annual audit work that broadens on the scope of various types of audits (financial attestation, performance), identifies the portfolio and underlying entities to be audited, and portfolio-wise and audit-activity-wise allocation of resource time.

3.4. Communication with audited FAP

The audit team aims at having good communications with the audited FAP. It is so because the effectiveness of audit also depends on the extent and clarity of communication with the audited FAP. The audit processes that relate to communication with the audited FAPs are provided below:

Entity Communication Letter: indicating the team authorized to conduct the audit and the time of the audit, and explain about the nature and scope of audit before the commencement of audit work. The letter may be accompanied with a detailed information requisition enlisting documents necessary for the auditor to undertake effective audit planning.

FAP management shall be required to provide the draft financial statements pertaining to the period under audit within 45 days of receipt of Entity Communication Letter.

Please refer to **Annexure B** for a sample of entity communication letter.

Entrance Meeting: meeting conducted with the FAP management when beginning the audit.
Written Representation: Obtain written representations from the management.

Exit/Discussion Meeting: meeting conducted with the FAP management to discuss information about the audit findings and provide the opportunity to management to respond and/or produce evidences regarding the audit findings. This is also a time to identify that the fieldwork is completed and that audit is entering in the reporting phase.

Preliminary Audit Report: the audit report issued to the management of FAP to communicate all significant issues found during audit and to provide management with an opportunity to respond, if they have not provided a response during the exit meeting.

Final Audit Report: the audit report issued to the FAP management stating audit opinion and management letter containing all unsettled audit issues, after considering the auditee's responses and the evidence for the audit issues stipulated in the preliminary audit report.

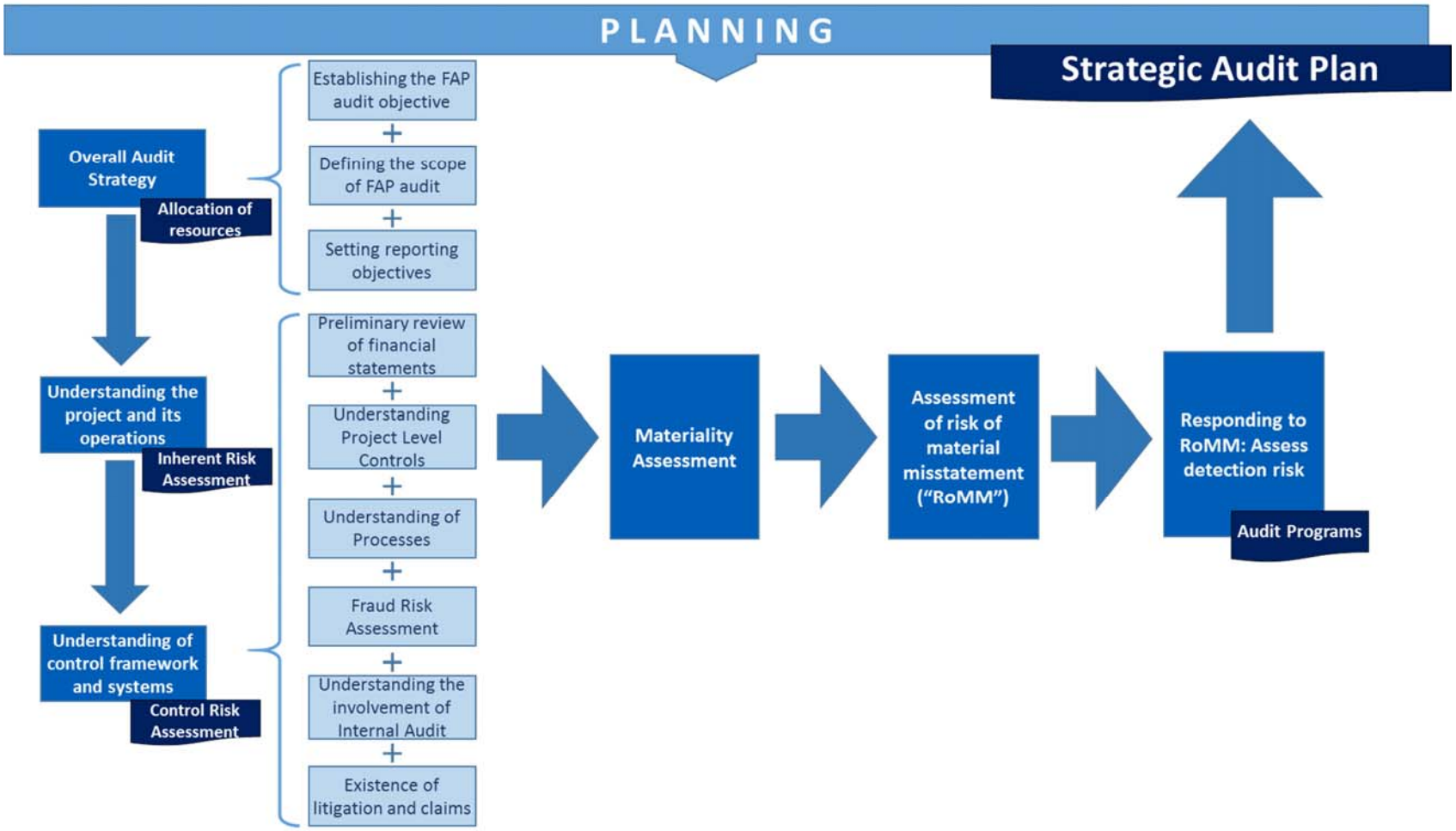
3.5. Planning the FAP audit

The auditor should plan the nature, timing and extent of direction and supervision of the audit team and the review of their work [ISSAI 1300.11]. The nature, timing and extent of planning activities will vary according to the size and complexity of the project, the area of audit, the risks of material misstatement, and the capabilities and competence of personnel performing the audit work.

Planning an audit involves establishing the overall audit strategy and developing an audit plan. Adequate planning benefits the audit of financial statements in several ways, including: [ISSAI 1300.2]

- Helping the auditor to devote appropriate attention to important areas of the audit;
- Helping the auditor identify and resolve potential problems on a timely basis;
- Helping the auditor properly organize and manage the audit so that it is performed in an effective and efficient manner;
- Assisting in the selection of team members with appropriate levels of capabilities and competence to respond to anticipated risks, and the proper assignment of work to them;
- Facilitating the direction and supervision of team members and the review of their work;
- Assisting, where applicable, in coordination of work done by auditors of components and experts.

3.6. FAP Audit Planning Cycle



3.7. Overall Audit Strategy

Process Table	
STEP 1	Establishing the FAP audit objective
STEP 2	Defining the Scope of audit of FAPs
STEP 3	Previous audit findings
STEP 4	Setting Reporting objectives
STEP 5	Determining requirement of Resources

An overall audit strategy that sets the scope, timing and direction of the FAP audits, and that guides the development of the audit plan shall be established. The establishment of the overall audit strategy involves summary of the audit work completed during the strategic planning phase of the audit. [ISA 300.7]

The auditor shall document the overall audit strategy in respect of an individual FAP audit.

3.7.1. Establishing the FAP audit objective

Objective for the audit of foreign aided projects is to express an opinion on the financial statements of the project as to whether the financial information presented in those financial statements provide a true and fair view in all material respects as to the utilization of funds obtained by the Government of Pakistan under the memorandum of understanding and the agreements with development partner organizations. These audits provide assurance to the development partner as to the accountability of funds entrusted to the Government of Pakistan.

Following are the established objectives of audit of FAPs:

- Sanction of expenditure was as per **budget** and done with the **approval of the competent and relevant authority** in the project for expending the granted money.
- Ascertaining the amount shown in accounts as expenditure was authorized for the **purpose for which it was spent**;
- All the expenditure incurred was in **conformity with laws, rules and regulations** framed to regulate the procedure for expending granted money.
- Propriety audit which extends beyond scrutinizing the mere formality of expenditure to its **wisdom and economy** and to bring to light cases of improper expenditure or waste of granted money;
- Determination of **appropriateness of project plans** and approval;
- Notwithstanding audit of expenditure/utilization, identification of all **material instances of non-compliance and illegal acts** that have occurred or are likely to have occurred.

3.7.2. Defining the Scope of audit of FAPs

The auditor shall consider the following in order to define the scope of audit of FAP:

- Applicable financial reporting framework, including applicable legislative or regulatory requirements;
- Development-partner-specific requirements related to financial reporting; and
- Locations covered by FAP's geographical presence and needs to be audited.

a. Applicable financial reporting framework, including applicable legislative or regulatory requirements;

FAPs in Pakistan have mainly adopted IPSAS Cash Basis for the purposes of preparing and presenting financial statement.

Auditor shall obtain understanding of applicable financial reporting framework, as well as relevant legislative and regulatory requirements as a part of taking understanding of project. Obtaining such an understanding will assist the auditor in:

- Determining whether the applicable financial reporting framework that the project is using prescribes certain conditions for the recognition, measurement, and disclosure of transactions and events;
- Providing basis for discussion with management about how management has applied those requirements and auditor's determination of whether they have been applied accordingly; and
- Determining applicability of various laws including, social laws, labor laws, tax laws, environmental laws and auditor's determination of whether they have been applied accordingly.

b. Development-partner-specific requirements related to financial reporting;

The auditor shall obtain an understanding of the relevant development partners' financial reporting requirements. These requirements are usually laid out in the legal agreements (Loan/grant covenants, project agreement, project implementation letters, etc.) underlying the FAP and mostly accompanied with templates for such reporting.

Therefore, auditor needs to familiarize himself/herself with the legal agreements, and understand the reporting requirements and formats.

Understanding of the financial reporting requirements will also enable the auditor to draw expectations over the financial systems that should be in place for transparent and effective financial reporting.

c. Locations covered by FAP's geographical presence that needs to be audited.

The auditor shall identify locations through which the project is being implemented and ascertain whether the locations are significant and need to be audited. Scoping of locations will enable the auditor to plan appropriate resources required for the FAP audit.

3.7.3. Previous audit findings

The auditor shall review the previous year's audit report and management letter to identify relevant areas of attention for the current year's audit, consequently consider impact for required resources.

3.7.4. Setting Reporting objectives

The auditor shall ascertain the reporting objectives of the audit to plan the timing of the audit and the nature of the communications required.

This may include considering the deadlines for financial reporting, and setting key dates for expected communications with FAP management.

This also includes the key dates for audit reporting and to ensure that all those involved in the audit collectively have sufficient time to perform the assigned work.

a. Communications with project's management

Communication with project's management at the time of planning reduces the expectation gap between the auditor and project's management and also streamlines the flow of provision of necessary documents and information for the purpose of conductance of well-organized effective and efficient audit.

Matters that need to be considered for communications in respect of reporting objectives include:

- The organization of meetings with FAP management to discuss audit work.
- Discussion with FAP management regarding the expected type and timing of reports, including the auditors' report, management letters and communications to the EA/IA management.
- Discussion with management regarding the expected communications on the status of audit work throughout the engagement.
- Where the project has an internal audit function, communication may include, how the internal auditor and DAGP's audit team can work together in a constructive and complementary manner, including any planned use of the work of the internal audit function, and any planned use of internal auditors to provide direct assistance.
- Communications regarding roles and responsibilities of auditor and management shall take place to remove any expectation gap.

b. Communications among engagement team

- The expected communications among engagement team members, including scheduled team meetings and timing of the review of work performed.

3.7.5. Determining requirement of Resources

The auditor shall determine the resources required for the FAP audit based on the overall audit strategy. The overall audit strategy shall enable the auditor to:

- Select appropriate audit team;
- Deploy resources for specific audit areas, such as the use of appropriately experienced team members for high risk areas;
- Timely deploy resources, such as whether at an interim audit stage or at key cut-off dates;
- Schedule reviews, direct and supervise resources; and
- Devise budget for the audit.

Chapter 4:
PLANNING AT FIELD LEVEL

4.1. Introduction

This chapter deals with the auditor's responsibilities at the time of planning FAP audits at the field level whence audit field formations have been deputed on site. The chapter therefore entails:

- Detailed procedures for obtaining understanding of the project and its control framework;
- Assessment of the risk of material misstatements;
- Output of the complete planning exercise: Strategic Audit Plan;
- Development of audit programs that contains procedures in response to the auditor's assessment of the risk of material misstatement; and
- Sampling requirements for the audit.

4.2. Understanding the Project as an Entity and Its Operations

Process Table	
STEP 1	Understanding the relevant sector and external factors
STEP 2	Understanding the nature of the project
STEP 3	Understanding the project objectives and strategies, and related project risks
STEP 4	Measurement and review of project's operational and financial performance

Auditor shall obtain an understanding of the following: **[ISA 315.11]**

- Relevant sector and external factors;
- The nature of the project, including:
  - Its operations
  - Its management, operational, and governance structures;
  - The way that the project is structured and how it is financed;
- The project's objectives and strategies, and related risks that may result in risks of material misstatement; and
- The measurement and review of the project's financial performance in comparison with targets set under project budget.

The auditor shall document his understanding of each element of the project and its operations. Please refer **Annexure D** for audit planning procedures addressed at obtaining understanding of project and its operations.

4.2.1 Understanding the relevant sector and external factors

The auditor shall obtain understanding of relevant sectoral factors including sector conditions such as the existing similar interventions, vendor and beneficiary relationships, and technological developments within the sector.

The auditor shall further obtain understanding of other external factors such as general economic conditions and the political environment and consider implications for the sector in which the FAP is operating.

Sector-specific understanding will enable the auditor to develop expectations regarding the infrastructural support, design and implementation of the project. [ISA 315.A25]

Moreover, obtaining sector-specific understanding shall enable the auditor to identify risks of material misstatement arising from the nature of the project. [ISA 315.A26]

4.2.2 Understanding the nature of the project

Auditor shall obtain understanding of the nature of project, project structure and project operations. Factors relevant to obtaining such an understanding include:

- Nature and number of funding sources, project interventions, and target beneficiaries; [ISA 315.A32]
- Use of technology for implementation of project interventions; [ISA 315.A32]
- Conduct of operations (for example, stages and methods of operationalization, or activities exposed to environmental risks) [ISA 315.A32]
- Alliances, ventures, and outsourcing activities [ISA 315.A32]
- Geographic dispersion and segmentation [ISA 315.A32]
- Location of warehouses, and offices [ISA 315.A32]
- Location and quantities of inventories [ISA 315.A32]
- Important vendors of goods and services [ISA 315.A32]
- Employment arrangements (existence of government regulation related to employment matters, hiring of individual consultants) [ISA 315.A32]
- Technical assistance and corresponding expenditures [ISA 315.A32]
- Planned or recently executed project expansions [ISA315.A32]
- Discontinuation of project interventions [ISA 315.A32]
- Significant capital expenditures [ISA 315.A32]

4.2.3 Understanding the project objectives and strategies, and related project risks

Strategies are the approaches by which management intends to achieve its objectives. The project's objectives are defined under the project agreement, which are complemented by annual implementation plans.

Project risk is broader than the risk of material misstatement of the financial statements, though it includes the latter. Project risk may arise from change or complexity. A failure to recognize the need for change may also give rise to project risk. Project risk may arise, for example, from: [ISA 315.A38]

- Additional project interventions, or new operational mechanisms set for the achievement of project objectives; [ISA 315.A38]
- Project beneficiaries although successfully targeted and identified, are inadequate to support achievement of project objectives; or [ISA 315.A38]
- Flaws in project operationalization inducing risk of project failure. [ISA 315.A38]

The auditor shall obtain understanding of the project risks facing the EA/IA/PMU/PIU in order to increase the likelihood of identifying risks of material misstatement, since project risks are also likely to have financial consequences and, therefore, an effect on the financial statements. However, auditors

do not have a responsibility to identify or assess all project risks because not all project risks give rise to risks of material misstatement. [ISA 315.A39]

4.2.4 Measurement and review of project's operational and financial performance

The auditor shall consider development partner expectations related to the project's operational and financial performance, particularly those that may put pressures on, or provide incentives to, project's management to engage in fraudulent financial reporting.

Prior to performing verification procedures, the auditor shall obtain an understanding of the information internally generated by the management including the manner in which progress information is collected, and used to evaluate progress, as well as monitoring and control checks over the assimilation of such information used to report operational and financial performance.

For example, disbursement of a subsequent tranche may be contingent upon stage of completion, say, procurement and installation of generators in a power project. The auditor will be required to verify as part of project costs, physical verification, whether a stage of completion certificate has been issued by an appropriate authority/expert, the procedures applied by the expert to verify the stage of completion, whether the auditor is able to satisfy himself with the expert's procedures.

4.3. Inherent Risk Assessment

At this stage of planning, the auditor shall perform an inherent risk assessment of the project.

Inherent risk is the risk that significant misstatements, both intentional and unintentional, may occur, disregarding the effectiveness of internal control to prevent or detect and correct such misstatements. The number and size of misstatements depend on many conditions or events relating to the project's operations. Indicators of such conditions and events may include:

- Complex project activities such as technological solutions;
- Geographically diverse locations;
- Unique projects;
- Significant dealing in cash transactions, such as income support programs;
- Items susceptible to theft such as inventory in healthcare related interventions;
- Items that are susceptible to misappropriation either directly or indirectly through devices such as kickback arrangements or fictitious transactions, employees, vendors or customers. Examples of such projects include where operationalization require extensive outsourcing arrangements, or sourcing of different types of expensive technical expertise;
- Greater management intervention for data collection and processing.

Please refer to **Annexure E** for a template of inherent risk assessment.

4.4. Control Risk Assessment

Process Table	
STEP 1	Preliminary review of financial statements
STEP 2	Obtaining understanding of project level controls
STEP 3	Obtaining understanding of processes
STEP 4	Assessing the risk of fraud
STEP 5	Obtaining understanding of the involvement of Internal Audit Function
STEP 6	Inquiring about the existence of litigation and claims
STEP 7	Concluding the control risk assessment

Control risk is a function of the effectiveness of the design, implementation and maintenance of internal control by management to address identified risks that threaten the achievement of the project's objectives relevant to preparation of the project's financial statements.

The auditor shall perform a control risk assessment of the project. Prior to ascertaining the control risk prevalent in the FAP, the auditor will need to obtain understanding of the control environment and systems in place including an examination of the outputs of such control systems.

4.4.1. Preliminary review of financial statements

The auditor shall perform a preliminary review of financial statements of FAP to be audited.

Auditor shall evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting framework, and the reporting requirements of development partners. In making this evaluation, he shall consider whether the financial statements are presented in a manner that reflects the appropriate: [ISA 330.24]

- Classification and description of financial information and the underlying transactions, events and conditions; and [ISA 330.24]
- Presentation, structure and content of the financial statements. [ISA 330.24]

The audit procedures performed to evaluate whether the overall presentation of the financial statements is in accordance with the applicable financial reporting shall include:

- Reading the financial statements
- Discussing with management:
  - Any transactions requiring application of new accounting policies that took effect in the current period;
  - Any expected future transactions requiring accounting policies that will need to be implemented in the future.
- Evaluating whether the project's accounting policies are appropriate for its operations and consistent with the applicable financial reporting framework. To make this evaluation, auditor shall:
  - Review the consistency of application of accounting policies from period to period;

- Determine whether those accounting policies are appropriately disclosed in the financial statements.

Comparative Information

Comparative information is the amounts and disclosures included in the financial statements in respect of one or more prior periods in accordance with the applicable financial reporting framework. [ISA 710.6(a)]

Auditor shall evaluate whether;

- The comparative information agrees with the amounts and other disclosures presented in the prior period or, when appropriate, have been restated; and [ISA 710.7(a)]
- The accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed. [ISA 710.7(b)]

If auditor becomes aware of a possible material misstatement in the comparative information while performing the current period audit, he shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient appropriate audit evidence to determine whether a material misstatement exists. If the prior period financial statements are amended, auditor shall determine that the comparative information agrees with the amended financial statements. [ISA 710.8]

4.4.2. Obtaining understanding of project level controls

The auditor shall obtain understanding of the project-level-controls. Project-level-controls operate at the project level rather than at the assertion level and, therefore, have an important but indirect effect on the likelihood that a misstatement will be prevented, or detected and corrected, on a timely basis.

Project-level-controls include the following components of internal control:

- Control environment;
- Project's risk assessment process;
- Communication; and
- Monitoring of controls.

Auditor shall document the key elements of the understanding obtained regarding each of the aspects of the internal control components, the sources of information from which the understanding was obtained, and the risk assessment procedures performed. [ISA 315.32(b)]

a. Control environment

Auditor shall obtain an understanding of the control environment. As part of obtaining this understanding, the auditor shall evaluate whether: [ISA 315.14]

- Management, with the oversight of EA/IA Principal Office, has created and maintained a culture of honesty and ethical behavior; and [ISA 315.14(a)]
- The strengths in the control environment elements collectively provide an appropriate foundation for other components of internal control, and whether those other components are not undermined by deficiencies in the control environment. [ISA 315.14(b)]

As part of the control environment, the auditor shall obtain understanding of management's philosophy and operating style. Such an understanding will include:

- Management attitude towards project risk, financial reporting, information processing and accounting; [ISA 315.A78(d)]

- Organizational structure; [ISA 315.A78(e)]
- Commitment to competence; [ISA 315.A78(b)]
- Assignment of authority and responsibility; and [ISA 315.A78(f)]
- Human resource policies and practices. [Source: ISA 315.A78(g)]

If relevant, auditors shall also obtain understanding of the project's IT environment and should generally include the following:

- Data input and processing;
- General nature of software utilities used at computer processing locations that provide the ability to add, alter, or delete stored information;
- General nature of software used to restrict access to programs and data at computer processing locations;
- Overall impact of microcomputers on the entity's operations, including the extent of integration of microcomputers in the accounting system (such as whether microcomputers are used to generate or process information for financial reporting);
- General nature of microcomputer use (such as word processing, spread sheets, or data base);
- Adequacy of policies and procedures to control the access to microcomputers and use of software; and
- General types and extent of licensed software in use;

The auditor shall document the key elements of understanding including:

- How management, with the oversight of EA/IA Principal Office, creates and maintains a culture of honesty and ethical behavior;
- How management enforces and communicates to employees its views on operational practices and ethical behavior. [ISA 315.A78, ISA 315.A79]
- The extent of IT in use by the FAP;
- The IT controls in place; and
- The design and implementation of such controls.

b. Project's Risk Assessment Process

Auditor shall obtain an understanding of whether the project has a process for: [ISA 315.15]

- Identifying project risks relevant to operational and financial reporting objectives, including risks of fraud;
- Estimating the significance of the risks;
- Assessing the likelihood of their occurrence; and
- Deciding about actions to respond to and manage those risks.

If the project has established a risk assessment process, auditor shall obtain an understanding of it, and the results thereof. If auditor identifies risks of material misstatement that management failed to identify, auditor shall evaluate whether there was an underlying risk of a kind that could have been expected to be identified by the project's risk assessment process. If there is such a risk, he shall obtain an understanding of why that process failed to identify it, and evaluate whether the process is appropriate to its circumstances or determine if there is a significant deficiency in internal control with regard to the project's risk assessment process. [ISA 315.16]

c. Communication

Auditor shall obtain an understanding of how the project communicates financial reporting roles and responsibilities and significant matters relating to financial reporting, including: [ISA 315.19]

- Communications between management and EA/IA's Principal Office;
- Formal job descriptions appropriately addressing finance staff's responsibilities; and
- External communications, such as those with regulatory authorities and development partners.

d. Monitoring of controls

Auditor shall understand the mechanism in place for monitoring of controls. The auditor shall specifically consider whether the project's mechanism for monitoring includes: [ISA 315 Appendix 1.11]

- Preparation and review of bank reconciliation statements on a timely basis; [ISA 315 Appendix 1.11]
- Internal auditors' evaluation of personnel's compliance with the project's policies on terms of contracts; and [ISA 315 Appendix 1.11]

4.4.3. Obtaining understanding of processes

Project-level-controls by their design do not provide sufficient appropriate audit evidence regarding the effectiveness of internal control associated with relevant financial statement assertions related to significant accounts and disclosures.

As a result, when auditor intends to rely on controls as part of his response to the assessed RoMM, the auditor shall evaluate the effectiveness of controls that are directly linked to processes relevant to financial reporting and specific financial statement assertions.

The financial reporting processes will be embedded as part of the project's information system that will comprise of:

- Standard journal entries: Standard journal entries are journal entries that are required on a recurring basis to record transactions. [ISA 315.A93]
- Non- Standard journal entries: Non-standard journal entries are those made to record nonrecurring, unusual transactions or adjustments. [ISA 315.A94]
- Other Adjustments: Other adjustments are adjustments made to the financial statements that are made outside the general ledger and are therefore not journal entries. [ISA 240.A41]
- Post-closing entries: Post-closing entries are adjustments made in the financial statement closing process (also referred to as the "post-closing period" or "course of preparing the financial statements") which begins when the financial data is transferred from the general ledger to prepare the financial statements (for example, into a spreadsheet or the draft financial statements).

Auditor shall obtain an understanding of the information system, including the related project processes, relevant to financial reporting, including the following areas: [ISA 315.18]

- The classes of transactions in the project's operations that are significant to the financial statements;
- The procedures, within both information technology ("IT") and manual systems, by which those transactions are initiated, authorized, recorded, processed, corrected as necessary, transferred and reconciled to the general ledger and reported in the financial statements;
- The related accounting records, supporting information and specific accounts in the financial statements that are used to initiate, authorize, record, process and report transactions (this includes the correction of incorrect information and how information is transferred and reconciled to the general ledger). The records may be in either manual or electronic form;
- How the information system captures events and conditions, other than transactions, that are significant to the financial statements; and
- The financial reporting process used to prepare the project's financial statements.

Procedures to obtain an understanding of the process activities

Procedures for obtaining an understanding of the process activities shall include: [ISA 315.6]

- Inquiries of relevant project personnel; and
- Observation and inspection.

Auditor may also choose to perform a walkthrough as part of obtaining an understanding of process activities which will include determining how transactions are initiated, authorized, processed, corrected as necessary, and transferred and reconciled to the general ledger.

As part of processes, the auditor shall obtain understanding of routine and non-routine transactions relevant to the FAP.

The classes of transactions (including internal transfers and allocations) recognized during the period can be categorized into: Routine transactions – transactions with the outside world that occur on a day-to-day basis; and non-routine transactions – transactions that are unusual either due to size or nature, or that occur infrequently.

The auditor shall review the accounting records underlying the financial statements in order to identify non-routine transaction.

4.4.4. Assessing the risk of fraud

The primary responsibility for both fraud prevention and detection rests with FAP management and EA/IA. (ISSAI 1240.4)

In determining which controls to implement to prevent and detect fraud, management considers the risks that the financial statements may be materially misstated as a result of fraud. As part of this consideration, management may conclude that it is not cost effective to implement and maintain a particular control in relation to the reduction in the fraud risks to be achieved. [ISA 240.A31]

It is therefore important to obtain an understanding of the controls that management has designed, implemented and maintained to prevent and detect fraud. In doing so, auditor may learn, for example, that management has consciously chosen to accept the risks associated with a lack of segregation of duties. Information from obtaining this understanding may also be useful in identifying fraud risks factors that may affect our assessment of the risks that the financial statements may contain material misstatement due to fraud. [ISA 240.A32]

Fraud is a broad legal concept, for the purposes of audit, auditor shall be concerned with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant [ISA 240.3]

1. Misstatements resulting from fraudulent financial reporting; and
2. Misstatements resulting from misappropriation of assets.

a. Reasons for fraud

Usually fraud is committed when there are certain factors present such as:

- Incentive or pressure to commit fraudulent financial reporting may exist when management is under pressure to achieve an expected target. In the public sector employees or management may be under pressure to deliver high quality services with few resources and to meet budgets.
- There is an opportunity to commit fraud when internal control can be overridden. Lack of employee skill or high volume and low value cash transactions may be opportunities for fraud.

- Rationalization of the act of fraud when staff (including management) has ethical values allowing them to commit a dishonest act. Lower salaries may lead employees to justify misuse of funds. [ISSAI 1240 P5]

b. Objective of the Auditor

The objective of auditor is; [ISA 240.10]

- To identify and assess fraud risk factors and fraud risks;
- To respond appropriately to fraud or suspected fraud identified during the audit; and
- To obtain sufficient appropriate audit evidence regarding the assessed financial statement level fraud risks and the assessed risk of material misstatement due to fraud, through designing and implementing appropriate procedures.

c. Responsibilities of the Auditor

The auditor is mainly responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. [ISA 240.5]

The auditor should be primarily concerned with fraud that causes a material misstatement of the financial statements. However, in case of immaterial misstatements arising from fraud, the auditor should consider its impact when evaluating other audit evidence and also consider reporting the same as part of audit findings.

The auditor shall maintain an attitude of professional skepticism whilst carrying out the audit. Professional skepticism includes:

- Maintaining an objective state of mind;
- Asking questions;
- Not being satisfied with less-than-persuasive audit evidence based on a belief that management and those charged with governance are honest and have integrity;
- Carefully considering the reasonableness of responses to inquiries in light of other evidence obtained during the audit;
- Remaining alert for incentives or pressures, opportunities and attitudes or rationalization in interaction with project personnel; and
- Discussing and raising awareness of the relevant fraud risk factors and fraud risks with all audit team members.

Unless auditor has reason to believe the contrary, he may accept records and documents as genuine. [ISA 240.13]
Auditor shall make inquiries of the management as regards their assessment of the risk of fraud prevalent in the FAP.

The auditor shall exercise an increased level of professional skepticism where fraud risk has been identified in a project. Other procedures required to respond to fraud risk include:

- Assign and supervise personnel taking account of the knowledge, skill and ability of the individuals to be given significant audit responsibilities and the auditor's assessment of the fraud risks for the project audit; and [ISA 240.29(a)]
- Incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. [ISA 240.29(c)]

Fraud risk considerations shall include the risk of management override of controls. Although the level of risk of management override of controls will vary from project to project, the risk is nevertheless present in all projects. [Source: ISA 240.31]

The auditor shall perform specific procedure to assess the risk of management override of control that will include, but not limited to procedures laid out as part of **Annexure F**.

4.4.5. Obtaining understanding of the involvement of Internal Audit Function

Auditor shall inquire individuals within the internal audit function about:

- Application of professional internal auditing standards; and
- Access to records and whether there are limitations on the scope of their activities.

If the nature of the internal audit function's responsibilities and assurance activities are related to the project's financial reporting, auditor may be able to use the work of the internal audit function to develop an understanding of the project's control framework and to modify the nature or timing, or reduce the extent, of audit procedures to be performed directly in obtaining audit evidence. [Source: ISA 315.A117]

4.4.6. Inquiring about the existence of litigation and claims

Auditor shall design and perform audit procedures in order to identify litigation and claims involving the project which may give rise to a risk of material misstatement.

Litigation and claims involving the project may have a material effect on the financial statements and thus may be required to be disclosed or accounted for in the financial statements. [ISA 501.A17]

Auditor may get information about litigation and claims by performing the following procedures;

- Reading minutes of progress meetings of project's management, governing bodies of governmental entities and appropriate committees held during, and subsequent to, the period being audited; and
- Read contracts, loan agreements, leases and correspondence from taxing or other governmental agencies and major vendors and similar documents.

If auditor assesses a risk of material misstatement regarding litigation or claims that have been identified, or when audit procedures performed indicate that other material litigation or claims may exist, the auditor shall, in addition to the procedures required by other subsequent parts of the manual, seek direct communication with the project's/EA/IA's external legal counsel. The auditor shall do so through a letter of audit inquiry, prepared by project's management and sent by him, requesting the entity's external legal counsel to communicate directly with auditor.

Direct communication with the entity's external legal counsel assists in obtaining sufficient appropriate audit evidence as to whether potentially material litigation and claims are known and management's appropriately considered and disclosed the implications in the financial statements. [ISA 501.A21]

Please refer to **Annexure G** for a template of letter of audit enquiry addressed to the project's legal counsel.

4.4.7. Concluding the control risk assessment

a. Evaluation of the design and implementation of controls

When evaluating the design and implementation of controls, auditor considers the design of the control first and if the control is designed effectively, auditor evaluates whether the control is implemented effectively to prevent, or detect and correct, material misstatements.

After having obtained understanding of the project's internal control relevant to the audit, it is a matter of his professional judgment whether a control, individually or in combination with others, is relevant to the audit. [ISA 315.12]

b. Evaluation of control deficiencies

A deficiency in internal control exists when: [ISA 265.6(a)]

- A control is designed, implemented or operated in such a way that it is unable to prevent, or detect and correct, misstatements in the financial statements on a timely basis; or [ISA 265.6(a)]
- A control necessary to prevent, or detect and correct, misstatements in the financial statements on a timely basis is missing. [ISA 265.6(a)]

In determining whether auditor has identified one or more deficiencies in internal control, he may discuss the findings with the appropriate level of FAP management. This discussion provides an opportunity to alert management on a timely basis to the existence of deficiencies of which management may not have been previously aware. [ISA 265.A1]

Indicators of significant deficiencies [ISA 265.A7]

- Absence of a risk assessment process within the project where such a process would ordinarily be expected to have been established;
- Audit evidence of an ineffective project risk assessment process, such as management's failure to identify a risk of material misstatement that auditor would expect the project's risk assessment process to have identified;
- Audit evidence of an ineffective response to identified significant risks (e.g. absence of controls over such a risk);
- Misstatements detected by the auditor's procedures that were not prevented, or detected and corrected, by the project's internal control;
- Restatement of previously issued financial statements to reflect the correction of a material misstatement due to error or fraud;
- Audit evidence of management's inability to oversee the preparation of the financial statements.

A deficiency in internal control on its own may not be sufficiently important to constitute a significant deficiency. However, a combination of deficiencies affecting the same account balance or disclosure, relevant assertion, or component of internal control may increase the risks of material misstatement to such an extent as to give rise to a significant deficiency, even though such deficiencies individually may be less severe. [ISA 265.A8]

c. Impact of control deficiencies on audit

Auditor shall assess the control risk prevalent in the project, and shall determine whether the identified control deficiencies, individually or in the aggregate, significantly impact our:

- Audit strategy

- Audit approach
- Assessment of risk of material misstatement
- Evaluation of project level controls

A history of significant deficiencies and/or a high number of deficiencies in internal control is a factor that may indicate that a lower performance materiality may be appropriate for financial statements as a whole or a particular significant account or disclosure.

Please refer **Annexure H** for a template of control risk assessment.

4.5. Assessing Materiality

Process Table	
STEP 1	Determine materiality for the financial statements as a whole
STEP 2	Determine performance materiality

The objective of the auditor is to apply the concept of materiality appropriately throughout the audit, especially when:

- Identifying the components to be audited (strategic planning);
- Determining the nature, timing and extent of audit procedures (detailed planning); and
- Evaluating the effect of misstatements (reporting).

Auditor shall set an appropriate amount of materiality for the financial statements as a whole.

Materiality is defined as:

Misstatements, including omissions, are considered to be material if they, individually or in the aggregate, could reasonably be expected to influence the economic decisions of users taken on the basis of the financial statements. [ISA 320.2]

Judgments about materiality are based on the consideration of the common financial information needs of users as a group, and are made in light of surrounding circumstances, and are affected by the size or nature of a misstatement, or a combination of both. [ISA 320.2]

While setting the level of materiality it is reasonable to assume that users: [ISA 320.4]

- Have a reasonable knowledge of the project, economic activities and accounting and a willingness to study the information in the financial statements with reasonable diligence;
- Understand that financial statements are prepared, presented and audited to levels of materiality; and
- Make reasonable economic decisions on the basis of the information in the financial statements.

The circumstances related to some misstatements may cause the auditor to evaluate them as material even if they are below materiality.

Materiality can be divided into two categories namely quantitative and qualitative materiality. When judgments about materiality are made in light of surrounding circumstances and are affected by the size or value of financial statement values, that materiality is referred to as quantitative materiality.

The term qualitative materiality is used when the judgments are measured in terms of the nature of the item in question. For example, procurement by a particular project may not be material in terms of the total value of the financial statements but may be deemed material because of poor procedural practices in past years or a development partner requirement to review all procurements or lack of rationale [ISSAI 1320].

The auditor shall set levels of materiality for the audit of FAP's financial statements as follows:
1. Determine materiality for the financial statements as a whole; and
2. Determine performance materiality.

Please refer to **Annexure I** for a template of materiality assessment form.

4.5.1. Determine materiality for the financial statements as a whole

Given the nature of FAP projects, the benchmark for setting the materiality threshold will be total expenditure during the period under audit. The threshold will be within 0.5% ~ 2% of the amount of total expenditure.

4.5.2. Determine performance materiality

Auditor shall determine performance materiality at an amount (or amounts) that reduces to an appropriately low level the probability that the aggregate of uncorrected and undetected misstatements in the financial statements exceeds materiality for the financial statements as a whole (the aggregation risk).

The determination of performance materiality involves the exercise of professional judgment and performance materiality shall be at 75 % of materiality set by the auditor for the financial statements as a whole. The threshold can be reduced in case the auditor assesses a high level of aggregation risk, and vice-versa.

4.6. Assessment of the risk of material misstatement

Process Table	
STEP 1	Consideration of risk factors
STEP 2	Risk Assessment and planning discussion
STEP 3	Analytical review

Risk of material misstatement is a function of inherent and control risks. The auditor shall combine the two to assess the RoMM prevalent in FAP. The following text outlines how the auditor converges on his assessments of the inherent and control risks.

4.6.1. Consideration of risk factors

As part of the assessment of RoMM, the auditor shall revisit the following risk factors:
- Budget overspending due to weak budgetary controls;
- New programs;
- Major changes to existing programs;

- New financing sources;
- New legislation and regulations or directives;
- Political decisions such as relocation of operations;
- Increased public expectations;
- Procurement of goods and services
- Outsourcing of government activities;
- Operations subject to special investigations;
- Changes in political leadership;
- Indications of waste or abuse;
- Public and private partnerships

4.6.2. Risk Assessment and Planning Discussion

The auditor shall convene a discussion among the audit team members about the susceptibility of the project's financial statements to material misstatement due to fraud or error. [ISA 315.A21, ISA 240.A10]

Such a discussion assists the team members to gain a better understanding of the potential for material misstatement of the financial statements in the specific areas assigned to them, and to understand how the results of the audit procedures that they perform may affect other aspects of the audit including the decisions about the nature, timing, and extent of further audit procedures; [ISA 315.A21]

It also provides:

- An opportunity for more experienced team members, including the DG, to share their insights based on their knowledge of the project. [ISA 315.A21, ISA 240.A10]
- A basis upon which team members communicate and share new information obtained throughout the audit that may affect the assessment of risks of material misstatement or the audit procedures performed to address these risks [ISA 315.A21]

The DG and other key audit team members shall discuss: [ISA 315.10]

- The susceptibility of the project's financial statements to material misstatement; and [ISA 315.10]
- The application of the applicable financial reporting framework to the project's facts and circumstances (i.e. the selection and application of accounting principles, including related disclosure requirements). [ISA 315.10]

The discussion shall place particular emphasis on: [ISA 240.15]

- How and where the project's financial statements (including disclosures) may be susceptible to material misstatement due to fraud, including how fraud might occur;
- How management could perpetrate and conceal fraudulent financial reporting;
- How the assets of the project could be misappropriated; and
- How fraud might be perpetrated or concealed by omitting or presenting incomplete or inaccurate disclosures.

Audit team may also discuss:

- A consideration of the risk that management may attempt to present disclosures in a manner that may obscure a proper understanding of the matters disclosed (for example, by including too much immaterial information or by using unclear or ambiguous language) [ISA 240.A11]
- A consideration of management's involvement in overseeing employees with access to cash or other assets susceptible to misappropriation [ISA 240.A11]

4.6.3. Analytical review

Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. Analytical procedures also encompass such investigation as is necessary of identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount**.** [ISA 520.4]

Auditor shall perform planning analytical procedures as part of his risk assessment procedures, which are designed to: [ISA 315.6(b), ISA 240.22]

- Enhance understanding of the project and the significant transactions and events that have occurred since the prior year end; and
- Identify areas that might represent specific risks relevant to the audit, including the existence of unusual transactions and events, and amounts, ratios, and trends that warrant investigation.

From a FAP perspective, planning analytical procedures should include:

- Comparison of current year expenditure with budget and previous year figures;
- Comparison of current year expenditure in relation to KPI's as compared to previous year expenditure in relation to KPI's;
- Comparison of elements in the current period's financial information with corresponding relationship with previous year's financial statement. E.g., expense by type as a percentage of total expenditure;
- Use of existing experience of similar projects to develop an expectation of values of expenses;

Auditor shall establish a tolerable difference of variation with expectation when performing analytical procedure and shall enquire of management any unusual or difference in excess of tolerable difference and perform substantive testing.

Auditor will evaluate whether unusual or unexpected relationships that have been identified in performing planning analytical procedures, may indicate fraud risks. [ISA 240.22]

When designing planning analytical procedures, auditor may consider any key performance indicators and/or other performance measures that management or other users of the project's financial statements use to measure and review financial performance.

4.7. Strategic Audit Plan

Once the overall audit strategy has been established, an audit plan can be developed to address the various matters identified in the overall audit strategy, taking into account the need to achieve the audit objectives through the efficient use of resources.

The auditor shall develop a documented audit plan that shall include a description of: [ISA 300.9]

- An understanding of the project and its internal control;
- Planned risk assessment procedures performed to obtain understanding and enable assessment of the risk of material misstatement;
- Auditor's assessment of the risk of material misstatement;
- Nature, timing and extent of planned further audit procedures at the assertion level, explained in detail in Chapter 5 of the manual.
- Other planned audit procedures that are required to be carried out to check compliance with development partner requirements for project implementation;

The strategic audit plan shall be made part of the audit documentation. [ISA 300.12(b)] Please refer to **Annexure J** for a template exhibit of an audit plan.

The strategic audit plan is more detailed than the overall audit strategy in that it includes the nature, timing and extent of audit procedures to be performed by audit team members. Planning for these audit procedures takes place over the course of the audit as the audit plan for the FAP develops. [ISA 300.A12]

For example, planning of risk assessment procedures occurs early in the audit process. However, planning the nature, timing and extent of specific further audit procedures depends on the outcome of those risk assessment procedures. [ISA 300.A12]

In addition, the auditor may begin the execution of further audit procedures before planning all remaining further audit procedures. [ISA 300.A12]

4.8. Audit Programs

Audit programs contain audit procedures designed to obtain sufficient and appropriate audit evidence commensurate with the audit risk determined by the auditor based on his assessment of the risk of material misstatement performed as part of the audit planning. Please refer to **Annexure K** for auditor's assessment of audit risk for development of audit programs.

Therefore, as part of the planning stage and before any fieldwork can be performed, the auditor shall develop audit programs which will identify the test and the procedures required to meet the audit objectives identified in the strategic audit plan.

In developing appropriate audit programs, the auditor needs to identify the areas, which are going to be audited and the associated assertions being tested. For each assertion, the auditor is to identify the control environment. This means that the auditor will identify what management has put in place to ensure that the assertions are achieved. For example: for inventory, if the assertion is existence, how management ensures those assets that are to be included in the inventory really do exist?

Based on the assessment of internal controls, the auditor may test the internal controls that were identified. If the assessment was that, the auditor's reliance on internal controls was low, additional substantive procedure would be required.

Consequently, audit programs are documentation that reflect the area being audited, the control environment and the level of reliance on these controls, and finally the test of detail and analytical procedure for each area and assertions, which need to be tested. The test developed by the auditor should include the nature, extent, and timing for each test. This allows the auditor to ensure that the developed test will gather the information that will meet the audit objectives.

For documentation purposes, the auditor can separate each audit program to correspond with the area audited. This allows the distribution of the work within the audit team members.

Please refer **Annexure L** for sample audit programs.

Caveat: ***Audit programs may need to be tailored to reflect the nature of the FAP and control systems in place at the project.***

4.8.1. Computer assisted audit techniques

The auditor may use CAATs to assist the auditor in the:

- Testing of the entire population of data, including re-performance of FAP's calculations and checking for the consistency of data with accounting measures
- Identification of unusual items in a population that meet pre-set criteria
- Performance of risk assessment procedures
- Performance of analytical procedures
- Testing of the operating effectiveness of controls
- Testing of the mathematical accuracy of system generated reports.

For applying CAATs, the auditor shall consider the reliability of the system's output, and evaluate and test the consistent operation as such, to the extent necessary.

4.9. Sampling

Audit Sampling involves applying audit procedures to less than 100 percent of items within a population. The key importance in selecting an audit sample is that all items have an equal chance to be selected. Proper audit sampling will enable the auditor to obtain and evaluate audit evidence about characteristic of the items selected in order to form a conclusion on the population as a whole.

The terminologies given below are frequently used in designing an audit sample, which the auditors need to understand:

- Population: is the entire set of data from which auditors wish to sample in order to reach a conclusion. Therefore, the population from which the sample is drawn has to be appropriate and complete for the specific audit objective. For example, the audit population for monthly payroll cheques would be all monthly cheques paid by the entity being audited.
- Sample size: is the number of sample items selected from the given population for testing. When determining sample sizes, auditors should consider sampling risk, the amount of error that would be acceptable and the extent to which the auditors are willing to accept.
- Sampling risk: arises from the possibility that the auditors' conclusion, based on a sample, may be different from the conclusion that would be reached if the entire population were subjected to the same testing.

4.9.1 Selecting items for testing

In preparation for performing procedures laid out in the audit programs, the auditor shall select samples of transactions to be tested. Sample selection checklist is used to record the identity of each sample and the date on which it was collected as given in **Annexure M.**

If the auditor applies tests of details to a selected sample in an account, the auditor should accept some uncertainty in the audit evidence obtained, because:

- Audit evidence obtained by the auditor is persuasive rather than conclusive;
- Audit evidence obtained by auditor may be gathered from more than one source performing analytical procedures in addition to the tests of details; and
- Even if the auditor examines all the individual items, there may still remain some uncertainty about completeness of transactions.

Auditor shall use either of the following means for selecting items for testing are: [ISA 500.A52]

1. Selecting all items (100% examination) [ISA 500.A52(a)]
   100% examination may be appropriate when, for example: [ISA 500.A53]

- The population constitutes a small number of large value items [ISA 500.A53]
- There is a significant risk and other means do not provide sufficient appropriate audit evidence, or [ISA 500.A53]
- The repetitive nature of a calculation or other process performed automatically by an information system makes a 100% examination cost effective. [ISA 500.A53]

2. Selecting specific items [ISA 500.A52(b)]
   In making this decision, factors that may be relevant include understanding of FAP, the assessed risks of material misstatement, and the characteristics of the population being tested. The judgmental selection of specific items is subject to non-sampling risk.

4.9.2 Audit sampling

Audit sampling is designed to enable conclusions to be drawn about an entire population on the basis of testing a sample drawn from it. Various factors will affect sampling size that include

- Population value
- Population size
- Variability of sampling units
- Materiality
- Planned precision
- Expected aggregate error
- Confidence level
- Sampling risk

4.9.3 The sampling process

1. Identification of the population to be tested
2. Identification of high value and abnormal value items that requires the auditor to analyze the attributes of population, subgrouping to population with similar characteristics and determining sampling units;
3. Determining the sample size- use of statistical or professional judgment with objectivity to determine the sample size to be tested by using audit techniques such as tests of controls, substantive procedures;
4. Selecting items for testing- identifying the items of the population to be tested with objectivity for the use of various sampling methods such as; random sampling, interval sampling, judgmental sampling etc.;
5. Performing the audit procedures- actually performing audit procedures selected for testing and reviewing the audit procedures; and
6. Evaluation of sample result- evaluating the sample results, the nature and cause of deviations or misstatements identified, projecting errors of sampling and the effects of any estimated errors in achieving the audit objectives.

The degree of sampling risk that the auditor is willing to accept from the results of the sample affects the sample size, which depends upon the importance of the results of the audit procedure involving sampling to the auditor's conclusions. The greater reliance on the results and the lower the sampling risk auditors are willing to accept, the larger the sample size needs to select. The auditor should consider sample size in the context of the overall risk assessment.

Step 1: Identifying the population to be tested

The population to be tested is a class of transactions or transactions underlying an account balance. It is the entire set of data on which the auditor must obtain assurance for the audit opinion.

Transactions constituting the population should cover the entire financial year. If sampling is done for an interim audit that includes only part of the financial year, additional sampling will have to be done during the final audit. The auditor may sample from the same population to perform different kinds of audit tests. In this case, samples already drawn from the relevant population may be used to perform all applicable audit tests.

Auditors should also take samples, where appropriate, from non-financial information when considering additional public sector audit objectives. For example, where number of patients treated in a government hospital was used as a basis to calculate key performance measures (such as cost per patient) in the financial statements, public sector auditors might also take samples to test the accuracy and completeness of the number of patients reported. Judgmental sampling approach may be appropriate in this case in drawing a sample from non-financial information. (ISSAI 1530. P6)

Selecting the Sample and Performing Appropriate Audit Procedures

The auditor shall select items for the sample in such a way that each sampling unit in the population has a chance of selection. [ISA 530.8]

The auditor will select a representative sample without bias, by choosing sampling units which have characteristics typical of the population. [ISA 530.A12, ISA 530.A13]

Performing Appropriate Audit Procedures

The auditor shall perform audit procedures, appropriate to the purpose, on each item selected for the sample. [ISA 530.9]

If the audit procedure is not applicable to the selected item, the auditor shall perform the procedure on a replacement item. [ISA 530.10]

If it is not possible to apply the designed audit procedures, or suitable alternative procedures, to a selected item, the auditor shall treat that item as a deviation from the prescribed control. [ISA 530.11]

Reliability of the information provided by FAP management

When performing audit sampling, the auditor shall perform audit procedures to obtain evidence that the population from which the audit sample is drawn is complete. [ISA 500.9(a), ISA 530.A5]

Step 2: Identification of high value and abnormal items

The population is stratified to select high value and abnormal items. Stratification is the process of dividing a population into sub-populations with similar characteristics for substantive testing. High value transactions are separated from the population and included in the sample for testing. For example, when auditing valuation of accounts receivable, the account area can be stratified by ageing the population and separating long outstanding debtors for testing.

Step 3: Determining the sample size from the remaining items

The auditor should adopt judgmental sampling in determining the sample size by applying statistical formula and using professional judgment.

Step 4: Selecting items for testing

There are a number of sample selecting methods, the following methods commonly used in auditing:

Random selection

The use of this selection method ensures that all items in the population have an equal chance of being selected.

Monetary Unit Sampling (MUS)

This type of statistical sample uses a monetary unit as a basis of selection (such as the rupee) rather than a physical sample. One key advantage of using an MUS sample is that large items are automatically selected.

Systematic selection

Systematic sampling is normally applicable for large numbers of transactions in the population with similar characteristics. Interval sampling method involves selecting item at a constant or uniform interval throughout the population, the first interval beginning random start. The sizes of population and sample determine the extent of intervals. The number of items in the population is divided by the required sample size to determine interval. For example, in the circumstances where there is a population is 1000 items and a required sample is 50 items, the interval of sampling will be 20 items.

Haphazard (Judgmental) selection

In haphazard selection, the auditor selects sampling units with no particular reason for including or excluding particular items. The auditor is warned, however against distorting the sample by selecting only unusual items, items having one physical characteristic or omitting items such as the first or the last. This method requires care to guard against making an unbiased selection.

This method may be an acceptable alternative to random selection provided auditors are satisfied that the sample is representative of the entire population.

Block Selection

In this selection method the auditor selects all items of specified type processed on a particular day, week or month. For example, the auditor may examine all transaction of specific month (July). The auditor gives special emphasis on the transactions for the selected month due to substantial expenditure or irregularities or risks observed in previous years. The basic problem with this selection is that the sampling units are selected for a period of time rather than the value or importance of transaction and a valid sample size may also appear impractically large. As a result, the sampling period selected under this method may not be representative of the population.

Step 5: Performing the audit procedures

The auditor should perform audit procedures appropriate to the particular audit objective on each item selected. If the audit procedure is not applicable to the selected item, the auditor should perform the procedure on a replacement item.

If the auditor is unable to apply the designed audit procedures or suitable alternative procedures to a selected item, the auditor should treat that item as a deviation from the prescribed control, in the case of tests of controls or a misstatement, in the case of tests of details. An example of when the auditor is unable to apply the designed audit procedures to a selected item is when documentation relating to that item is lost. In relation to the voided cheque, an example of a suitable alternative procedure might be the examination of subsequent cash receipts together with evidence of their source and the items they are intended to settle when no reply has been received in response to a positive confirmation request. (ISSAI 1530.11)

Step 6: Evaluating sample results

Having carried out the audit procedures to each sample item, which are appropriate to the particular audit objective, the auditor should evaluate the sample results, the nature and cause of any deviations or misstatements identified, and their possible effect on the particular audit objective and other areas of the audit. Additionally, the auditors should evaluate whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. (ISSAI 1530.12; 15)

In tests of controls, an unexpectedly high sample error rate may lead to an increase in the assessed risk of material misstatement, unless further audit evidence substantiating the initial assessment is obtained. In the extremely rare circumstances when the auditor considers a misstatement or deviation discovered in a sample to be an anomaly, the auditor should obtain a high degree of certainty that such misstatement or deviation is not representative of the population. The auditor shall obtain this degree of certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the misstatement or deviation does not affect the remainder of the population. (ISSAI 1530.13)

In analyzing the errors detected in the sample, the auditor first should determine that an item in question is in fact an error. In designing the sample, the auditor should define those conditions, which constitute an error by reference to the audit objectives.

For example, wrong posting between accounts of advances to staff and suppliers/contractors does not affect the total figures.

When the expected audit evidence regarding a specific sample item cannot be obtained, auditors may be able to obtain sufficient appropriate audit evidence through performing alternative procedures. In analyzing the errors discovered, the auditors may observe that many have a common feature. For example, type of transaction, location, product line or period of time.

Key item selection

As with high value items, the auditor select items that the auditor believes to be prone to misstatement because they are unusual, unexpected or in excess of a designated monetary amount. And which warrant special auditor attention. Generally, these items will include transactions that cause an account to show a negative balance (e.g. an asset account with a credit balance) or unusual non-recurring items. The auditor will use judgment and experience to help identify these key items.

Therefore, the auditor will identify the key items which need individual attention and will remove them from the population of items from which the samples are selected.

The auditor should be aware of the fact that key items having a high value can be other unusual or suspicious items, such as:

- Multiple transactions with very similar values/dates/suppliers;
- Apparently duplicate transactions; and
- Items which are unmatched; or items with other specific characteristics that catch the auditors' attention

Chapter 5:
AUDIT EXECUTION

Audit execution (fieldwork) should be conducted in a manner to ensure that appropriate sufficient audit evidence is obtained in accordance with applicable auditing standards to form the basis of audit opinions, conclusions and recommendations.

The audit execution phase is initiated with the Entrance Meeting conducted between the FAP management and the audit team. It is followed by the implementation of the Audit Strategy developed at the Planning stage and ends with the Exit Meeting with FAP management. This chapter details the following components of Audit execution:

Audit Evidence: Guidelines for designing, performing & evaluating the results of audit techniques for the purpose of obtaining sufficient appropriate audit evidence.
Test of Controls: Provides procedures relating to testing the effectiveness of FAP system of internal control for the prevention and detection of material misstatements.
Substantive procedures: Provide procedures & guidelines for conducting the substantive testing of assertions in order to obtain reasonable assurance that the accounting records are accurate and reliable.
External Confirmations: Guidance on the auditor's use of external confirmations as a means of obtaining audit evidence.
Management's Experts: Provide guidance to auditors while using the work of a specialist in performing an audit.
Written Representations: Details purpose of written representation and provides guidelines for requesting appropriate written representations from management, on which the auditor can base his opinion.
Subsequent Events: Guidelines regarding the planning and performing of audit procedures so as to consider all significant transactions occurring after the reporting period.
Disclosures: Guidelines to ensure that all related disclosures in the financial statements are adequate in the context of the applicable financial reporting framework.

5.1. Audit Evidence

Audit evidence may be obtained from sources inside or outside FAP and includes information contained in the accounting records underlying the financial statements. Most of the auditor's work in forming opinion(s) consists of obtaining and evaluating audit evidence. [ISA 500.A2]

The information providing audit evidence can be either:

a. External information:
   i. Source information: generated by a third party and used by the FAP to initiate the recording of transactions in the information system
   ii. Other information: any information obtained from third parties that is not source information

b. Internal information: Referred to as information produced by FAP. It is generated internally, and includes information generated by a service organization or management's expert, that the auditor may use as audit evidence when designing and performing audit procedures.

Information may be provided in a number of forms such as a report, a document or as a set of data

The auditor shall design and perform audit techniques that are appropriate in the circumstances for the purpose of obtaining sufficient appropriate audit evidence. [ISA 500.6]

Reasonable assurance is obtained when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. [ISA 500.A3]

Audit evidence may also include information obtained from other sources e.g. previous audits [ISA 200.A30, ISA 500.A1]

Audit evidence shall comprise both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In addition, in some cases the absence of information also constitutes audit evidence. [ISA 200.A30, ISA 500.A1]

The matter of difficulty or expense involved shall not be in itself a valid basis for omitting an audit procedure for which there is no appropriate alternative. [ISA 500.A6]

The auditor shall obtain audit evidence to draw reasonable conclusions on which to base his/her opinion(s) by performing: [ISA 500.A10]

a. risk assessment procedures, including obtaining an understanding of the FAP's internal control,
b. further audit procedures, which comprise:
   i. tests of controls, when required or when the auditor have chosen to do so,
   ii. Substantive procedures, including tests of details and substantive analytical procedures.

Tests of Controls

Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation conditions which indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the auditor. Please refer to **Section 4.2** for details on performing test of controls.

Substantive procedures

They comprise tests of details and substantive analytical procedures. Designing substantive procedures shall include identifying conditions relevant to the purpose of the test that constitute a misstatement in the relevant assertion. Please refer to **Section 4.3** for details on performing substantive procedures.

5.1.1. Sufficiency and appropriateness of audit evidence

The auditor must plan and perform audit procedures to obtain sufficient appropriate audit evidence to provide a reasonable basis for his or her opinion.

a. Sufficiency

Sufficiency is the measure of the quantity of audit evidence. The quantity of audit evidence needed is affected by the following: [ISA 500.A4, ISA 200.A31]

A. Auditor's assessment of the risks of misstatement [ISA 500.A4, ISA 200.A31]

Risk of material misstatement (in the audit of financial statements) or the risk associated with the control (in the audit of internal control over financial reporting).As the risk increases, the amount of evidence

that the auditor should obtain also increases. For example, ordinarily more evidence is needed to respond to significant risks.

B. The quality of such audit evidence [ISA 500.A4, ISA 200.A31]

Obtaining more audit evidence, however, may not compensate for its poor quality [ISA 500.A4, ISA 200.A31]

b. Appropriateness

Appropriateness is the measure of the quality of audit evidence, i.e., its relevance and reliability. To be appropriate, audit evidence must be both relevant and reliable in providing support for the conclusions on which the auditor's opinion is based. It may be relating to detecting misstatements in the classes of transactions, account balances, and disclosures and related assertions

The reliability of audit evidence shall be influenced by its source and by its nature, and shall be dependent on the individual circumstances under which it is obtained. [ISA 500.A5, ISA 200.A32]

5.1.2. The use of assertions in obtaining audit evidence

In representing that the financial statements are in accordance with the applicable financial reporting framework, management implicitly or explicitly makes assertions regarding recognition, measurement and presentation of classes of transactions and events, account balances and disclosures. [ISA 315.A127]

The auditor shall use relevant assertions in considering the different types of potential misstatements that may occur and provide a basis when the auditor design and perform audit procedures in order to obtain sufficient appropriate audit evidence.

Attributes indicating the potential relevance of an assertion include the:

a. Nature of the assertion
b. Volume of transactions or data related to the assertion, and
c. Nature and complexity of the systems.

Assertions [ISA 315.A129]

Assertion	Statement of Receipts & Expenditures	Balance Sheet Account balances
Completeness	All transactions and events that should have been recorded have been recorded in the correct accounting period.	All assets, liabilities and equity interests that should have been recorded have been recorded.
Existence (balance sheet) Occurrence (income statement)	Transactions and events that have been recorded have occurred, and have been recorded in the correct accounting period.	Assets, liabilities and equity interests exist.
Accuracy	(Accuracy) Amounts and other data relating to recorded transactions and events have been recorded correctly.	(Accuracy) Amounts and other data relating to recorded assets, liabilities and equity interests have been recorded correctly.
	(Classification and Allocation) Transactions and events have been classified and allocated to the appropriate accounts.	(Classification and Allocation) Assets, liabilities and equity interests have been classified and allocated to the appropriate accounts.
Valuation		Assets, liabilities and equity interests have been recorded at appropriate amounts, and any resulting valuation or allocation adjustments are appropriately recorded.
Cut-off/ Obligations and rights	FAP has the rights and obligations to transactions and events that it has recorded (i.e. transactions and events pertain to the FAP management).	FAP holds or controls the rights to assets. Liabilities and equity interests are the obligations of the FAP.
Presentation and disclosure	Financial information is appropriately presented and disclosed in the financial statements.	
	Transactions and events, balances and other matters disclosed in the financial statements: a. are appropriately aggregated or disaggregated and clearly described b. are relevant and understandable in the context of the requirements of the applicable financial reporting framework c. have occurred and/or are relevant to the accounting period d. pertain to the FAP management e. Are disclosed at appropriate amounts	

	All disclosures related to transactions and events, balances and other matters that should have been included in the financial statements have been included. Other matters disclosed in the financial statements are disclosures not directly related to recorded transactions, events or account balances.

5.1.3. Audit procedures for obtaining audit evidence

The nature and timing of the audit techniques to be used may be affected by the fact that some of the accounting data and other information may be available only in electronic form or only at certain points or periods in time. [ISA 500.A12]

If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit. [ISA 330.14]

The auditor may consider whether information obtained during the prior period audit(s), including information obtained when obtaining an understanding of relevant controls, is relevant to auditor's risk assessment in the current period audit.

Various types of audit techniques that may be used by the auditor to obtain audit evidence include:

Type of audit procedure	Considerations
1. Inspection	Inspection involves examining records or documents, whether internal or external, in paper form, electronic form, or other media, or a physical examination of an asset. [ISA 500.A14] Inspection of records and documents provides audit evidence of varying degrees of reliability, depending on their nature and source and, in the case of internal records and documents, on the effectiveness of the controls over their production. [ISA 500.A14] Inspection of records or documents can be used: i. as tests of controls: for example, inspection of records for evidence of authorization [ISA 500.A14] ii. to test application of accounting policy: for example, inspection of an executed contract may provide audit evidence relevant to revenue recognition [ISA 500.A15] iii. as direct audit evidence of assertions, such as existence. Inspection of such documents may not necessarily provide audit evidence about ownership or value. [ISA 500.A15] Inspection of tangible assets involves the physical examination of an asset and may provide reliable audit evidence with respect to their existence, but not necessarily about the FAP management's rights and obligations or the valuation of the assets. [ISA 500.A16]
2. Observation	Observation consists of looking at a process or procedure being performed by others. [ISA 500.A17]

Type of audit procedure	Considerations
	Observation provides audit evidence about the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed. [ISA 500.A17]
3. External confirmation	An external confirmation represents audit evidence obtained by the auditor as a direct written response to him/her from a third party (the confirming party) in paper form, or by electronic or other medium [ISA 500.A18] External confirmation procedures frequently are relevant when addressing assertions associated with certain account balances and their elements. However, external confirmations need not be restricted to account balances only. [ISA 500.A18] External confirmation procedures also are used to obtain audit evidence about the absence of certain conditions. [ISA 500.A18]
4. Recalculation	Recalculation consists of checking the mathematical accuracy of documents or records. Recalculation may be performed manually or electronically. [ISA 500.A19]
5. Re performance	Re performance involves auditor's independent execution of procedures or controls that were originally performed as part of the FAP management's internal control. [ISA 500.A20]
6. Analytical procedures	Analytical procedures consist of evaluations of financial information through analysis of plausible relationships among both financial and non-financial data. [ISA 500.A21] Analytical procedures also encompass the investigation of identified fluctuations and relationships that are inconsistent with other relevant information or deviate significantly from predicted amounts. [Source: ISA 500.A21]
7. Inquiry	Inquiry consists of seeking information of knowledgeable persons, both financial and non-financial, within FAP or outside FAP. Inquiry is used extensively throughout the audit in addition to other audit procedures. Inquiries may range from formal written inquiries to informal oral inquiries. [ISA 500.A22] Inquiry may involve: i. considering the knowledge, objectivity, experience, responsibility, and qualifications of the individual ii. asking clear, concise, and relevant questions iii. using open or closed questions appropriately iv. listening actively and effectively v. considering reactions/responses, asking follow-up questions vi. Evaluating the response. The auditor may inquire of more than one individual to evaluate the validity and consistency of the responses obtained.

Type of audit procedure	Considerations
	Although inquiry may provide important audit evidence, and may even produce evidence of a misstatement, inquiry alone does not provide sufficient audit evidence Accordingly, when evaluating design and implementation and testing operating effectiveness, other audit procedures are performed in conjunction with inquiry. [ISA 500.A2] **Management's intent** In these cases, the auditor may obtain relevant information to corroborate the evidence obtained through inquiry by understanding management's: [ISA 500.A24] i. past history of carrying out its stated intentions [ISA 500.A24] ii. stated reasons for choosing a particular course of action, and [ISA 500.A24] Ability to pursue a specific course of action. [ISA 500.A24]

5.1.4. Relevance and reliability of audit evidence

When designing and performing audit procedures, the auditor shall consider the relevance and reliability of the information to be used as audit evidence.

a. Relevance

Relevance deals with the logical connection with, or bearing upon, the purpose of the audit procedure and, where appropriate, the assertion under consideration. The relevance of information to be used as audit evidence may be affected by the direction and timing of testing. [ISA 500.A27]

A given set of audit procedures may provide audit evidence that is relevant to certain assertions, but not others. [ISA 500.A28]

Similarly, obtaining audit evidence regarding a particular assertion is not a substitute for obtaining audit evidence regarding another assertion. On the other hand, audit evidence from different sources or of a different nature may often be relevant to the same assertion. [ISA 500.A28]

b. Reliability

The reliability of information to be used as audit evidence, and therefore of the audit evidence itself, is influenced by its source and its nature, and the circumstances under which it is obtained, including the controls over its preparation and maintenance where relevant. Therefore, generalizations about the reliability of various kinds of audit evidence are subject to important exceptions. Even when information to be used as audit evidence is obtained from sources external to the FAP management, circumstances may exist that could affect its reliability. [ISA 500.A31]

While recognizing that exceptions may exist, the following generalizations about the reliability of audit evidence may be used by the auditor: [ISA 500.A31]

a. The reliability of audit evidence is increased when it is obtained from independent sources outside FAP [ISA 500.A31].

b. the reliability of audit evidence that is generated internally is increased when the related controls, including those over its preparation and maintenance, are effective [ISA 500.A31]
c. audit evidence obtained directly by the auditor is more reliable than audit evidence obtained indirectly or by inference [ISA 500.A31]
d. audit evidence in documentary form, whether paper, electronic, or other medium, is more reliable than evidence obtained orally [ISA 500.A31]
e. Audit evidence provided by original documents is more reliable than audit evidence provided by photocopies, facsimiles or documents that have been transformed into electronic form.

5.1.5. Inconsistency in, or doubts over reliability of, audit evidence

If: [ISA 500.11]

a. audit evidence obtained from one source is inconsistent with that obtained from another,
b. the auditor has doubts over the reliability of information to be used as audit evidence,

the auditor shall determine what modifications or additions to audit procedures are necessary to resolve the matter, and shall consider the effect of the matter, if any, on other aspects of the audit.

5.1.6. Conclusion on sufficient appropriate audit evidence

Whether sufficient appropriate audit evidence has been obtained to reduce audit risk to an acceptably low level, and thereby enable the auditor to draw reasonable conclusions on which to base his opinion, is a matter of professional judgment. [ISA 500.A6]

5.2. Testing the Operating Effectiveness of Controls

Tests of controls are performed as part of auditor's response to the risks of material misstatement identified during risk assessment. They are designed to evaluate the operating effectiveness of controls in preventing, or detecting and correcting, material misstatements at the assertion level.

Designing tests of controls to obtain relevant audit evidence includes identifying conditions (characteristics or attributes) that indicate performance of a control, and deviation conditions which indicate departures from adequate performance. The presence or absence of those conditions can then be tested by the auditor.

The auditor may perform tests of controls only on those controls that the auditor has determined are suitably designed and implemented to prevent, or detect and correct, a material misstatement in a relevant assertion. The auditor shall design and perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls if: [ISA 330.8]

a. assessment of Risk of Material Misstatement includes an expectation that the controls are operating effectively
b. substantive procedures alone cannot provide sufficient appropriate audit evidence at the assertion level

It is not necessary to test controls that, even if deficient, would not present a reasonable possibility of material misstatement to the financial statements.

If substantially different controls were used at different times during the period under audit, each is considered separately. [ISA 330.A20]

The evidence necessary to support control risk assessment depends on the degree of reliance the auditor plans to place on the effectiveness of a control. In designing and performing tests of controls, the auditor shall: [ISA 330.10].

a. Perform other audit procedures in combination with inquiry to obtain audit evidence about the operating effectiveness of the controls, including: [ISA 330.10(a)]
    i. how the controls were applied at relevant times during the period under audit [ISA 330.10(a)(i)]
    ii. the consistency with which they were applied, and [ISA 330.10(a)(ii)]
    iii. by whom or by what means they were applied [ISA 330.10(a)(iii)]
b. Determine whether the controls to be tested depend upon other controls (indirect controls) and, if so, whether it is necessary to obtain audit evidence supporting the effective operation of those indirect controls (e.g. general IT controls). [Source: ISA 330.10(b)]

The auditor shall test the operating effectiveness of a control by determining whether

a. the control is operating as designed
b. the person performing the control possesses the necessary authority and competence

The auditor may consider the use of specialists or the work of the internal audit function or may request direct assistance from internal auditors

5.2.1. Nature of Tests of Control

The following audit procedures may be used, depending upon the purpose, to obtain audit evidence about the operating effectiveness of controls:

a. Inquiry
b. observation
c. inspection
d. re performance
e. recalculation

The nature of the particular control influences the type of audit procedure necessary to obtain audit evidence about whether the control was operating effectively. [ISA 330.A27]

The following table describes factors that the auditor may consider when planning to obtain audit evidence about the effectiveness of the operation of a control.

Circumstance	Factors to consider
The auditor observes the performance of the control	There is a risk that a control will be performed effectively just because the auditor is present.
The control does not detect any misstatement as it is operating	This does not necessarily mean that the control is operating effectively as there may have been no misstatements present to detect.
The control detects a misstatement	The detection of a misstatement by a control provides some evidence that the control is operating effectively. The auditor may determine whether management corrects the misstatement. The auditor also may investigate the nature and cause of the misstatement and consider the

Circumstance	Factors to consider
	impact on auditor's assessment of the risk of material misstatement. The auditor may also consider whether there is a deficiency in another control which allowed the misstatement to arise.
The control failed to identify misstatements that did arise	In order to determine the impact of the control failure on the nature, timing, and extent of auditor's audit procedures, the auditor may investigate the nature and cause of the control breakdown identified and evaluate the effect on audit. As part of evaluation, the auditor may consider whether the breakdown in controls is an anomaly, or if the deviation only occurred for a specific portion of the period or at a specific location.

5.2.2. Extent of Tests of Controls

The extent of an audit procedures judged necessary is determined after considering the materiality, the assessed risk, and the degree of assurance the auditor plans to obtain. In general, the extent of audit procedures increases as the risk of material misstatement increases. [ISA 330.A15]

When more persuasive audit evidence is needed regarding the effectiveness of a control, it may be appropriate to increase the extent of testing of the control. In addition to the degree of reliance on controls, matters which the auditor will consider in determining the extent of tests of controls include the following: [ISA 330.A28]

a. the frequency of the performance of the control by the FAP during the period [ISA 330.A28]
b. the length of time during the audit period that the auditor is relying on the operating effectiveness of the control [ISA 330.A28]
c. The auditor's assessment of risk of failure
d. Whether the control is an automated control
e. The expected rate of deviation from a control [ISA 330.A28]
f. The relevance and reliability of the audit evidence to be obtained regarding the operating effectiveness of the control at the assertion level [ISA 330.A28]
g. The extent to which audit evidence is obtained from tests of other controls related to the assertion
h. For an automated control, the effectiveness of relevant general IT controls.

The auditor shall design audit procedures to be sufficiently extensive in order to provide reasonable assurance that the controls operated effectively throughout the period. The extent of evidence may be increased by:

- selecting more controls to test (e.g. the breadth of controls) or
- by increasing the number of performances of a specific audit procedure

5.2.3. Timing of Tests of Controls

Timing of an audit procedure refers to when it is performed, or the period or date to which the audit evidence applies. [ISA 330.A6]

- When the risk of material misstatement is high, the auditor may decide to perform audit procedures unannounced or at unpredictable times. [ISA 330.A11]
- Relevant factors that influence the auditor's consideration of when to perform audit procedures include the following: [ISA 330.A14]
  a. the effectiveness of the control environment
  b. when relevant information is available
  c. the nature of the risk
  d. the period or date to which the audit evidence relates
  e. the timing of the preparation of the financial statements
- Testing of the operating effectiveness of controls may take place at the time the controls are operating. Audit evidence pertaining only to a point in time may be sufficient for auditor's purpose, however, if the auditor intends to rely on a control over a period, tests that are capable of providing audit evidence of the control effectiveness during that period are appropriate.
- In cases where FAP management implement changes to their controls prior to period end, the auditor will consider how these affect the auditor's reliance on controls.

5.2.4. Risk of Failure

The auditor will consider the risk of failure of the control when determining the extent of evidence necessary to persuade the auditor that the control is effective. As the risk of failure of the control decreases, the evidence that the auditor obtains also decreases and vice versa.

For each relevant control selected for testing the operating effectiveness, except for those controls that are intended to respond to a fraud risk (i.e. anti-fraud controls), the auditor shall assess and document the risk of failure of the control as lower or higher using professional judgment, based on the specific circumstances of the control.

For each relevant control selected for testing operating effectiveness that is intended to respond to a fraud risk, there is a presumption that the risk of failure is higher

5.2.5. Using Audit Evidence Obtained in Prior Period(s) Audit

The auditor may use prior period audit evidence regarding the operating effectiveness of controls. If the auditor plans to rely on controls over a significant risk, the auditor shall test those controls in the current period. [ISA 330.15

If the auditor plans to use audit evidence from a previous audit about the operating effectiveness of specific controls, the auditor shall establish the continuing relevance of that evidence by obtaining audit evidence about whether significant changes in those controls have occurred subsequent to the previous audit by performing a walkthrough. [ISA 330.14]

The auditor shall include in audit documentation: [ISA 330.29]

a. Audit evidence from prior periods
b. Procedures performed to determine that no changes in the design or implementation of the subject controls have occurred since last evaluation

c. Conclusions reached about relying on such controls. [ISA 330.29]

5.2.6. Evaluating the Results of Tests of Controls

The results of test of controls will be evaluated in order to analyze the audit evidence obtained from the procedures performed.

a. Nature and Cause of Deviations

Control deviations refer to an instance or activity that did not occur as per expectations. The auditor shall investigate the nature and cause of any deviations identified and evaluate their possible effect on the purpose of the audit procedure and on other areas of the audit. [ISA 530.12]

- If deviations from controls are detected, the auditor shall make specific inquiries to understand these matters and their potential consequences, and shall determine whether: [ISA 330.17]
  a. The tests of controls that have been performed provide an appropriate basis for reliance on the controls [ISA 330.17(a)]
  b. Additional tests of controls are necessary, or [ISA 330.17(b)]
  c. The potential risks of misstatement need to be addressed using substantive procedures. [ISA 330.17(c)]
- If the identified control deviation is a systematic or intentional control deviation, the auditor shall consider the possible implications of fraud and consider the impact on audit approach.

When evaluating a deviation discovered in testing controls to determine whether it is a control deficiency, the auditor may consider several factors, including:

a. How was the deviation detected?
b. Is the deviation confined to a single location, process or application, or is it pervasive in the organization?
c. How significant is the control deviation from stated policy?
d. How often were deviations detected in relation to how frequently the control is performed?

b. Evaluating results of audit sampling

The auditor shall evaluate: [ISA 530.15]

a. The results of the sample, including sampling risk, [ISA 530.15(a)]
b. Whether the use of audit sampling has provided a reasonable basis for conclusions about the population that has been tested. [ISA 530.15(b)]

If the auditor concludes that audit sampling has not provided a reasonable basis for conclusions about the population that has been tested, the auditor may: [ISA 530.A23]

a. Request management to investigate deviations and make necessary adjustments, [ISA 530.A23]
b. Tailor the nature, timing and extent of those further audit procedures to best achieve the required assurance. [ISA 530.A23]

c. Concluding on Operating Effectiveness of Controls

If the auditor has evaluated the design and implementation of a control to be effective, and tests of operating effectiveness do not identify any deficiencies, then the auditor may conclude that the control is operating effectively. [ISA 330]

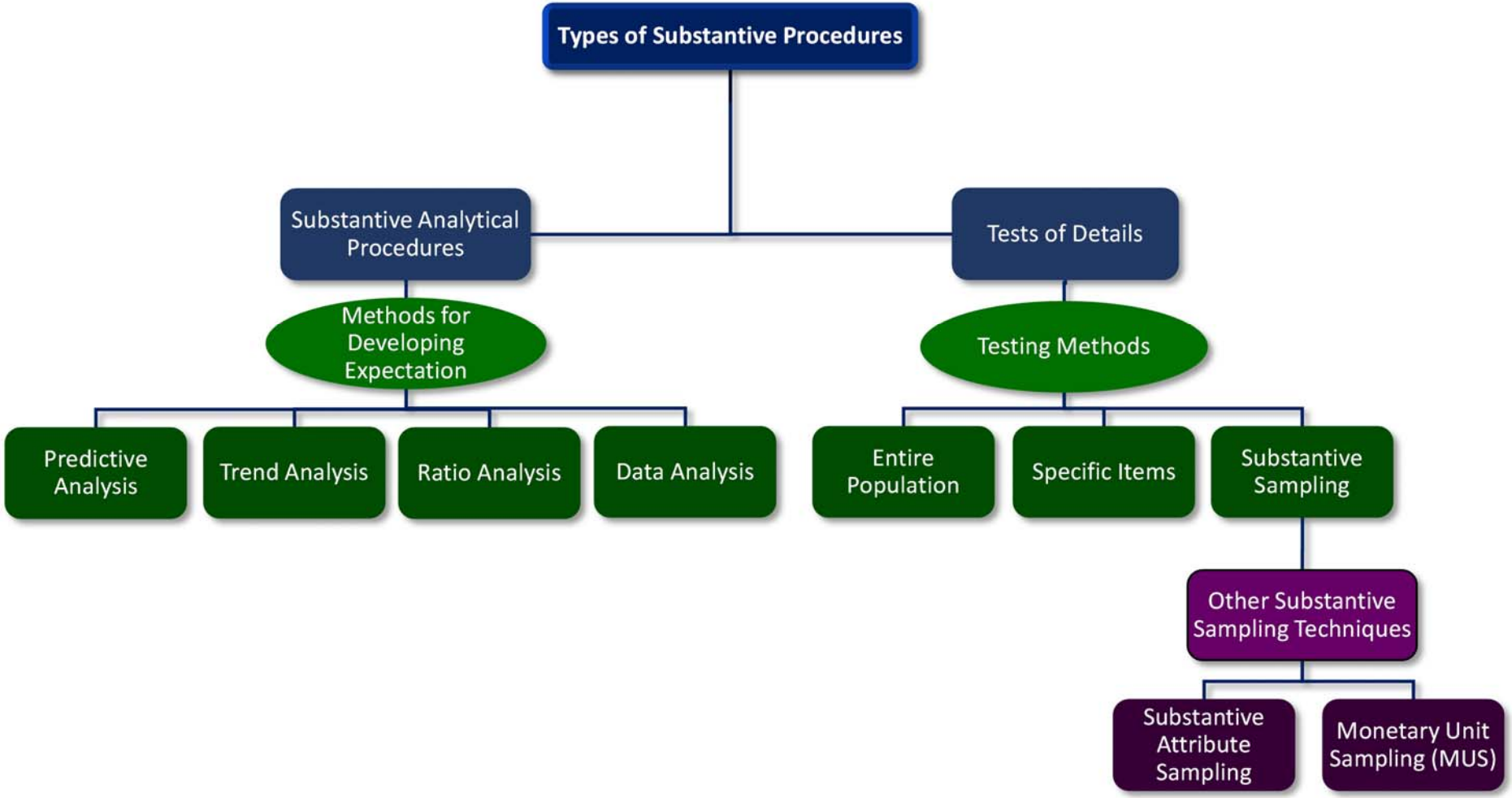
Where a control is found to be ineffective and the auditor still chooses to rely on controls for the relevant assertions, the auditor shall both identify compensating controls and test those, or if the control is remediated by management, the auditor shall test the remediated control.

5.2.7. Additional documentation requirements

Audit documentation relevant to the procedures performed will be maintained in the audit file. This is detailed in **Section 7.4.** The audit documentation of tests of controls shall include: [ISA 330.28]

a. Description of the nature, timing and extent of tests of operating effectiveness [ISA 330.28(a)]
b. The linkage of those procedures with the assessed risks at the assertion level,[ISA 330.28(b)]
c. Results of tests of operating effectiveness, including the conclusions where these are not otherwise clear [ISA 330.28(c)]

5.3. Substantive testing



Substantive procedures are direct tests of transactions and accounting items including Analytical Procedures. The auditor should carry out substantive procedures while certifying accounts and financial statements. These procedures are intended to verify that the accounting information complies with decisions and intentions, as well as with legislation, regulations and relevant rules.

Substantive procedures are particularly necessary in cases where the auditor cannot base their work on the entity's risk management measures (internal control). Substantive procedures are performed in order to detect material misstatements at the assertion level, Substantive procedures comprise of:

- Tests of details of classes of transactions, account balances, and disclosures; and
- Substantive analytical procedures.

The auditor shall design and perform further audit procedures whose nature, timing, and extent are based on and are responsive to the assessed RoMM. [ISA 330.6]

In designing the further audit procedures to be performed, the auditor shall consider the reasons for the assessment given to RoMM level for each significant account and disclosure and obtain more persuasive audit evidence the higher the auditor's assessment of risk. [ISA 330.7]

5.3.1. Substantive Analytical Procedures

Analytical procedures are used to evaluate financial information through analysis of plausible relationships among financial and non-financial data. These procedures also include any investigation relating to identified fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by significant amount. Analytical procedures consist of the application of **comparisons**, **computations**, **enquiries**, **inspections** and **observations** to analyze and develop expectations about relationships among various financial and operating data. Analytical procedures may be applied at various stages of an audit:

- To assist in the planning stage for assessing the risks;
  For example, to identify significant financial statement accounts, classes of transactions and financial statement assertions with a relatively higher risk of significant misstatements.

- To obtain effective audit evidence in a form of substantive testing (audit execution stage);

- To assist in the review and interpretation of audit findings and in developing information useful for audit reports (reporting stage);
  For example, the auditor may compare the Project's financial statements to common performance indicators for the Project, analytical procedures may improve the understanding of the operations and insights about relationships to the auditor and these matters can be presented in audit reports.

The relationship between individual items of the financial statements as traditionally practiced in business entities may not be sufficient in the audit of government or other public sector entities. For example, many public sector entities usually have direct relationship between revenues and expenditures. Likewise, there may be relation between the cost of per kilometer of road construction with number of equipment or vehicle used.
Analytical procedures do not normally provide evidence about certain additional objectives, such as compliance with authorities. They should be considered together with other audit tests and with the results

of other audits. In addition, analytical procedures are not usually effective to obtain audit evidence for some audit objectives.

For example, analytical procedures generally cannot replace confirmations of loan balances, interest receivable, confirmations from banks for revenue deposited in government accounts, advances to contractors.

An analytical procedure generally consists of three components:

Prediction;
The auditor may predict an account balance, a class of transactions, or a ratio involving financial and/or operating data.

Comparison;
Comparing figures and information of audit with related transactions to identify significant difference.
Use of professional judgment in investigating and concluding on the differences observed.
The following examples of analytical procedure can give reasonable assurance through comparison figures and information:

- Comparison between budgeted and actual.
- Month on month comparison, for example on salaries and wages.
- Comparison between prior year and current year expenditure.
- Comparing expected results.
- Comparing the information and data between similar entities, programs or projects.

When designing and performing substantive analytical procedures, either alone or in combination with tests of details the auditor shall: [ISA 520.5]

a. Determine the suitability of particular substantive analytical procedures for given assertions,
b. Develop an expectation of recorded amounts or ratios
c. Evaluate whether the expectation is sufficiently precise, when combined, with audit evidence from other audit procedures, to identify a material misstatement,
d. Determine the amount of any difference of recorded amounts from expected values that is acceptable without further investigation.
e. Evaluate the reliability of data from which expectation of recorded amounts or ratios is developed,

When performing and evaluating the results of substantive analytical procedures, the auditor shall:

a. Calculate or identify the expected amounts or ratios
b. Compare the recorded amounts, or ratios developed from recorded amounts, with the expectations, and
c. Evaluate the results.

a. Categories of analytical procedures

There are three main categories of analytical procedures:

A. Reasonableness tests

A reasonableness test is a term often used to refer to a computation used to estimate an amount such as an account balance or class of transactions. The auditor develops a model, computes a prediction of the amount

through the use of relevant financial and operating data and compares the prediction with the recorded amount.

B. Trend analysis

A trend analysis is a term often used to refer to the analysis of the changes in a given account balance or class of transactions between the current and prior periods or over several accounting periods. This contrasts with a reasonableness test which involves an analysis of the changes within one accounting period.

The auditor should obtain an understanding of what causes the trend in the account balance and class of transactions. Using this knowledge, the auditor requires computing what the auditor expects the current year's amount to be, based on the past trend and the knowledge of the Project's current transactions. The auditor then compares this prediction with the recorded amount. In this way, the auditor may identify potential problems when there is little or no change in the current balance from the prior period but a significant change would reasonably be expected to occur.

The predictions range from simple calculations of a single variable based on the trend in annual data to more complex analyses using many variables.

It is important to understand the reasons why the auditor expects a trend to be predictable, since data sometimes appear to be causally related when they are not.

For example, there may be no reason to expect expenditures for legal fees in one year to be indicative of legal expenditures for the next year.

C. Ratio analysis

A ratio analysis is a term often used to refer to the analysis of the ratio of:

i. An account balance to another account balance;
ii. For revenue and expense accounts, the auditor may analyze the ratios of:
    - investment income to investments
    - A class of transactions to an account balance;
    - Financial data to operating data.
iii. The auditor may analyze the ratio of payroll expense to average employee numbers.
iv. The auditor may analyze the changes in ratios within the Project's operations over time or analyze the ratios of different entities or different segments within the Project's operations.

b. Performing analytical procedures

There are five stages in performing analytical procedures as described below:

A. Considering the independence and reliability of financial and operating data used in the model

The independence and reliability of the financial and operating data used directly affects the accuracy of the prediction and hence the auditor should ensure to the extent possible the reliability of the audit evidence to be used in the analytical procedure. As far as possible, the auditor should develop the prediction using data independent of the account being predicted.

The judgment about the reliability of data required should consider whether:

- the data comes from independent sources outside the Project or from sources within the Project;
- the sources within the Project are independent of those who are responsible for the amount being audited;
- the data are subject to effective internal control;
- the data are subject to audit procedures in the current or prior year; and

- the auditor develops the predictions using data from a variety of sources.

B. Computing the prediction and comparing it to the recorded amount.

While comparing the prediction with the recorded amount, the auditor should consider the following matters:

- The frequency with which the relationship is measured. The more frequently the auditor observes a particular relationship, the more the auditor can be assured of the consistency of that relationship.
- Expected variations and abnormal fluctuations. In analytical procedures, the auditor is attempting to distinguish between expected variations and abnormal fluctuations. While comparing monthly amounts, the auditor often expects to see seasonal variations and not a constant amount each month.
- The absence of expected variations. This highlights the importance of understanding the Project's operations.

C. Considering whether the difference is significant

Differences may exist because:

- The account or class of transactions contains a misstatement; or
- The account or class of transactions does not contain a misstatement but the prediction is inaccurate. For example, the auditor has used inaccurate data or made an incorrect prediction.

D. Obtain explanations for significant differences and corroborate important matters

Whenever there is a significant difference between the prediction and the recorded amount, the auditor should seek explanations from management. Other appropriate Project staff could also be requested to provide explanations as to corroborate important matters.

If there are no reasonable explanations, the auditor should reconsider the data and assumptions the auditor used to calculate the prediction and the consequent range of acceptable values. The auditor may perform the computation again, using a refined model to see whether the difference is still unacceptable.

If significant differences still exist, tests of details ordinarily are performed to obtain audit evidence as to whether significant misstatements are present.

E. Consider significance of Audit findings

The auditors should evaluate the audit evidence obtained from analytical procedures. The audit findings may include not only misstatements in the account but also observations about the functioning of internal control, the information system and other matters.

If the auditors identify an audit finding, the auditor should investigate its nature and cause and should consider whether it indicates a significant misstatement in the financial statement assertions addressed by the audit objective and its implications for the Project's operations.

5.3.2. Tests of Details

Tests of details are the application of one or more of the types of audit techniques to individual items or transactions that make up an account balance or class of transactions. Tests of details can include the following types of audit procedures: [ISA 500.A2]

a. Inquiry
b. Inspection
c. Observation
d. External Confirmation

e. Recalculation
f. Re performance.

Testing methods for performing tests of details have been provided in **Section 4.1**

Rotation with tests of details

Sometimes, analytical procedures and tests of details are alternative approaches to obtaining sufficient appropriate audit evidence for a given audit objective. If so, the auditor may choose to apply tests of details in one year and choose to apply analytical procedures in another year.

For example, in the first year of an audit, the auditor may apply tests of details to payroll. In the second year, the auditor may choose analytical procedures recognizing that tests of details in the prior year provided persuasive audit evidence about data on which the auditor makes a prediction.

In the example, tests of details in the first year provide an anchor for analytical procedures in the subsequent year.

It may be useful to rotate analytical procedures and tests of details among locations or among audit objectives for which analytical procedures and tests of details are acceptable alternative approaches.

Rotation may improve the audit, over time, in the following ways:
- Audit evidence is more persuasive because it is derived from different types of audit procedures;
- The audit procedures are less predictable to the Project's employees; and
- By varying the approach, the auditor is more likely to develop useful suggestions for the Project.

Vouching is a term often used to refer to tests of details using a combination of computation and inspection techniques. Inspections involve the auditors themselves checking the financial information, transactions and documents (voucher tests) or assets (physical examination) to ensure that the information are correct.

Computations or recalculations involve auditors checking the calculations in documents – for example verifying that the rates used for calculating dues are correct.

5.3.3. Reconciliation of financial statements and underlying accounting records

Auditor's substantive procedures related to the preparation and presentation of the financial statements shall include agreeing or reconciling information in the financial statements with the underlying accounting records, including agreeing or reconciling information in disclosures, whether such information is obtained from within or outside of the general and subsidiary ledgers. [ISA 330.20(a)]

Auditor's substantive procedures related to the financial statement closing process shall include examining material adjustments made during the financial statement closing process ("post-closing entries"). [ISA 330.20(b)]

5.3.4. Nature and Extent of Substantive Procedures

Depending on the circumstances, the auditor may determine that: [ISA 330.A43]

a. Performing only substantive analytical procedures will be sufficient to reduce audit risk to an acceptably low level [ISA 330.A43]
b. Only tests of details are appropriate [ISA 330.A43]
c. A combination of substantive analytical procedures and tests of details are most responsive to the assessed risks. [ISA 330.A43]

Because the assessment of RoMM takes account of internal control, the extent of substantive procedures may need to be increased when: [ISA 330.A46]

a. The auditor does not intend to rely on the operating effectiveness of controls
b. The design and/or implementation of controls is/are determined to be ineffective
c. The results from tests of controls are unsatisfactory. [ISA 330.A46]

However, increasing the extent of an audit procedure is appropriate only if the audit procedure itself is relevant to the specific risk. [ISA 330.A46]

When designing tests of details, the auditor shall determine means of selecting items for testing that are effective in meeting the purpose of the audit procedure. [ISA 500.10]

a. Considering whether External Confirmation Procedures are to be performed

The auditor shall consider whether external confirmation procedures are to be performed as substantive audit procedures. [ISA 330.19]

b. Timing of substantive procedures

Relevant factors that influence auditor's consideration of when to perform audit procedures include the following: [ISA 330.A14]

a. The effectiveness of the control environment [ISA 330.A14]
b. When relevant information is available [ISA 330.A14]
c. The nature of the risk [ISA 330.A14]
d. The period or date to which the audit evidence relates [ISA 330.A14]
e. The timing of the preparation of the financial statements [ISA 330.A14]

c. Substantive procedures responsive to significant risks

In designing the further audit procedures to be performed, the auditor shall obtain more persuasive audit evidence the higher the auditor's assessment of risk. [ISA 330.7(b)]

When obtaining more persuasive audit evidence because of a higher assessment of risk, the auditor may increase the quantity of the evidence, or obtain evidence that is more relevant or reliable.

If the auditor has determined that there is an inherent risk of error that is assessed as Significant, the auditor shall perform substantive procedures that are specifically responsive to that risk. When the approach consists only of substantive procedures, those procedures shall include tests of details. [ISA 330.21]

The auditor will perform substantive procedures that are specifically responsive to risks that the auditor determines to be significant risks

d. Fraud risk

If the auditor determines that there is an assertion level fraud risk, the auditor shall design and perform substantive procedures whose nature, timing and extent are specifically responsive to that risk. The auditor's substantive procedures to address an assertion level fraud risk shall include tests of details.

While substantive analytical procedures alone may provide sufficient appropriate audit evidence for risks of error, substantive analytical procedures alone do not provide sufficient appropriate audit evidence for assertion level fraud risks.

In determining overall responses to address the financial statement level fraud risks, the auditor shall incorporate an element of unpredictability in the selection of the nature, timing and extent of audit procedures. [ISA 240.29(c)]. This can be done by:

a. performing substantive procedures on selected account balances, disclosures and assertions not otherwise tested due to their materiality or risk [ISA 240.A36]
b. increasing the extent of substantive procedures performed on significant accounts and disclosures (e.g. by increasing the sample size for tests of details)
c. adjusting the timing of audit procedures from that otherwise expected [ISA 240.A36]
d. using different sampling methods [ISA 240.A36]
e. selecting items for testing that have lower amounts or are otherwise outside customary selection parameters
f. Performing audit procedures at different locations or at locations on an unannounced basis.

Responses to address the assessed assertion level fraud risks may include changing the nature, timing, and extent of audit procedures in the following ways: [ISA 240.A37].

a. The nature of audit procedures to be performed may need to be changed to obtain audit evidence that is more reliable and relevant or to obtain additional corroborative information.
b. The timing of substantive procedures may need to be modified
c. The extent of the procedures applied reflects the assessment of the fraud risks.

5.3.5. Substantive Procedures for Non-Significant Accounts

Irrespective of the assessed risks of material misstatement, the auditor shall design and perform substantive procedures for each: [ISA 330.18]

a. Non-significant account that is greater than materiality and for each material disclosure,
b. Financial statement caption that is greater than materiality and for which the auditor has not identified at least one significant account or material non-significant account.

While performing substantive procedures the auditor shall exercise professional judgment to determine the nature, timing and extent of the procedures, taking into account that:

a. The objective of the substantive procedures is to identify misstatements that are greater than performance materiality,
b. Audit evidence for a non-significant account may be less persuasive than audit evidence for a significant account, and there is no requirement to perform substantive procedures on all non-significant accounts that make up the financial statement caption.

Additional substantive procedures that may be performed related to non-significant accounts

Substantive procedures	Relevant guidance
Data analysis	Such a procedure may include: i. obtaining the detail of the account balance that reconciles to the general ledger balance ii. analyzing the detail for unusual items that are inconsistent with auditor's understanding of FAP management and the nature of the account iii. Obtaining audit evidence related to identified unusual items. The level of precision for a substantive analytical procedure performed on a material non-significant account may be lower than that performed for a significant account.
Other substantive analytical procedures	A substantive analytical procedure may be an effective and efficient test for material non-significant accounts as such accounts generally do not require complex disaggregation and the account balance may not be much greater than the required precision for the test. The level of precision for a substantive analytical procedure performed on a material non-significant account may be lower than that performed for a significant account.
Judgmental selection of items to test	Such a procedure may include: i. obtaining the detail of the account balance that reconciles to the general ledger balance selecting a judgmental selection of items that is appropriate for the test ii. Obtaining audit evidence related to selected items.

5.3.6. Conclusion on Substantive Testing

In forming an opinion, the auditor will consider:

a. the conclusions related to relevant assertions for significant accounts and disclosures, including auditor's considerations of populations that have not been tested
b. the results of substantive procedures performed on non-significant accounts, including any misstatements identified in these accounts from these procedures and the impact on audit approach including the risk assessment related to the accounts with identified misstatements
c. all non-significant accounts where substantive procedures have not been performed, including:
   i. any misstatements identified in these accounts through procedures performed on related accounts,
   ii. All misstatements accumulated throughout the audit when determining if audit risk is acceptably low.

5.3.7. Additional documentation requirements

Audit documentation relevant to the procedures performed will be maintained in the audit file. This is detailed in **Section 7.4.** The audit documentation of substantive procedures shall include: [ISA 330.28]

a. The nature, timing, and extent of the substantive audit procedures performed [Source: ISA 330.28(a)]
b. The linkage of those procedures with the assessed risks at the assertion level, and [ISA 330.28(b)]
c. The results of the audit procedures, including the conclusions where these are not otherwise clear. [ISA 330.28(c)]

The form and extent of audit documentation is a matter of professional judgment, and is influenced by the nature, size and complexity of FAP and its internal control, availability of information from the FAP Management and the audit methodology and technology used in the audit. [ISA 330.A63]

5.4. External Confirmations

Confirmation is the process of obtaining a representation of information or of an existence of condition directly from the third party. Confirmation can be internal as well as external. Obtaining a management representation letter from the FAP management is a form of internal confirmation, whereas external confirmation to a particular transaction of the audited may be received from the related third parties such as bankers, debtors, creditors, investors etc. (ISSAI 1505).
External confirmation is taken from related third parties ordinarily in writing to corroborate information contained in the accounting records. An example of an external confirmation would be a confirmation letter sent to a bank to confirm the cash balance of an entity at period end. (ISSAI 1500. A18).

The auditor shall consider whether external confirmation procedures are to be performed as one of the substantive audit procedures. This would typically be done to confirm bank balances, loans, debtors, and creditors. Since external confirmations are a very reliable source of evidence auditors should consider obtaining confirmation as much as possible and practical. External confirmation procedures frequently are relevant:

- when addressing assertions associated with account balances and their elements. [ISA 330.A48]
- Obtaining audit evidence about the absence of certain conditions. [ISA 330.A48]

Other situations where external confirmations may provide relevant audit evidence include

a. bank balances and other information relevant to banking relationships [ISA 330.A48]
b. accounts receivable balances and terms [ISA 330.A48]
c. inventories held by third parties [ISA 330.A48]
d. property title deeds held by lawyers or financiers for safe custody or as security [ISA 330.A48]
e. amounts due to lenders, including relevant terms of repayment and restrictive covenants
f. accounts payable balances and terms [ISA 330.A48]
g. guarantees
h. contingent liabilities
i. significant transactions outside the normal course of business
j. Related party relationships and related party transactions.

When using external confirmation procedures, the auditor shall maintain control over external confirmation requests, including: [ISA 505.7]

a. determining the information to be confirmed or requested [ISA 505.7(a)]
b. selecting the appropriate confirming party [ISA 505.7(b)]
c. designing the confirmation requests, including determining requests are properly addressed and contain return information for responses to be sent to the auditor, [ISA 505.7(c)]

If management refuses to allow the auditor to send a confirmation request, the auditor shall consider the:

i. Reasonableness of management's refusal [ISA 505.8(a)]
ii. Implications for the assessment of RoMM [ISA 505.8(b)]
iii. Alternative audit procedures [ISA 505.8(c)]

If the auditor concludes that management's refusal to allow the auditor to send a confirmation request is unreasonable, or the auditor is unable to obtain relevant and reliable audit evidence from alternative audit procedures, the auditor shall communicate with the EA/IA and determine the implications for the audit.

Please refer to **Annexure N** and **Annexure O** for templates for external confirmations.

5.4.1. Types of Confirmations

The requests for confirmation may be positive or negative as described below:

Positive confirmations- Positive confirmations request for a direct response from respondents to the auditor in respect to agreeing or disagreeing of the data or information provided by the FAP management or providing the requested information or data. The respondent is requested to response in all cases.

Negative confirmations- These confirmation request the respondent to respond directly to the auditor only if the respondent disagrees with information stated on the request. This method provides less persuasive audit evidence than the positive confirmations since the auditor would be unable to distinguish between those non-respondents who agree with the confirmation request and those who have ignored it.

5.4.2. Reliability of responses to confirmation requests

If the auditor identifies factors that give rise to doubts about the reliability of the response to a confirmation request, the auditor shall obtain further audit evidence to resolve those doubts.

5.4.3. Evaluating the evidence obtained

The auditor shall evaluate whether the results of the external confirmation procedures provide relevant and reliable audit evidence, or whether further audit evidence is necessary. [ISA 505.16]

When evaluating the results of individual external confirmation requests, the auditor may categorize such results as follows: [ISA 505.A24]

a. a response by the appropriate confirming party to a positive confirmation request indicating agreement with the information provided in the confirmation request, or providing requested information without exception [ISA 505.A24]
b. a response deemed unreliable [ISA 505.A24]

c. a non-response, or [ISA 505.A24]
d. a response indicating an exception. [ISA 505.A24]

The auditor shall retain the confirmations received back from third parties as part of audit documentation.

5.5. Management's experts

The auditor shall determine whether to use the work of management's expert as audit evidence for the relevant assertion. The auditor shall evaluate the management's expert and their work for use as audit evidence for the relevant assertion.

If information to be used as audit evidence has been prepared using the work of a management's expert, the auditor shall, to the extent necessary, having regard to the significance of that management's expert's work for audit purposes, evaluate the competence, capabilities and objectivity of that management's expert. [ISA 500.8(a)]

5.6. Written Representation

Written representations are statements that FAP management makes to the auditor concerning matters relating to the financial statements. Representations may be oral or written, formal or informal. They should not be considered as a substitute for other audit evidence the auditor requires to satisfy the audit objectives. Please refer to **Annexure P** for sample template for written representation

5.6.1. Auditor's Responsibility

Auditor shall:

- Obtain written representations from management and, where appropriate, EA/ IA that they believe that they have fulfilled their responsibility for the preparation and fair presentation of the financial statements and for the completeness of information provided to the auditor [ISA 580.6(a)]
- Support other audit evidence relevant to the financial statements or specific assertions in the financial statements by means of written representations if determined necessary by auditor, and [ISA 580.6(b)]
- Respond appropriately to written representations provided by management and, where appropriate, EA/ IA, or if management or, where appropriate, EA/ IA do not provide the written representations requested by auditor. [ISA 580.6(c)].

5.6.2. Individuals from whom auditor request representations

Written representations are requested from those responsible for the preparation and presentation of the financial statements. For Foreign aided projects this will be the FAP management. Written representations may therefore be requested from the Project's Director and Head of Finance or other equivalent persons involved in the project. [ISA 580.A2].
In a multi-location audit, auditor may consider obtaining written representations from management at certain locations.

5.6.3. Information provided and completeness of transactions

Auditor shall request management to provide a written representation that: [ISA 580.11]

a. It has provided all relevant information and access as agreed in the terms of the audit engagement [ISA 580.11] such as:
   i. Completeness and availability of all minutes of meetings FAP Management and EA/IA or summaries of actions of recent meetings for which minutes have not yet been prepared
   ii. Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices.
b. All transactions have been recorded and are reflected in the financial statements. [ISA 580.11]

5.6.4. Other written representations

Sometimes it may be necessary for an auditor to request other written representations, including:

Accounting policies:

Management may include representations about the following: [ISA 580.A10]

- Significant assumptions and judgments made by management, e.g. whether the selection and application of accounting policies are appropriate [ISA 580.A10]
- Management intent, [ISA 580.A10]
- Information that is only known to management, e.g. aspects of laws, regulations and contractual agreements that may affect the financial statements [ISA 580.A10]
- To support other audit evidence relevant to the financial statements or one or more specific assertions in the financial statements.

Control deficiencies:

Auditor may consider it necessary to request management to provide a written representation that it has communicated to the auditor all deficiencies in internal control of which management is aware. [ISA 580.A11].

Specific assertions:

The auditor may consider it necessary to request management to provide written representations about specific assertions in the financial statements. [ISA 580.A13]

5.6.5. Materiality of written representations

Auditor may consider communicating to management a threshold for written representations. [ISA 580.A14] For representation purposes, 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 probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

5.6.6. Structure of written representations

Form of written representations

The written representations shall be in the form of a representation letter addressed to the auditor. [ISA 580.15].

Date of and period(s) covered by written representations

- The date of the written representations shall be as near as practicable to, but not after, the date of the auditors' report(s).
- The written representations shall be for all financial statements and period(s) referred to in the auditors' report(s). [ISA 580.14],

Evaluating the representations received

If auditor have concerns about the competence, integrity, ethical values or diligence of management, or about its commitment to or enforcement of these, he will determine the effect that such concerns may have on the reliability of representations (oral or written) and audit evidence in general.

If auditor conclude that the written representations are not reliable, as required by above auditor shall disclaim an opinion in accordance with ISA 705. [ISA 580.20(a)].

In the case of identified inconsistencies between written representations and audit evidence from another source, auditor may consider whether the risk assessment remains appropriate and, if not, he may revise the risk assessment and determine further audit procedures. [ISA 580.A23]

5.6.7. Requested Written Representations not provided

In case management or others from whom auditor request representations do not provide one or more of the requested written representations, he shall: [ISA 580.19]

- Discuss the matter with management, and, if appropriate, others, including EA/ IA
- Reevaluate the integrity of management or others from whom he requested representations
- Take appropriate actions, including determining the possible effect on auditor opinion

5.7. Subsequent Events

Subsequent events are events occurring between the date of financial statements and the date of the auditor's report, and facts that become known to the auditor after the date of the auditor's report.

Financial statements may be affected by certain events that occur after the date of the financial statements or even after the auditors' report. These events provide evidence of:

- Conditions that existed at the date of the financial statements; and
- Conditions which arose after the date of the financial statements. (ISSAI 1560.2).

In order to adequately consider the events subsequent to the audit of financial statements, the auditor should:

- Obtain sufficient appropriate audit evidence about whether all events which have occurred between the date of the financial statements and the date of the auditor's report and require adjustment of, or disclosure in, the financial statements are appropriately reflected in accordance with the applicable financial reporting framework; and
- Respond appropriately to facts that become known to the auditor after the date of the auditor's report, that, had they been known to the auditor at that date, may have caused the auditor to amend the auditor's report. (ISSAI 1560.4)

The auditor should perform audit procedures designed to ensure that all events that may require adjustment of, or disclosure in, the financial statements have been identified including those after the financial year-end up to date of the auditor's report. These procedures are in addition to procedures which may be applied to specific transactions occurring after period end to obtain audit evidence as to account balances as at period end. Auditors in public sector should also refer to any additional legislative requirements regarding auditing events subsequent to balance sheet date. (ISSAI 1560 P4; P5)

Public sector auditors may also consider the events that occurred have relevance in the performance of program objectives and its impact in the presentation and disclosure of financial statements. For such event identified, the auditor should ensure that whether events have been adequately disclosed in line with relevant reporting frameworks.

Auditor may consider the impact of subsequent events in the next year's financial statements where significant time has passed since the last financial statements to which the subsequent event relates.

5.8. Disclosures in the financial statements

The auditor should obtain sufficient appropriate audit evidence about whether related disclosures in the financial statements are adequate [ISA 540.6] in the context of the applicable financial reporting framework. [ISA 540.6]

In evaluating whether the financial statements appropriately disclose the significant accounting policies selected and applied, auditor consideration includes matters such as: [ISA 700.A4]

- Whether all disclosures related to the significant accounting policies that are required to be included by the applicable financial reporting framework have been disclosed [ISA 700.A4]
- Whether the information about the significant accounting policies that has been disclosed is relevant [ISA 700.A4]
- The clarity with which the significant accounting policies have been presented. [ISA 700.A4]

There may be cases where the financial statements, although prepared in accordance with the requirements of the financial reporting framework, do not achieve fair presentation. Where this is the case, it may be possible for management to include additional disclosures in the financial statements beyond those specifically required by the framework or, in extremely rare circumstances, to depart from a requirement in the framework in order to achieve fair presentation of the financial statements. [ISA 700.A16].
Communications of the auditor with EA/ IA about significant qualitative aspects of the project's accounting practices, may include:

- The issues involved, and related judgments made, in formulating particularly sensitive financial statement disclosures (e.g. disclosures related to, remuneration, going concern, subsequent events and contingency issues) [Appendix 2 of ISA 260]
- The overall neutrality, consistency and clarity of the disclosures in the financial statements. [Appendix 2 of ISA 260]

Since auditor have sole responsibility for the audit opinion expressed, auditor need to make the significant judgments in the audit engagement. Significant judgments include, but are not limited to, the following: [ISA 610.A19]

- Assessing the risks of material misstatement [ISA 610.A19]
- Evaluating the sufficiency of tests performed [ISA 610.A19]
- Evaluating significant accounting estimates, and [ISA 610.A19]
- Evaluating the adequacy of disclosures in the financial statements, and other matters affecting the auditors' report. [ISA 610.A19]

Auditor responsibility to consider laws and regulations in an audit

Laws & Regulations having direct effect:

Certain laws and regulations are well-established, known to the FAP Management and within the project's industry or sector, and relevant to the FAP financial statements. These laws and regulations generally are directly relevant to the determination of material amounts and disclosures in the financial statements and readily evident to the auditor. They could include those that relate to, for example: [ISA 250.A8]

- The form and content of financial statements [ISA 250.A8]
- Industry-specific financial reporting issues [ISA 250.A8]
- Accounting for transactions under government contracts [ISA 250.A8]
- The accrual or recognition of expenses for pension costs, or [ISA 250.A8]
- Employment and social security regulations.

The auditor will obtain sufficient appropriate audit evidence regarding the determination of amounts and disclosures in the financial statements in compliance with the relevant provisions of those laws and regulations. [ISA 250.A8]

Laws & Regulations having indirect effect:

Other laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements, but compliance with which may be fundamental to the operating aspects of the business, or to avoid material penalties (for example, compliance with the terms of an operating license, compliance with regulatory solvency requirements, or compliance with environmental regulations); non-compliance with such laws and regulations, including illegal acts, may therefore have a material effect on the financial statements [ISA 250.6].

The Auditor should identify non-compliance with those laws and regulations, including illegal acts that may have a material effect on the financial statements

Chapter 6:
COMPLETION

This chapter covers the final audit procedures to be carried out before preparation of the audit report. Specific areas include:

Update of Risk Assessment: The risk assessment process undertaken at the time of audit planning will be updated at this stage of the proceedings.
Final analytics: Process for carrying out final analytical procedures.
Overall Evaluation: Process for carrying out an overall evaluation at the completion stage including evaluation of evidence, fraud risk and accounting processes.
Communication with FAP management: Guidelines for communication with FAP management, EA/IA and third parties and preparation of management letter.

6.1. Inspection of minutes of meetings held after end date of financial statements

Auditor shall update his inspection of minutes, if any, of the meetings of FAP management and EA/IA, including relevant committees, that have been held after the date of the financial statements and inquire about matters discussed at any such meetings for which minutes are not yet available, up to the date of the auditors' report(s), or as near as practicable thereto. [ISA 560.7(c)]

During our completion activities, auditor shall also review the inquiries and observation and other inspection procedures performed during risk assessment to determine whether there is a need to update them.

6.2. Final analytics

Auditor shall read the financial statements and disclosures, and design and perform final analytical procedures near the end of the audit, through the end of the reporting period, that assist auditor: [ISA 520.6]

- When forming an overall conclusion as to whether the financial statements are consistent with understanding of the entity [ISA 520.6]
- In evaluating our conclusions formed regarding individual components or elements of the financial statements; and
- When forming an opinion on whether the financial statements as a whole are free of material misstatement.

In addition, the results of final analytical procedures may identify a previously unrecognized risk of material misstatement. In such circumstances, the auditor will revise assessment of the risks of material misstatement and modify the further planned audit procedures accordingly. [ISA 520.A18]

Auditor shall also evaluate whether final analytical procedures indicate a previously unrecognized fraud risk. [ISA 240.34]

6.2.1. Considerations pertaining to auditor's assessment of fraud risks – final analytics

Final analytical procedures may be helpful in identifying particular trends and relationships that affect the assessment of fraud risks made earlier in the audit and determining whether there is a need to perform additional or different audit procedures.

Determining which particular trends and relationships may indicate a fraud risk involves professional judgment. Certain unusual or unexpected transactions, events, amounts, or relationships could indicate a fraud risk if a component of the relationship involves accounts and disclosures that FAP management has incentives or pressures to manipulate.

6.2.2. Methods to perform final analytical procedures

Auditor generally use trend analysis, ratio analysis, or a combination thereof. The auditor may also use data analysis and predictive analysis, if considered necessary.

6.2.3. Designing final analytical procedures

The final analytical procedures may be similar to those that would be used for planning analytical procedures, as they may: [ISA 520.A19]

- Include both financial and, when available and relevant, non-financial information;
- Involve either aggregated (e.g. data at the financial caption level) or disaggregated financial data (e.g. data at a more detailed level than the financial caption level), or a combination of both.

Final analytical procedures are performed on the final adjusted amounts included in the financial statements or on unadjusted amounts if the effect of significant recorded adjustments is considered and documented.

If final analytical procedures identify fluctuations or relationships that are inconsistent with other relevant information or that differ from expected values by a significant amount, auditor shall investigate such differences by: [ISA 520.7]

a. Inquiring of FAP management and obtaining sufficient appropriate audit evidence in support of FAP management's responses to inquiries; and [ISA 520.7]
b. Performing other audit procedures as necessary in the circumstances, including when responses to inquiries appear to be implausible, inconsistent with other audit evidence, imprecise, or not at a sufficient level of detail to be useful.[ISA 520.7]

6.3. Overall Evaluation

6.3.1. Evaluation of audit evidence

Evaluation is primarily a qualitative matter based on auditor judgment. Such an evaluation may provide further insight about the fraud risks and whether there is a need to perform additional or different audit procedures. [ISA 240.A49]
Evaluation relies on preparation of sufficient and appropriate audit documentation on a timely basis that helps to enhance the quality of the audit, and facilitate the effective review and evaluation of audit evidence obtained and conclusions reached before the auditors' report(s) is finalized. [ISA 230.A1]

Auditor shall request further clarifications of the examined transactions, account balances disclosures and corrected misstatements from the FAP management. Moreover, auditor shall perform additional audit procedures to determine whether any misstatements remain. This requirement does not apply to instances of non-compliance with authorities or control deviations. Even if a transaction is correctly shown in the financial statements, if the transaction was unlawful or the control was not followed, by its nature it represents an instance of non-compliance with authorities or a control deviation or deficiency.

6.3.2. Considerations pertaining to auditor's assessment of fraud risks – audit evidence

Auditor shall identify and assess financial statement level fraud risks.

Auditor exercises professional judgment to determine whether it is appropriate to rebut the presumed risk of fraud, after considering and evaluating the facts and circumstances of the audit including: [ISA 240.A30]

- Limited perceived opportunity to commit fraud;
- Auditor has not identified any other assertion level fraud risks.

6.4. Communication with FAP management

Auditor shall communicate to FAP management at an appropriate level of responsibility on a timely basis: [ISA 265.10]

- In writing, significant deficiencies in internal control that we have communicated or intend to communicate to EA/IA, unless it would be inappropriate to communicate directly to FAP management in the circumstances, and [ISA 265.10(a)]
- In writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to FAP management by other parties and that, in our professional judgment, are of sufficient importance to merit FAP management's attention. [ISA 265.10(b)]

Auditor shall include in the written communication of significant deficiencies in internal control: [ISA 265.11]

- A description of the deficiencies and an explanation of their potential effects, and [ISA 265.11(a)]
- Sufficient information to enable EA/IA and FAP management to understand the context of the communication. [ISA 265.11(b)]

6.4.1. Exit Meetings

The Auditor shall carry out exit meetings with FAP management upon completion of field work. In addition to open communications during audit, it is a good practice to arrange a meeting with senior FAP management at the end of the fieldwork at each location. 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 the Director and Director General prior to discussing with FAP management. Where potentially sensitive matters are involved, the audit team leader should get instructions from the Director before the exit briefing.
Request for such meetings may be issued in a written format (such as via email) specifically asking the management to acknowledge such a request specifically mentioning the data of closing of field work. The auditor may consider issuing reminders for the request if not entertained by the management depending on

the time available for the fieldwork. In case of non-response by the management, the auditor should issue a written notification over the lack of response by the management to hold an exit meeting.

Exit meetings are significant as any additional information, explanations, documentary evidence are expected to be obtained from the management to make appropriate judgment on the audit findings. It can further help the auditor in reconfirming or modifying the audit conclusions and enable the auditor in making suitable modification in audit conclusions based on the management response.

Audit findings can be resolved after obtaining convincing replies, evidence or explanations from the management in the meeting. During the course of the audit, the auditor at different stages will have communicated the audit findings and request for additional evidence to those responsible for resolving those findings. The outcome of the exit meeting with the management and discussion minutes should be documented in the audit working files.

Issues discussed should be written in the exit meeting minute to ensure that the Project's management does not refute the issue later on (e.g. when certain documents and information are not available, projects management may later claim that supporting were made available for auditor's review).

Exit Meetings in case of decentralized sites

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 FAP management at the site cannot be done after the senior audit management has reviewed the audit findings. This means that the auditor should provide feedback to FAP management at the decentralized site prior to conducting a full review of findings.

6.4.2. Management Letter

At this stage of the audit, the transaction testing and related working papers should be completed and reviewed.

The auditor shall draft a management letter whilst ensuring that all audit findings have been comprehensively covered. Contents of the draft management letter root from unresolved audit queries.

The draft management letter will be shared with FAP management thereby ensuring audit findings have been formally considered and communicated to FAP. This allows the FAP management an opportunity to clarify and/or remediate the findings so that the same can be resolved prior to finalization of the management letter and any implications such findings may have on the auditor's report.

For each audit finding, the draft management letter shall exhibit:

- Title of observation;
- Area of expenditure;
- Criteria;
- Conditions;
- Causes and consequences, where possible;
- Recommendations;
- Management response; and
- Auditor's comments;

- DAC recommendations;
- Conclusion by the auditor.

The following are the definitions of the elements of a finding:

Criteria: The laws, regulations, contracts, grant/ loan agreements with development partners, standards, measures, expected performance, defined project practices and benchmarks against which performance is compared or evaluated. Criteria identify the required or desired state or expectation with respect to the program or operation and provide a context for evaluating evidence and understanding the findings.

Condition: Condition is a situation that exists. The condition is determined and documented during the audit.

Cause: The cause identifies the reason or explanation for the condition or the factor or factors responsible for the difference between the situation that exists (condition) and the required or desired state (criteria), which may also serve as a basis for recommendations for corrective actions. Common factors include poorly designed policies, procedures, or criteria; inconsistent, incomplete, or incorrect implementation; or factors beyond the control of program management. Auditors may assess whether the evidence provides a reasonable and convincing argument for why the stated cause is the key factor or factors contributing to the difference between the condition and the criteria.

Effect or potential effect: The effect is a clear, logical link to establish the impact of the difference between the situations that exists (condition) and the required or desired state (criteria).The effect or potential effect identifies the outcomes or consequences of the condition. When the audit objectives include identifying the actual or potential consequences of a condition that varies (either positively or negatively) from the criteria identified in the audit, “effect” is a measure of those consequences. Effect or potential effect may be used to demonstrate the need for corrective action in response to identified problems or relevant risks.

Please refer to Annexure Q for a template of the Management Letter.

6.4.3. Documentation of Communication

Where matters have been communicated in writing, auditor shall retain a copy of the communication as part of the audit documentation. [ISA 260.23]

Documentation of oral communication may include a copy of minutes prepared by the project retained as part of the audit documentation where those minutes are an appropriate record of the communication. [ISA 260.A54].

6.5. Communication with EA/IA

Auditor shall communicate with EA/IA:

- Uncorrected misstatements and the effect that they, individually or in aggregate, may have on the opinion in the auditors' report, unless prohibited by law or regulation. This communication shall identify material uncorrected misstatements individually. Auditor shall request that uncorrected misstatements be corrected. [ISA 450.12]
- The effect of uncorrected misstatements related to prior periods on the relevant accounts or disclosures, and the financial statements as a whole. [ISA 450.13]
- Significant deficiencies in internal control identified during the audit. [ISA 265.9]

Where there is a large number of individual immaterial uncorrected misstatements, auditor may communicate the number and overall monetary effect of the uncorrected misstatements, rather than the details of each individual uncorrected misstatement. [ISA 450.A27]

Unless all of EA/IA are involved in managing the entity, auditor shall communicate with EA/IA the written representations auditor has requested from FAP management. [ISA 260.16(c)(ii)]

Auditor may discuss with EA/IA the reasons for, and the implications of, a failure to correct misstatements, having regard to the size and nature of the misstatement judged in the surrounding circumstances, and possible implications in relation to future financial statements. [ISA 450.A28]

6.6. Communications with third parties

The auditor needs to consider informing regulatory and enforcement authorities of matters that have come to the auditor’s attention relating to:

- Actual or suspected fraud; and
- Non-compliance with laws and regulation including illegal acts.

Prior to undertaking communications with regulatory and enforcement authorities, the auditor shall undertake appropriate consultations within the Field Audit Offices, Office of the AGP and legal counsel.

When written communications containing information pertinent to FAP are provided to third parties, the auditor shall consider informing third parties that the respective communications are not prepared with them in mind, for example, by stating in written communications that: [ISA 260.A43]

a. Communication has been prepared for the sole use of FAP’s management and should not be relied upon by third parties [ISA 260.A43]
b. No responsibility is assumed by the auditor to third parties, and [ISA 260.A43]
c. There may be restrictions on disclosure or distribution of the information contained in the correspondence. [ISA 260.A43]

Other relevant communications with third parties including communications with lawyers and vendors have been covered in relevant sections of the manual.

Chapter 7:
REPORTING

This chapter aims to provide guidance to the auditor during the preparation and issuance phase of the audit report, focusing on the process of forming and expressing an independent opinion on the financial statements. Areas covered in this chapter are:

Development Partner' reporting requirements: Deals with understanding & fulfilling the reporting requirements of the development partners.
Forming an opinion: Provide framework for understanding & dealing with the factors effecting the auditor's report when formulating an opinion.
Different forms of opinions: Detailed descriptions of different forms of audit opinions and the difference between modified and unmodified report with relevant circumstances resulting in each.
Limitation on the scope of audit: Standard procedures regarding the imposed limitations on the scope of audit.
Key Audit matters: Deals with the auditor's responsibility to communicate key audit matters in the auditor's report.
Follow up of management letter: Deals with the issuance and follow up of management letter outlining control deficiencies.

7.1. Development Partner reporting requirements

In the audit of Foreign-aided Projects, the development partner will often have their own reporting requirements for the audit of foreign aided projects. The audit team should ensure that specific requirements of the development partner are met.

The auditor assigned to FAP audit shall obtain thorough knowledge and understanding of the development partners' audit methodology, scope and reporting requirements. The auditor shall have access through the Officer of the AGP to any relevant material required to develop an understanding of development partners' audit and reporting requirements.

The auditor shall also determine whether any changes have been introduced in the development partners' reporting requirements and familiarize himself with such changes.

7.2. Forming an opinion on the financial statements

The auditor will form an opinion based on the work of the audit team on whether the financial statements are prepared and presented fairly, in all material respects, in accordance with the applicable financial reporting framework. [ISA 700.10, ISA 700.12]

The auditor shall conclude as to whether he has obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. In doing so, he will: [ISA 700.11]

- Conclude, whether sufficient appropriate audit evidence has been obtained;
- Conclude, whether uncorrected misstatements are material, individually or in aggregate; and
- Evaluate the qualitative aspects of the project's accounting practices, including existence of significant assets where financial statements are prepared under IPSAS cash basis, and indicators of possible management bias towards contingencies that need to be disclosed;
- Evaluate, whether the financial statements adequately refer to or describe the applicable financial reporting framework [ISA 700.11(c)].

As the basis for opinion, Auditor will obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error.

Reasonable assurance is a high level of assurance reached when the auditor has obtained sufficient appropriate audit evidence to reduce audit risk to an acceptably low level. However, reasonable assurance is not an absolute level of assurance, because there are inherent limitations of an audit which result in most of the audit evidence on which auditor draw conclusions and base the opinion being persuasive rather than conclusive. [ISA 200.5].

Where FAP management refuses to adjust the financial statements containing material misstatements the auditor shall consider reasons for the refusal by management and evaluate whether the matter will cause the audit report to be modified

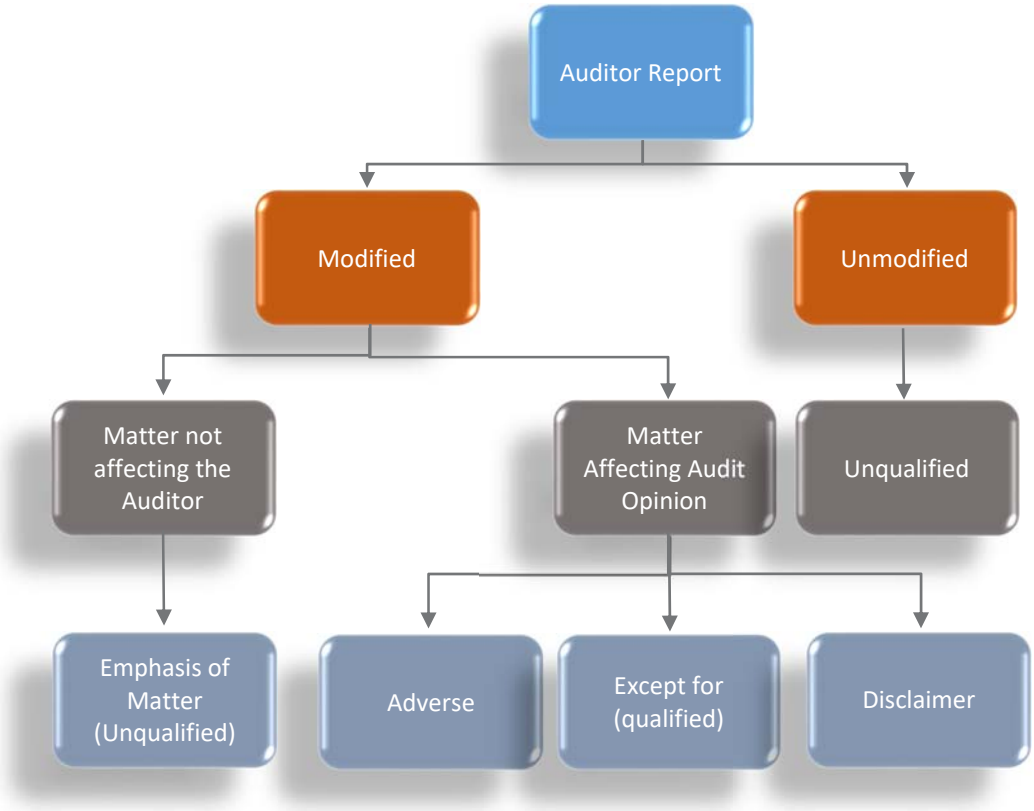
7.3. Report Preparation

Auditors are required to provide a report in accordance with a layout prescribed by the respective development partner and to use the required layout or wording in the report.

Understandability of reports – The audit report should be easy to read and understand. Clarity and understandability may be enhanced by:

- Use of non-technical language. All technical terms, unfamiliar abbreviations and acronyms should be clearly defined when used;
- Logical organization of material;
- Accuracy and precision in stating facts and in drawing conclusions;
- Effective use of titles and captions and topic sentences; and
- The audit report should be no longer than necessary to convey and support the message. Needless repetition should be avoided.

7.4. Different forms of Opinions



The audit report should contain a clearly written expression of opinion on the financial information. An auditor's opinion may be:

- Unmodified;
- Modified.

An unqualified opinion indicates the auditor's satisfaction in all material respects with the matters dealt with in the paragraphs above. When a qualified opinion, adverse opinion, or a disclaimer of opinion is given, the audit report should state in a clear and informative manner all of the reasons for such an opinion.

7.4.1. Unmodified Opinion

An unqualified opinion is given when the auditor is satisfied in all material respects that:

- The financial statements have been prepared using acceptable accounting bases and policies which have been consistently applied;
- The statements comply with statutory requirements and relevant regulations;
- The view presented by the financial statements is consistent with the auditor's knowledge of the audited FAP; and
- There is adequate disclosure of all material matters relevant to the financial statements."

The introductory paragraph: This identifies the financial statements covered by the auditor's opinion and distinguishes the responsibilities of management and the responsibilities of the auditor.

The scope paragraph: In this paragraph the auditor informs the reader that the audit was planned and performed in accordance with professional standards, and that the auditor has made judgments in applying these standards. It also provides the reader with some explanation of the nature and extent of an audit and the degree of assurance it provides.

The wording of an unqualified opinion is that "In our opinion,

- ***The financial statement present fairly, in all material respects, the cash receipt & payments by the project for the year ended------, in accordance with cash basis IPSAS, Financial Reporting under the Cash Basis of Accounting Standard.***
- ***The expenditure has been incurred in accordance with the requirements of legal agreement.***

7.4.2. Modified Opinion

The auditor should appropriately modify the opinion in the auditor's report when the auditor:

i. Concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement; or
ii. Is unable to obtain sufficient appropriate audit evidence.
iii. Determines that the auditee did not comply with responsibilities prescribed by the financial reporting framework to:
   - Achieve fair presentation of financial information.
   - Fulfil all requirements of the financial reporting framework.
iv. Any additional audit requirements, such as non-compliance with development partner requirements, legislation or internal control weakness which has a material or pervasive effect on the financial statements as it is not adequately disclosed or accounted for. (ISSAI 1705 P4-P6)

a. Qualified Opinion

The table below illustrates how the auditor judgment about the nature of the matter giving rise to the modification, and the pervasiveness of its effects or possible effects on the financial statements, affects the type of opinion to be expressed. [ISA 705.A1]

Materiality
Misstatements, including omissions, are considered material if individually or in the aggregate could influence the economic decisions, of users, taken on the basis of the financial statements.

Pervasiveness:
Pervasive is a term used to describe the effects on the financial statements of misstatements or possible effects, if any, which are undetected due to an inability to obtain sufficient and appropriate audit evidence. Pervasiveness of the finding will determine the kind of modified audit opinion which will be issued. Pervasive effects on the financial statements are those that, in the auditor's judgment:

- Are not confined to specific elements, accounts or items of the financial statements;
- Represent or could represent a substantial proportion of the financial statements; or
- Fundamental to users' understanding of the financial statements.

Nature of the matter giving rise to the modification	Auditor judgments about the pervasiveness of the effect or possible effects on the financial statements	
	Material but not pervasive	**Material & Pervasive**
Financial statements are materially misstated	Qualified Opinion	Adverse Opinion
Inability to obtain sufficient appropriate audit evidence	Qualified Opinion	Disclaimer of opinion

A qualified opinion should be expressed when the auditor has obtained ***sufficient appropriate audit evidence concludes that there are material misstatements in the financial statements*** or if the auditor cannot obtain adequate evidence on aspects of the audit.

Qualified opinion is issued when the misstatement or limitation on scope is material but not pervasive so as to require an adverse opinion or a disclaimer of opinion. It is expressed as being 'except for' the effects of the matter to which the qualification relates.

In accordance with Auditing Standards, Qualified Opinion shall be issued when any of the following circumstances occur, and when the auditor believes that the effect is or may be material:

- A scope limitation;
- A departure from the accounting principles; or
- Uncertainty affecting the financial statements.

Scope Limitation: In some circumstances, some difficulties may constitute a scope limitation that leads to a modification of the auditors' opinion.

Departure from accounting principles: A departure from the accounting principles occurs when there is:

- An inappropriate accounting treatment, such as the failure to record certain transactions or events that are required to be disclosed by the applicable stated accounting policies;
- A failure to disclose all of the information required, such as not segregating expenditures into all the categories that are called for by underlying grant/loan legal agreements; and

Uncertainty: An uncertainty normally involves a significant contingency or other event that is primarily dependent on future developments or future decisions by parties other than project officials.
The decision regarding which type of modified opinion is appropriate depends upon: [ISA 705.2]

- The nature of the matter giving rise to the modification, that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated, and [ISA 705.2(a)]
- Auditor judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements. [ISA 705.2(b)]

In case of a qualified opinion on the audit, a Basis for the Qualified Audit Opinion paragraph will be added, wording as follows:

"The Letter of the Credit (L/C), Bill of lading, L/C retiring documents & other documents in respect of PKR XXX imports included in the Statements of Receipts & Payments were not available for audit examination, & we were unable to satisfy ourselves through alternative audit procedures as to the legitimacy of these expenditures".

The wording of a qualified opinion will be "***In our opinion, except for the possible effects of the matter described in the Basis for the Qualified Opinion paragraph:***

- ***The financial statement present fairly, in all material respects, the cash receipt & payments by the project for the year ended------, in accordance with cash basis IPSAS, Financial Reporting under the Cash Basis of Accounting Standard.***
- ***The expenditure has been incurred in accordance with the requirements of legal agreement.***

b. Adverse opinion

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

If the auditor concludes that: [ISA 510.12]

- The current period's accounting policies are not consistently applied in relation to opening balances in accordance with the applicable financial reporting framework, or [ISA 510.12(a)]
- An adverse opinion can also be issued when there is a departure from the accounting principles that is:
- So pervasive and fundamental that the auditor is unable to describe clearly how the financial statements are affected; or
- So significant that it overshadows a clear description of how the financial statements are affected.

As with a qualified opinion, a reservation paragraph should be inserted between the scope paragraph and the opinion paragraph. The reservation paragraph should clearly and concisely describe all the matters of disagreement, and the financial effect should be quantified where relevant and practicable.

The wording of the reservation paragraph shall be as follows:
Procurements payments of PKR XXX included in the Statement of Receipt & Payments were not eligible for financing under the financing agreement no-----. As a result, payments are overstated by PKR XXX in the Statement of Receipts & Payments.

In these circumstances, a qualified opinion would not be adequate. The wording of an adverse opinion makes it clear that ***"In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph:***

- ***The financial statements do not properly present, in all material respects, the cash receipts & the payment by the project for the year ended----, in accordance with the Cash Basis IPSAS , Financial Reporting under the cash basis of Accounting Standard; or,***
- ***The expenditure has not been incurred in accordance with the requirements of legal agreement".***

c. Disclaimer of opinion

Where the auditor is unable to arrive at an opinion regarding the financial statements taken as a whole due to a scope limitation or uncertainty that is so fundamental, pervasive or significant that a qualified opinion

would not be adequate, a disclaimer is given. The wording of the disclaimer makes it clear that an opinion cannot be given.

As with a qualified and an adverse opinion, a reservation paragraph should be inserted between the scope paragraph and the opinion paragraph. The reservation paragraph should clearly and concisely describe the reason for the disclaimer.

The Reservation/ Basis for disclaimer of opinion paragraph shall state that, ***"Books of accounts & other supporting documentation were not maintained by the Project. As a result we were unable to obtain sufficient appropriate audit evidence to form an opinion".***

In this case the Opinion Paragraph would be amended to state something to the effect that, "***In my opinion, because of the significance of the matter described in the basis for disclaimer of opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide to provide a basis for audit opinion. Accordingly, we do not express an opinion on the financial statement".***

The scope paragraph should be amended by inserting "***Except as explained in the following paragraph" at the start.***

7.4.3. Modified report with unmodified opinion

Auditors should draw users' attention to a matter or matters presented or disclosed in or outside the financial statements that are important for users' understanding of the financial statements or the auditor's report. These matters should be included in an emphasis of matter or an 'other matter' paragraph. (ISSAI 1700 P4) (ISSAI 1706.5)

The auditor may select to issue an unqualified opinion with an emphasis of matter or with other matter. In this circumstance, the report will have to include a paragraph on the matter.

Communicating with EA/ IA the expectation to include an Emphasis of Matter paragraph or an Other Matter paragraph in the auditors' report(s) and the wording of this paragraph: [ISA 706.A18]

- Enables EA/ IA to be made aware of the nature of any specific matters that auditor intends to highlight in the auditors' report(s), and [ISA 706.A18]
- Provides them with an opportunity to obtain further clarification from the auditor where necessary. [ISA 706.A18]

In the case of restated financial statements, auditor shall include in the new or amended auditors' report, an Emphasis of Matter paragraph or Other Matter(s) paragraph referring to a note to the financial statements that more extensively discusses the reason for the restatement of the previously issued financial statements and to the earlier report(s) provided by the auditor. [ISA 560.16].

Emphasis of Matter Paragraph

Emphasis of matter paragraph refers to a matter appropriately presented or disclosed in the financial statements that, in the auditor's judgment, is of such importance that it is fundamental to users' understanding of the financial statements. Examples of circumstances where the auditor may consider it necessary to include an Emphasis of Matter paragraph are:

i. An uncertainty relating to the future outcome of exceptional litigation or regulatory action.
ii. A major catastrophe that has had, or continues to have, a significant effect on the project's financial performance.
iii. Bringing attention to the following aspects:
   - Non-compliance with legislation
   - Legislative actions on programs or the budget
   - Contradictive laws, regulations or directives with a significant effect on the Project.
   - Fraud, abuse or losses
   - Significant transactions
   - Significant internal control weaknesses
   - Questionable practices
   - Transactions entered into without due regard for economy
   - Prior period restatements
   - Environmental Issues
   - Propriety issues (proper behavior by public officials).

The Emphasis of Matter Paragraph in the Auditor's Report shall be stated as, "***Without qualifying our opinion, we draw your attention to Note X of the financial Statements relating to the payments by third parties. Under IPSAS Cash Basis disclosure of third party payments are a mandatory part of general purpose financial statements and should be disclosed separately on the face of the Statement of receipts & Payments of the [Project Name]. [Project Name] has disclosed third party payments as NIL on the basis that neither [Project Name] has formally advised by the third party or the recipients nor such payments have otherwise been verified. To fully capture third party payments [Project Name] needs to strengthen its existing accounting & financial reporting system.***

Other Matter Paragraph:

Other matter paragraph includes findings relating to matters relevant to the users of the report but not presented or disclosed in the financial statements. Other matter paragraphs normally include control weaknesses or non-compliance with laws and regulations as applicable.

7.5. Limitations on scope of the audit

A scope limitation occurs when the auditor is not able to apply all the tests and procedures considered necessary in the circumstances and, as a result does not have sufficient appropriate audit evidence to form an opinion as to whether the financial statements give a true and fair view, in all material respects, in accordance with the accounting principles.
Scope limitations may arise in a number of situations, including:

- Circumstances beyond the control of the FAP Management or the auditor, such as the destruction of accounting records in a fire;
- A limitation imposed by the FAP Management such as:
  - Refusing to allow the auditor to perform certain audit procedures; and
  - Failure to maintain adequate accounting records or internal control structures.

When the auditor has a scope limitation, the reporting objective is to inform the reader that the auditor:

- Has been unable to perform specific tests and procedures and obtain certain audit evidence; and, as a result,
- Is unable to determine whether or not there has been a departure from the accounting principles that materially affects the financial statements.

If the two-way communication between auditor and EA/ IA is not adequate and the situation cannot be resolved, auditor may take actions such as: [ISA 260.A53]

- Modifying the opinion on the basis of a scope limitation [ISA 260.A53]
- Communicating with third parties (e.g. a regulator), or a higher authority in the governance structure that is outside the project [ISA 260.A53]

7.5.1. Limitation on scope imposed by management

If, after audit initiation, auditor becomes aware that management has imposed a limitation on the scope of the audit that the auditor consider likely to result in the need to express a qualified opinion or to disclaim an opinion on the financial statements, then they shall request that management remove the limitation. [ISA 705.11]

If management refuses to remove the limitation, auditor will communicate the matter to EA/ IA, and determine whether it is possible to perform alternative procedures to obtain sufficient appropriate audit evidence. [ISA 705.12]

If auditor is unable to obtain sufficient appropriate audit evidence due to a management-imposed limitation, then they will determine the implications as follows: [ISA 705.13]

- If auditor conclude that the possible effects on the financial statements of undetected misstatements, if any, could be material but not pervasive, auditor will qualify the opinion, or [ISA 705.13(a)]
- If auditor conclude that the possible effects on the financial statements of undetected misstatements, if any, could be both material and pervasive so that a qualification of the opinion would be inadequate to communicate the gravity of the situation, auditor shall disclaim an opinion on the financial statements. [ISA 705.13(b)]

The audit may consider withdrawal from the audit, however, such a course of action may not be practicable given the development partner requirements for issuance of a report. If auditor has substantially completed the audit, he may decide to complete the audit to the extent possible, disclaim an opinion and explain the scope limitation within the Basis for Disclaimer of Opinion section. [ISA 705.A13]. Auditor may also consider it necessary to include an Other Matter paragraph in the auditors' report. [ISA 705.A14]

In certain instances, the auditors may find that the scope limitation is imposed by parties other than management, including those charged with governance or legislation and regulations on classification of information for example due to national security.

7.6. Comparative information disclosed in the financial statements

Corresponding figures refer to comparative information where amounts and other disclosures for the prior period are included as an integral part of the current period financial statements.

The auditor should obtain sufficient and appropriate audit evidence to be able to report about whether the comparative information included in the financial statements has been presented, in all material respects, in accordance with the requirements for comparative information in the applicable financial reporting frameworks.

If the auditor identifies a possible material misstatement in the comparative information during the current audit, the auditor should perform additional audit procedures to determine whether a material misstatement exists. If the prior period financial statements are corrected, the auditor shall determine that the comparative information agrees with the amended financial statements.

When the prior period financial statements are not audited, the auditor should state in the auditor's report that the corresponding figures or comparative financial statements are unaudited as applicable.

7.6.1. Reporting on corresponding figures

When corresponding figures are presented, the auditor's opinion should not specifically refer to the corresponding figures, since the audit opinion is on the current period financial statements as a whole, including those figures.

When the auditor's report on the prior period, as previously issued, included a qualified opinion, disclaimer of opinion, or adverse opinion and the matter which gave rise to the modification is resolved and properly dealt with in the financial statements, the current report should not refer to the previous modification. It may, however be appropriate to include an 'Other Matter' paragraph. (ISSAI 1710 P5)

However, if the matter is unresolved, it needs to be considered in light of the current year's financial statements. If it is material to the current period, the auditor should modify the current years report accordingly. The Basis for Modification paragraph in the auditor's report should either:

- Refer to both the current period's figures and the corresponding figures in the description of the matter giving rise to the modification when the effects or possible effects of the matter on the current period's figures are material; or
- In other cases, explain that the audit opinion has been modified because of the effects or possible effects of the unresolved matter on the comparability of the current period's figures and the corresponding figures. (ISSAI 1710.11)

The auditor may identify a material misstatement affecting the previous year's financial statements where an unmodified audit opinion was issued. In such circumstances, the auditor should consider whether the corresponding figures have been restated or not. If the corresponding figures have not been properly restated and/or appropriate disclosures have not been made, the auditor should request management to revise the corresponding figures or if management refuses to do so, appropriately modify the report.

If, in very rare circumstances the prior period financial statements were not audited, the auditor should state in an Other Matter paragraph in the auditor's report that the corresponding figures are unaudited. The auditor then should obtain sufficient appropriate audit evidence that the opening balances do not contain misstatements that materially affect the current period's financial statements.

7.6.2. Reporting on comparative financial statements

When the comparatives are presented as comparative financial statements, the auditor's opinion should refer to each period for which financial statements are presented and on which an audit opinion is expressed.

When reporting on the prior period financial statements in connection with the current year's audit, if the opinion on such prior period financial statements is different from the opinion previously expressed, the auditor should disclose the substantive reasons for the different opinion in an emphasis of matter paragraph.

7.7. Supplementary information presented with audited financial statements

The auditor should be satisfied that any supplementary information presented together with the financial statements that is not covered by the auditor's opinion is clearly differentiated from the audited financial statements. If the auditor concludes that the project's presentation of any unaudited supplementary information does not differentiate it sufficiently from the audited financial statements, the auditor should explain in the auditor's report that that information has not been audited. (ISSAI 1700.46)

Supplementary information that is not required by the applicable financial reporting framework but is nevertheless an integral part of the financial statements because it cannot be clearly differentiated from the audited financial statements due to its nature & how it is presented shall be covered by the auditor's opinion. (ISSAI 1700.47).

7.8. Key audit matters

7.8.1. Determining key audit matters

Key audit matters are those matters that, in auditor professional judgment, were of most significance in the audit of the financial statements of the current period. [ISA 701.10]

Auditor shall determine matters that required significant auditor attention in performing the audit. In making this determination, auditor shall take into account the following: [ISA 701.9, ISA 701.A29]

- Significant risks or financial statement level risks identified;
- Significant auditor judgments relating to areas in the financial statements that involved significant management judgment;
- The effect on the audit of significant events or transactions that occurred during the period;
- The importance of the matter to intended users' understanding of the financial statements as a whole, in particular, its materiality to the financial statements;
- The nature and materiality, quantitatively or qualitatively, of corrected and accumulated uncorrected misstatements due to fraud or error related to the matter, if any;
- The nature and extent of audit effort needed to address the matter, including: [ISA 701.A29]
  - The extent of specialized skill or knowledge needed to apply audit procedures to address the matter or evaluate the results of those procedures, if any [ISA 701.A29].
  - The nature of consultations outside the audit team regarding the matter [ISA 701.A29]
  - The nature and severity of difficulties in applying audit procedures, evaluating the results of those procedures, and obtaining relevant and reliable evidence on which to base auditor opinion, in particular as auditor's judgment become more subjective; [ISA 701.A29]
  - The severity of any control deficiencies identified relevant to the matter [ISA 701.A29].
  - Whether the matter involved a number of separate, but related, auditing considerations [ISA 701.A29].

Areas of significant auditor attention often affects auditor's overall audit strategy, the allocation of resources and extent of audit effort in relation to such matters. [ISA 701.A14].

The number of key audit matters to be included in the auditors' report may be affected by the size and complexity of the Project, its nature and environment, and the facts and circumstances of the audit engagement. [ISA701.A30].

7.8.2. Disclosures in the financial statements

Management or EA/ IA may decide to include new or enhanced disclosures in the financial statements or elsewhere in the annual report relating to a key audit matter in light of the fact that the matter will be communicated in the auditors' report. [ISA 701.A37].

It is expected that, to the extent possible, the information included in the auditors' report with respect to key audit matters is also disclosed in the financial statements or in another publicly available document.
Auditor may encourage management or EA/ IA to disclose additional information, rather than auditor providing original information in the report. Original information is any information about the FAP that has not otherwise been made publicly available by the FAP Management. [ISA 701.A35, ISA 701.A36]

7.8.3. Management Bias

In the event there is a possible bias in management's judgment relating to disclosures in the financial statements, auditor shall include in the audit documentation:

- Indicators of possible management bias.
- How management bias indicators were addressed.

7.9. Follow-up of management letter

The management letter shall be issued by the auditor as guidelines laid out in Chapter 6 of the manual. Depending on the timeline for submission of audit report to the relevant development partner, time shall be granted to the project's management for comments, and to convene the Departmental Accounts Committee ("DAC").

Chapter 8:
QUALITY ASSURANCE

This chapter covers all aspects of Quality Assurance applied by the DAGP to ensure the conduct of the audit in an efficient and effective manner and the achievement of auditor objectives. Primary areas covered include:

Personnel: Provide guidance on the professional development of audit staff and the establishment of a culture aimed at providing quality services.

Review Direction and Supervision: Procedures and guidelines for the review and supervision of the audit by the senior auditors, Directors and Director General during audit fieldwork and after the audit completion stage.

Quality Control Review: Internal and external Quality control review procedure to ensure quality deliverables

Audit Documentation: Provides guidelines for the retention of working papers in the form of audit files (current and permanent) and the maintenance of audit files.

8.1. Personnel

The continuing competence of the DAGP staff depends to a significant extent on an appropriate level of continuing professional development so that staff maintain their knowledge and capabilities. Effective policies and procedures emphasize the need for continuing training for all levels of DAGP staff, and provide the necessary training resources and assistance to enable them to develop and maintain the required competence and capabilities.

Competence can be developed through a variety of methods, including the following:

i. Professional education.
ii. Continuing professional development, including training.
iii. Work experience.
iv. Coaching by more experienced staff, for example, other members of the audit team.
v. Independence education for staff who are required to be independent.

The DAGP may use a suitably qualified external person, for example, when internal technical and training resources are unavailable.

Performance evaluation, compensation and promotion procedures give due recognition and reward to the development and maintenance of competence and commitment to ethical principles. Steps the DAGP may take in developing and maintaining competence and commitment to ethical principles include:

i. Making staff aware of DAGP expectations regarding performance and ethical principles;
ii. Providing staff with evaluation of, and counseling on, performance, progress and career development; and
iii. Helping staff understand that advancement to positions of greater responsibility depends, among other things, upon performance quality and adherence to ethical principles, and that failure to comply with the DAGP's policies and procedures may result in disciplinary action.

8.1.1. Assignment of Audit Teams

a. Directors/Director Generals

Policies and procedures may include systems to monitor the workload and availability of Directors and Director Generals so as to enable these individuals to have sufficient time to adequately discharge their responsibilities.

b. Audit Teams

The DAGP's assignment of audit teams and the determination of the level of supervision required, include for example, consideration of the audit team's:

i. Understanding of, and practical experience with, audits of a similar nature and complexity through appropriate training and participation;
ii. Understanding of donor guidelines/regulations, professional standards and applicable legal and regulatory requirements;
iii. Technical knowledge and expertise, including knowledge of relevant information technology;
iv. Knowledge of relevant industries in which the clients operate;
v. Ability to apply professional judgment; and
vi. Understanding of the DAGP's quality control policies and procedures.

8.1.2. Promoting an Internal Culture of Quality

The AGP's leadership and the examples it sets significantly influence the internal culture of the DAGP. The promotion of a quality-oriented internal culture depends on clear, consistent and frequent actions and messages from all levels of the DAGP that emphasize the DAGP quality control policies and procedures, and the requirement to:

i. perform work that complies with professional standards and applicable legal and regulatory requirements; and
ii. Issue reports that are appropriate in the circumstances.

Such actions and messages encourage a culture that recognizes high quality work. These actions and messages may be communicated by, but are not limited to, training seminars, meetings, formal or informal dialogue, mission statements, newsletters, or briefing memoranda. They may be incorporated in the DAGP's internal documentation and training materials, and in staff appraisal procedures such that they will support and reinforce the DAGP's view on the importance of quality and how, practically, it is to be achieved.

Of particular importance in promoting an internal culture based on quality is the need for the DAGP's leadership to recognize the overriding requirement to achieve quality in all the audits that the DAGP performs. Promoting such an internal culture includes the provision of sufficient resources for development, documentation and support of its quality control policies and procedures.

8.2. Review, Direction and Supervision

To ensure that high quality work is done, appropriate standards must be followed. The objectives of the particular type of work or the particular assignment should dictate the specific standards that are followed.

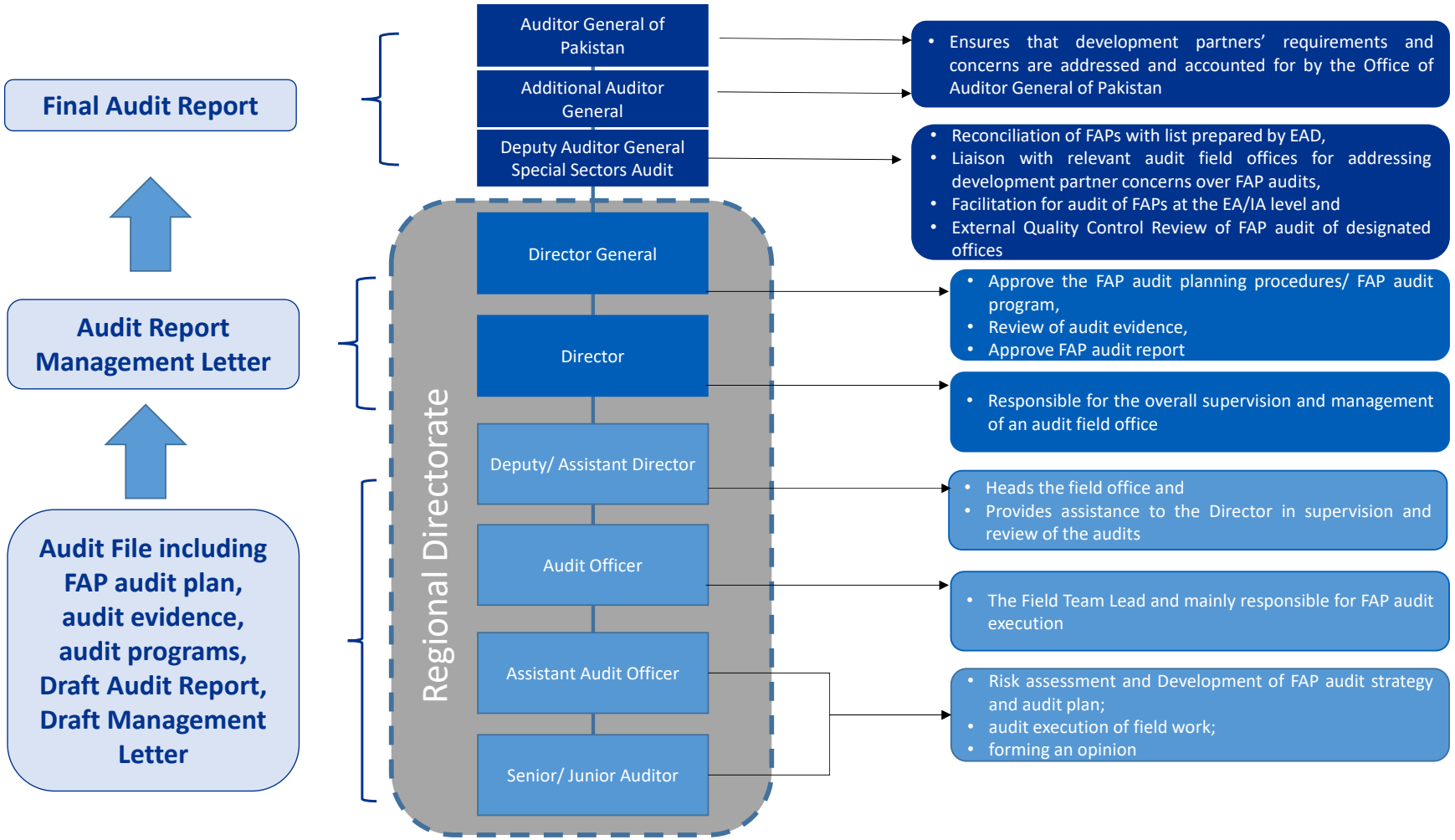
Because of the importance of ensuring a high standard of work by the DAGP it shall pay particular attention to quality assurance programs in order to improve audit performance and results. The benefits to be derived from such programs make it essential for appropriate resources to be available for this purpose. It is important that the use of these resources be matched against the benefits to be obtained.

The Department of the AGP shall establish systems and procedures to:

(a) Confirm that integral quality assurance processes have operated satisfactorily.
(b) Ensure the quality of the audit report; and
(c) Secure improvements and avoid repetition of weaknesses.

The quality of the work of the Department shall be enhanced by strengthening internal review and by independent appraisal of its work.

The Department shall ensure that applicable standards are followed on all audits and that deviations from the standards which are determined to be appropriate are documented.


Final Audit Report
Audit Report Management Letter
Audit File including FAP audit plan, audit evidence, audit programs, Draft Audit Report, Draft Management Letter
Regional Directorate
Auditor General of Pakistan
Additional Auditor General
Deputy Auditor General Special Sectors Audit
Director General
Director
Deputy/ Assistant Director
Audit Officer
Assistant Audit Officer
Senior/ Junior Auditor
• Ensures that development partners' requirements and concerns are addressed and accounted for by the Office of Auditor General of Pakistan
• Reconciliation of FAPs with list prepared by EAD,
• Liaison with relevant audit field offices for addressing development partner concerns over FAP audits,
• Facilitation for audit of FAPs at the EA/IA level and
• External Quality Control Review of FAP audit of designated offices
• Approve the FAP audit planning procedures/ FAP audit program,
• Review of audit evidence,
• Approve FAP audit report
• Responsible for the overall supervision and management of an audit field office
• Heads the field office and
• Provides assistance to the Director in supervision and review of the audits
• The Field Team Lead and mainly responsible for FAP audit execution
• Risk assessment and Development of FAP audit strategy and audit plan;
• audit execution of field work;
• forming an opinion

8.2.1. Quality assurance during fieldwork

DAGP's Auditing Standards require, "The work of the audit staff at each level and audit phase should be properly supervised during the audit, and documented work should be reviewed by a senior member of the audit staff."

This section discusses the role of supervision and review. It also discusses the need for effective time reporting.

a. Supervision

DAGP's Auditing Standards state: 'Supervision is essential to ensure the fulfilment of audit objectives and the maintenance of the quality of the audit work. Proper supervision and control is therefore necessary in all cases, regardless of the competence of individual auditors.'

The Directors and Directors General must ensure that the audit is carried out efficiently, effectively, and with a high standard of professional competence. This requires auditors to be properly supervised during each audit assignment.

The extent of the required supervision will vary from situation to situation. In general:

- Junior staff should be supervised more closely than senior staff;
- Auditors who are not familiar with the entity or the audit procedures being performed should be supervised more closely than auditors who are familiar with the entity and the specific audit procedures; and
- Auditors performing procedures that require a great deal of experience and professional judgment should be supervised more closely than auditors performing simple, routine audit procedures.

Supervision involves ensuring that:

- The members of the audit team fully understand all of the planning decisions before commencing the fieldwork;
- The fieldwork is performed in accordance with applicable standards and guidelines;
- The audit programs are completed as planned, unless changes are required;
- If changes are required to the audit plan, the additional areas that require examination, or the areas that require additional examination, are properly planned and the work is properly performed;
- Only essential work is performed;
- Sufficient evidence will have been obtained when the work is completed;
- Audit findings and conclusions are being adequately supported by evidence in the working papers;
- The audit is performed within the time budget and by the deadline dates set; and
- The work is being done in a strong team environment, which promotes the success of the audit and the development of audit skills within the team.

It is difficult to supervise staff from a distance. Supervision is most effective when the supervisor is on the job with the audit team.

While each audit situation is different, it would normally be appropriate for the supervisors of the lowest level staff to be on the job on a full-time basis. Supervisors of more senior staff could be on the job less frequently.

b. Review of working paper files

At the completion of each section of the audit work, the supervisor should review the work performed. This should include a thorough review of the working paper files to provide further assurance that the matters noted above are adequately dealt with. In addition, the review of the working paper files helps to ensure that:

- All evaluations and conclusions are soundly based and are supported by competent, reliable, relevant and reasonable audit evidence;
- All errors, deficiencies and unusual matters have been properly identified, documented and evaluated; and
- Changes and improvements necessary to the conduct of future audits are identified, recorded and taken into account in later audit plans and in staff development activities.

While the working paper files need to be reviewed at the completion of the audit work, there is no need for the reviewer to wait until then before commencing a review. A preliminary review at an interim date could detect problems with the work at an earlier date, allowing for speedier correction and saving valuable audit hours.

To improve the learning experience, the reviewer should provide the auditor with feedback on his/her performance shortly after the file review, as opposed to waiting until after the reporting phase.

c. Time reporting and monitoring

The purpose of supervision and review is not only to ensure that the work is being carried out as per the required standards. It is also to ensure that the work is being performed efficiently and will be completed by the required deadline date.

If the audit is not on track, remedial action is necessary. Existing staff may need to be assigned to the audit for longer periods of time than originally planned, or additional staff may need to be assigned to the audit to complete it on schedule. In either case, the planning for other audits in the directorate may be affected. As a result, it is good practice for the directors on all audits to report their progress to the Director General on a regular basis.

All variances from the audit plan should be explained. This process will not only help the supervisor to evaluate the auditor's work during the current year, but will also help the auditor to refine the optimum combination of tests of internal control, analytical procedures and substantive tests of details.

8.2.2. Quality assurance during the evaluation phase

Audit review will be carried out at the following levels:

- First level – reviews by the Director
- Second level – review by Director General

The working papers should be reviewed immediately after each segment of the work has been completed. The reviewer should be aware that timely review provides better progress and control of the quality of the audit work.

The reviewer should consider the following fundamental issues when reviewing an audit file:

- All required working papers and procedure steps have been adequately addressed, signed by preparer and reviewer, dated and cross-referenced. When a working paper or procedural steps is omitted, adequate reasons should be supplied;

- The audited financial statements (and other relevant information) have been identified and clearly linked to the audit;
- Acquired knowledge of business/the entity is adequate to support the auditors' decision relating to the audit approach;
- Conclusions were adequately drawn and supported by appropriate and sufficient audit evidence;
- Significant deviations from the overall audit plan and changes, if any, in the scope of the audit have been documented;
- Adequate level of audit coverage has been obtained for material areas;
- All significant professional judgments made have been documented and are supported by appropriate audit evidence;
- The audit was conducted in accordance with the relevant audit approach, guidelines and other directives;
- All significant audit matters have been resolved and/or appropriately reported to management in the management letter as well as in the audit report;
- The work performed and results obtained have been adequately documented;
- Based on the underlying audit work and findings the appropriate audit opinion has been expressed; and
- Reported findings are supported by adequate and sufficient audit evidence.

The scope of the reviewer's control should be increased if he/she identifies other possible risk areas or if there is any indication that the audit file does not meet the required technical standards.

a. Review by the Director

For the first level of review, some reliance can be placed on the field level review already performed. The first level reviewer will also review the work performed by the audit team leader. The experience and seniority of the field level team leader will influence the reliance placed on the field level works conducted.

The first level reviewer will concentrate on the work performed by focusing on the documentation contained in key working papers:

- Entity Communication letter or Authorization letter;
- Overall audit plan, including significant risk areas and audit approach;
- Preliminary Management letter, confirming whether there is adequate audit evidence supporting the findings;
- Audit differences between audit plan / programme and actual work done; and
- Audit report with supporting audit evidence for the findings.

b. Review by the Director General

The Director General will perform a second level review. He will approve the overall audit strategy before any of the fieldwork is conducted. If this is not possible, then he shall at least be consulted to obtain his or her inputs regarding the audit plan and audit scope. This is to ensure that the correct audit approach is followed and that the person who is responsible for this review is aware of the aspects covered in the audit plan. The focus will be on the following aspects:

- Work performed by the first-level reviewer;
- Appropriate and sufficient audit evidence exists to support the audit findings;
- Exceptions raised, Management letter and Draft audit report;
- Comparison of the work performed with the strategic audit plan to ensure that all risk areas have been addressed and deviations from the strategy have been documented;

- All reporting working papers including overall audit summary memorandum, deviations between audit plan/programmes and actual work done, events subsequent to balance sheet date/fiscal year etc.; and
- Financial statements and related disclosures.

Subject matters to be reviewed and commented by the first and second level reviewers are to be documented in the working paper

8.2.3. Documentation by Director/ Director General

The Director or Director General shall document, that:

i. The procedures required by the DAGP's policies on audit quality control review have been performed;
ii. The audit quality control review has been completed on or before the date of the auditor's report; and
iii. The reviewer is not aware of any unresolved matters that would cause the reviewer to believe that the significant judgments the audit team made and the conclusions it reached were not appropriate.

8.3. Quality Control Review

After appropriate deliberations, if any, with the project's management, the audit reporting pack comprised of the auditor's report, audited financial statements and management letter is forwarded to the senior reporting tier, i.e., Deputy Auditor General ("DAG") for internal quality control check ("IQCC") and for external quality control check ("EQCC") to the designated DAG who is charged with the portfolio for audit of foreign aided projects. During this phase, overall evaluation/ assessment of the quality of the engagement is conducted to ensure that:

- the Director and the Director General have reviewed the working paper files;
- the audit work is complete;
- Standard of work performed was in accordance with ISSAI
- sufficient appropriate audit evidence has been obtained to support the auditor's opinion;
- all matters that should be reported are included in the opinion;
- Either:
  (a) An unqualified opinion can be issued; or
  (b) The auditor's opinion contains all of the required reservations; and
- The auditor's opinion can be signed and released by the respective Director General

After completion of EQCC, relevant DG issues the report under his endorsement to the development partner through the Officer of AGP and EAD.

8.4. Documentation

Audit documentation refers to all relevant working papers and audit evidence that has been prepared and obtained throughout the audit and is obtained to support significant conclusions and judgments. Audit documentation may be recorded manually, electronically or in any other media.

The auditor shall include in the audit documentation: ISA 220

i. Issues identified with respect to compliance with relevant ethical requirements and how they were resolved.
ii. Conclusions on compliance with independence requirements that apply to the audit, and any relevant discussions with the DAGP that support these conclusions.

iii. The nature and scope of, and conclusions resulting from, consultations undertaken during the course of the audit.

In addition to working papers, audit documentation may also include documents, reports, and third party confirmations, e.g., bank balance certificates, external confirmations, reports on the work done by other auditors and other evidence supporting the audit findings etc. Where working papers are not applicable the fact that they are not applicable and the reasons therefore should be documented.
Audit working papers should be duly signed by the auditor conducting the examination i.e. the Director and the Director General.

8.4.1. Purpose of Audit Documentation

The purpose of audit documentation is to provide a record of how the objectives of an audit assignment were achieved and how the audit was planned and performed. Basically documents are used for quality control which includes:

- Direction – e.g. planning documents, audit programs
- Supervision – e.g. the documentation should help the auditor to identify that the work is being carried out as planned
- Control – e.g. should indicate that audit procedures as indicated by ISSAIs have been complied and documented and the results & conclusion drawn are well evidenced

Appropriate audit documentation provides: (ISSAI, ISA 230)

i. Evidence of the auditor's basis for a conclusion about the achievement of the overall objectives of the auditor; and
ii. Evidence that the audit was planned and performed in accordance with ISAs and applicable legal and regulatory requirements.

Audit documentation serves a number of additional purposes, including the following:

i. Assisting the audit team to plan and perform the audit.
ii. Assisting audit team to direct and supervise the audit work and to discharge their review responsibilities adequately.
iii. Enabling the audit team to be accountable for its work.
iv. Retaining a record of matters of continuing significance to future audits.
v. Enabling the conduct of quality control reviews and inspections
vi. Enabling the conduct of external inspections

8.4.2. Timely Preparation of Audit Documentation

The auditor shall prepare audit documentation on a timely basis. Preparing sufficient and appropriate audit documentation on a timely basis helps to enhance the quality of the audit and facilitates the effective review and evaluation of the audit evidence obtained and conclusions reached before the auditor's report is finalized. Documentation prepared after the audit work has been performed is likely to be less accurate than documentation prepared at the time such work is performed.

8.4.3. Form, Content and Extent of Audit Documentation

The auditor shall prepare audit documentation that is sufficient to enable an experienced auditor, having no previous connection with the audit, to understand:

i. The nature, timing and extent of the audit procedures performed to comply with the ISAs and applicable legal and regulatory requirements;

ii. The results of the audit procedures performed, and the audit evidence obtained; and
iii. Significant matters arising during the audit, the conclusions reached thereon, and significant professional judgments made in reaching those conclusions.

In documenting the nature, timing and extent of audit procedures performed, the auditor shall record:
i. The identifying characteristics of the specific items or matters tested;
ii. Who performed the audit work and the date such work was completed; and
iii. Who reviewed the audit work performed and the date and extent of such review.

The auditor shall document discussions of significant matters with management, those charged with governance, and others, including the nature of the significant matters discussed and when and with whom the discussions took place.

If the auditor identified information that is inconsistent with the auditor's final conclusion regarding a significant matter, the auditor shall document how the auditor addressed the inconsistency.

The form, content and extent of audit documentation depend on factors such as:
- The size and complexity of the entity.
- The nature of the audit procedures to be performed.
- The identified risks of material misstatement.
- The significance of the audit evidence obtained.
- The nature and extent of exceptions identified.
- The need to document a conclusion or the basis for a conclusion not readily determinable from the documentation of the work performed or audit evidence obtained.
- The audit methodology and tools used.

Audit documentation may be recorded on paper or on electronic or other media. Examples of audit documentation include:
- Audit programs.
- Analyses.
- Observations memo
- Summaries of significant matters.
- Letters of confirmation and representation.
- Checklists.
- Correspondence (including e-mail) concerning significant matters.

The auditor may include abstracts or copies of the entity's records (for example, significant and specific contracts and agreements) as part of audit documentation. Audit documentation, however, is not a substitute for the entity's accounting records.

In addition to the above specified documentation the auditor may include in the file:
- Documentation of Compliance with ISSAIs
- Consultation Documentation
- Documentation of Discussions of Significant Matters with FAP Management, EA/IA and Others such as persons providing professional advice to the FAP.

The auditor need not include in audit documentation superseded drafts of working papers and financial statements, notes that reflect incomplete or preliminary thinking, previous copies of documents corrected for typographical or other errors, and duplicates of documents.

Oral explanations by the auditor, on their own, do not represent adequate support for the work the auditor performed or conclusions the auditor reached, but may be used to explain or clarify information contained in the audit documentation.

8.4.4. Audit File

The auditor shall assemble the audit documentation in an audit file and complete the administrative process of assembling the final audit file on a timely basis after the date of the auditor's report. After the assembly of the final audit file has been completed, the auditor shall not delete or discard audit documentation of any nature before the end of its retention period.

Audit documentation either relates solely to the current year or it may be of a more permanent nature. With regard to recurring audits, audit evidences gathered by the auditor should be separated in two audit files, i.e. permanent audit file and current audit file.

a. Permanent Audit File

A permanent audit file should be retained with the documentation of the working papers and supporting evidence that are applicable for more than one financial year. Working papers, documents and information that may be useful in planning and performing audits for subsequent years should be retained in the permanent file. The permanent audit file may be maintained systematically at an appropriate level such as project-level, ministry-level or audit unit level so that the papers, documents and information can be easily used in subsequent audits. Relevant laws, rules, regulation, applicable policy, directives and official circulars need to be documented in the Permanent Audit file.

The permanent file contains information of continuing nature about the entity's operations, organizational structure, accounting systems and other features (for example loan/funding agreements) that are important to the conduct of the audit. The contents of the permanent file should be reviewed at every audit and schedules updated to show the latest position. Schedules considered to be outdated should be removed. This file may include the following information:

- Information concerning the legal and organizational structure, physical and financial size of the FAP
- Strategic plan, important policies, procedures and functional manuals of the entity,
- Appropriate statutory or legal regulations, extracts or copies of important legal documents, agreements and minutes,
- Loan or grant agreements, project appraisal report, review mission reports, projects' periodic and completion reports,
- A short description of the type of business carried on and the places of business.
- Names, title and responsibilities of Key personnel,
- Notes regarding significant accounting policies,
- Audit History - a brief reference of each audit performed, including nature, date and period of audit, important comments and results and the matters or issues to be reviewed or followed up by subsequent audits.

b. Current Audit File

The audit file for the current year should include all the working papers and supporting evidence relating to the current year's audit objectives.

Working papers, documents and evidences obtained during current audit should be arranged in logical sequence in the current audit file. The appropriate audit directorate should maintain the current audit

file of every audited unit, preferably on an entity basis or as directed by. This file may include the following information:

- Evidence of the planning process of an audit and audit program,
- A record of the study and evaluation of the accounting system and related internal controls,
- Analysis of transactions and balances,
- A record of the nature, timing and extent/scope of audit procedures performed, and the results of such procedures,
- Evidence that the work performed by assistants was supervised and reviewed,
- An indication as to who performed the audit procedures and when they were performed,
- Copies of communication with other auditors, experts and third parties,
- Copies of letter or notes concerning audit matters communicated to or discussed with the client including the terms of the engagement and material weaknesses in internal control systems,
- Letters of representation or conformations received from the client,
- The bank reconciliation statements,
- Conclusions reached by the auditor concerning related audit issues including exceptional and unusual matters (if any) and audit procedure followed for their resolution,
- Copies of the financial information being reported on and the related audit reports.
- Working papers used in the audit

An index of the documents in the current working file should be presented at the face of the file for easy reference and tracking.

c. Cross-referencing and indexing

All working papers of the audit file should be cross-referenced so as to ensure that another auditor can understand where the evidence is coming from or going to. The documentation placed in an audit file should have individual reference numbers. The source documents should be cross-referenced to the summaries and working papers where the audit work has been documented and concluded on and vice versa.

The audit findings will have to be referenced to the original sources of documents and not only to schedules compiled by the auditors. Auditors should throughout the audit be aware of the requirements relating to evidence and file copies of audited source documents where the problems were found.

Working papers should be indexed to facilitate the cross-referencing of working papers to each other and to the report. The relationship of the working papers to the particular areas or segments of the audit finding should also be indicated.

8.4.5. Maintenance of Audit Documentation

a. Confidentiality, safe custody, integrity, accessibility and retrievability of audit documentation

Relevant ethical requirements establish an obligation for the DAGP's staff to observe at all times the confidentiality of information contained in audit documentation, unless specific client authority has been given to disclose information, or there is a legal or professional duty to do so.
Whether audit documentation is in paper, electronic or other media, the integrity, accessibility or retrievability of the underlying data may be compromised if the documentation could be altered, added to or deleted without the DAGP's knowledge, or if it could be permanently lost or damaged.
Accordingly, controls that the DAGP designs and implements to avoid unauthorized alteration or loss of audit documentation may include those that:

- Enable the determination of when and by whom audit documentation was created, changed or reviewed;
- Protect the integrity of the information at all stages of the audit, especially when the information is shared within the audit team or transmitted to other parties via the Internet;
- Prevent unauthorized changes to the audit documentation; and
- Allow access to the audit documentation by the audit team and other authorized parties as necessary to properly discharge their responsibilities.

Controls that the DAGP designs and implements to maintain the confidentiality, safe custody, integrity, accessibility and retrievability of audit documentation may include the following:

- The use of a password among audit team members to restrict access to electronic audit documentation to authorized users.
- Appropriate back-up routines for electronic audit documentation at appropriate stages during the audit.
- Procedures for properly distributing audit documentation to the team members at the start of the audit, processing it during audit, and collating it at the end of audit.
- Procedures for restricting access to, and enabling proper distribution and confidential storage of, hardcopy audit documentation.

b. Retention of audit documentation

Audit documentation will be retained for a period sufficient to meet the needs of the DAGP or as required by law or regulation. In the specific case of audits, the retention period would ordinarily be as required by the relevant development partner.

Procedures that the DAGP adopts for retention of audit documentation include those to:

- Enable the retrieval of, and access to, the audit documentation during the retention period;
- Provide a record of changes made to audit documentation after the audit files have been completed;
- Enable authorized external parties to access and review specific audit documentation for quality control or other purposes.

Unless otherwise specified by law or regulation, audit documentation is the property of the DAGP. The DAGP may, at its discretion, make portions of, or extracts from, audit documentation available to EA/IA, provided such disclosure does not undermine the validity of the work performed, or, in the case of assurance audits, the independence of the DAGP or its staff.

ANNEXURES

ANNEXURE A: GENERAL REQUIREMENTS RELATING to AUDIT of DEVELOPMENT PARTNER FUNDS

ADB Requirements

This section has been derived from:

- Financial Management Technical Guidance Note
- Project Administration Instructions
- Sample Project Administration Manual

Key ADB requirements and expectations in relation to audit of projects funded by it have been detailed in this manual and are summarized below:

- Audits of FAPs shall be planned while keeping in mind form, content and timing of project financial statements as laid out in the Project Administration Manual ("PAM").
- Special consideration shall be given to harmonization requirements laid out in PAM for co-financed projects.
- The audit shall be carried out in accordance with the auditing standards applicable in Pakistan that are based on International Standards of Supreme Audit Institutions as issued by the International Organization of Supreme Audit Institutions.
- The audits will conducted in a manner so as to enable the auditor to provide an independent and objective opinion on whether the financial statements present fairly in all material respects, or give a true and fair view of, the project/entity's financial position, its financial performance and cash flows in accordance with the applicable financial reporting standards –IPSAS and IFRS.
- The auditor will take heed of any specific audit requirements such as performance audit, audit of resettlement expenditures, procurement, and spot audit as made part of the relevant agreements underlying the project.
- Audited financial statements along with audit report will be submitted for each fiscal period with 6 months of the fiscal year end.
- Auditor's opinion will provide assurance over a) whether the loan proceeds have been utilized for the purposes of the project, and b) compliance with financial covenants in accordance with the legal agreement of the project.
- The auditor will inform the EA/IA of any internal control deficiencies and irregularities in compliance with ADB's imprest account procedures, statement of expenditure procedures or the procurement process, vide a management letter.
- The auditor should be independent, qualified and experience to handle the terms of reference relevant to the audit.

World Bank ("WB") Requirements

This section has been derived from various documents including:

- World Bank Operations Manual;
- WB Guidelines for Procurement of Goods, Works, And Non-Consulting Services;
- WB Guidelines for Procurement of Consulting Services;
- Legal agreements underlying a sample of WB funded projects that comprised of:
  - Disbursement Letter;
  - Project Paper; and
  - Loan/Grant Agreement;
  - Project Appraisal Document;
  - Procurement plan;
  - Project Implementation Manual.

Legal agreements underlying the project outlines auditing requirements and the period for submission of the annual audit reports duly annexed to the Project's Performance Audit Report.

Audit planning will encompass obtaining understanding of the project, project's key development impact indicators for measuring progress in reaching project development objectives, project's key progress indicators for monitoring delivery of project inputs and achievement of project outputs, and project's key financial indicators to assess the project's budgetary and financial health.

Auditor will be required to ascertain major loan covenants that require special attention and need to be checked for compliance. Further, audit scope will cover verification of both quality and quantity of goods, works and services procured and proper use of funds.

The auditor will undertake procedures to verify achievement of Development Linked Indicators ("DLI").

Audit needs to provide reasonable assurance on the appropriate use of Program funds and safeguarding of its assets.

Auditor needs to be aware that:

- Any acts intended to materially impede the exercise of the WB's inspection and audit rights shall be treated as "obstructive practice" which is against the highest standard of ethics required by WB during the procurement and execution of WB-financed-contracts;
- All accounts, records, and other documents relating to the submission of bids and contract performance are fall under the auditors' purview of audit and thereby authorize the right to inspection thereon.

The project is required to submit annual audited financial statements after the close of the project's financial year. Audits need to be carried out by auditors with independence, experience, and capacity acceptable to WB, and under terms of reference acceptable to WB.

Depending on the nature of the project and project's annual financial statements, audit may need to be complemented by other reviews to address certain risks or to strengthen the project's audit/inspection arrangements.

USAID requirements

This section has been derived from "Additional guidance for the audit of USAID funded projects" to be used by FAOs of the DAGP.

The specific audit objectives as defined in "Additional guidance for the audit of USAID funded projects" are:

- 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.

Building up on the objectives, scope of work of the audit of USAID funded projects will include a report on the Fund Accountability Statement, report on the Internal Controls related to USAID funded projects, and report on compliance with agreement terms, applicable laws and regulations related to USAID funded projects.

Requirements for the Field Audit Offices ("FAOs") of DAGP in carrying out audit of USAID funded programs/projects are as follows:

- Develop audit plans and programs keeping in view the overall expectations of the USAID and the GOP from the audit of US AID assisted projects;
- Include all the USAID projects in their annual plans for audit;
- In performing the risk and materiality assessment of projects, FAO's should keep in mind intervening sector, sector-specific infrastructure and reforms and project implementation mechanism. Following are project implementation mechanisms as adopted by USAID for funding projects in Pakistan:
  - Budget Support Cash Transfer;
  - Sector Specific Budget Support Cash Transfer;
  - Sector Specific Budget Support with Special Currency;
  - Fixed Amount Reimbursements;
  - Cost Reimbursement Agreements; and
  - Purpose Accomplished Upon Disbursement.
- Develop an overall audit risk profile and customized audit programs in the light of various provisions of Chapters 5 of "DAGP Guidelines for Audit of FAPs (DAGP Guidelines)" , and requirements USAID under the Memorandum of Understanding signed between DAGP and USAID which is the overarching agreement for applicability of USAID audit requirements;
- Entity Communication Letter issued under Chapter 5 of DAGP Guidelines serves as an alternative of engagement letter required under the International Standards on Auditing ("ISA"). Entity Communication Letter may further include:
  - DAGP's current understanding of the project;
  - Timetable of the audit work;
  - Details of assistance required from internal audit and other project staff;
  - Information to be provided by project officials; and
  - Follow-up matters from the previous audit.
- 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.
- Reporting requirements include:
  - Title page, table of contents, and transmittal letter;
  - 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;

  - 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 FAM/ISSAI.
  - 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.
- The cognizant USAID mission should be notified of entry and exit meetings held with the project's management in order that USAID representatives may attend, if deemed necessary.
- In cases where the audited entities do not respond to the auditor's requests for holding exit meetings on time, the FAOs are advised to bring the subject to the notice of the donors.

Auditor's roles and responsibilities attached with the auditor of USAID funded projects include:

- Hold entrance and exit conferences with the recipient;
- Obtain a Management Representation Letter;
- communicate information to the audited entity regarding the nature and extent of planned testing and reporting;
- Use the Quality Management Framework (QMF) of the AGP
- 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 auditors must ascertain that audits of its sub-recipients were performed
- The auditors must properly maintain and store the audit documentation

UNHCR Requirements

This section is derived from UNHCR's official website:

- http://www.unhcr.org/excom/standcom/3ae68cf310/implementing-partners-compliance-audit-certification.html)

Mainly, UNHCR requires an audit certificate from Governmental partners, issued by the appropriate government audit authority, within three months of the final date of the liquidation of commitments.

ANNEXURE B: SAMPLE ENTITY COMMUNICATION LETTER

DEPARTMENT OF AUDITOR GENERAL OF PAKISTAN

DIRECTORATE GENERAL AUDIT WORKS (FEDERAL)

ADDRESS:

PHONE: FAX:

NO. DATED:

The Secretary,

Ministry of Communications,

Islamabad.

Subject: Audit of (organization name) for the Audit Year

The Auditor General of Pakistan conducts audit of the accounts of Federal Government and authorities established by the Federal Government as Pakistan 1973 read with sections 8 and 9 of the Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001. The 18th amendment to the constitution further strengthens the mandate of the Auditor General of Pakistan under which any authority or body established, or under the control of federal government shall also be subject to audit by the Auditor General of Pakistan. As per audit cycle, audit execution phase-I continues for a duration from (mention the duration) and phase-II from (mention the duration).

In exercise of above said mandate this office has planned to commence audit of the accounts of (organization name) for the year (audit period). A tentative list of planned formations/projects in respect of (organization name) is attached. Accounts of previous year of Formations/Projects not audited during the previous year will also be subject to audit scrutiny/review. Besides regular compliance with authority audit, annual mandatory financial attest audit of Foreign-Aided Projects will also be conducted.

It is requested that (organization name) may kindly be directed to inform all its Project Authorities/General Managers concerned about commencement of audit with direction to arrange the record and keep it ready for production to Field Audit Teams during audit. All concerned may also be informed that non production of record tantamounts to hindering the parliamentary oversight and auditorial functions of the Auditor General and any person or authority hindering the auditorial functions of Auditor General regarding inspection of accounts shall be subject to disciplinary action under relevant Efficiency and Discipline Rules, applicable to such person as per Section 14 of the Auditor General's (Functions, Powers and Terms and Conditions of Service) Ordinance, 2001.

DIRECTOR

ANNEXURE C: OTHER MATTERS TO BE CONSIDERED AT THE TIME OF DEVELOPING OVERALL AUDIT STRATEGY

- The nature of the control relationships between a principal FAP office (PMU) and its geographically/functionally distinct components that determine how the transactions and event are recorded, reported and consolidated;
- The extent to which components are audited by other audit teams from other Field Audit Offices;
- The nature of the project, specifically project interventions, to be audited, including the need for specialized knowledge;
- Importance attached to internal control throughout the project to the successful operation of the project;
- The reporting currency to be used, including any need for currency translation for the financial information audited;
- Results of previous audits that involved evaluating the operating effectiveness of internal control, including the nature of identified deficiencies and action taken to address them;
- The expected use of audit evidence obtained in previous audits, for example, audit evidence related to risk assessment procedures and tests of controls;
- The effect of information technology on the audit procedures, including the availability of data and the expected use of computer assisted audit techniques; and
- Whether there are any other expected communications with third parties, including any statutory or contractual reporting responsibilities arising from the audit.
- Preliminary identification of areas where there may be a higher risk of material misstatement;
- The manner in which we emphasize to engagement team members the need to maintain a questioning mind and to exercise professional skepticism in gathering and evaluating audit evidence;
- The process(es) management uses to identify and prepare the disclosures required by the applicable financial reporting framework, including disclosures containing information that is obtained from outside of the general and subsidiary ledgers;
- Significant project developments affecting the project, including changes in information technology and business processes, and changes in key management;
- Significant industry developments such as changes in industry regulations and new reporting requirements; and
- Other significant relevant developments, such as changes in the legal environment affecting the project.

ANNEXURE D: AUDIT PLANNING PROCEDURES

Sr. No.	Audit Plan	Yes/No /N/A	W/P Ref.
1. Understanding of Project and its Operations for Risk Assessment			
1.1.	Obtain a general understanding of sector in which project is operating, by comparing practices performed by similar entities, media reports analysis, and review newspaper clipping related to that particular sector.		
1.2.	Identify risks related to respected sector;		
1.3.	Identify the legislative and regulatory authorities, their jurisdiction, and related legislative requirements for the sector.		
1.4.	Obtain a copy of project agreement with development partner and a copy of any amendments therein to assess project's intervention and operational guidelines as specified by development partner.		
1.5.	Obtain a copy of all the necessary financial information from project which includes; o Project paper/Project appraisal document o Disbursement letter o Financial statements o Project's financial reporting to the development partner o Project's loan/Grant agreement o Procurement plan o Project implementation manual and any other information that AGPR deems necessary for understanding of project.		
1.6.	Evaluate the size of project by identifying project's interventions, its localities, and divisions. *Answer: Specify project's size its nature as evaluate by AGPR* *E.g. (its expenditure, operations, operating locations, divisions, financial resources available, number of team members involved, number of size of deliverables, complexities of deliverables).*		
1.7.	Review loan agreement to identify major loan covenants, requiring special attention and need, to check for compliance.		

1.8.	Identify the applicable financial reporting framework, adopted by project *Answer: Specify the applicable financial reporting framework adopted by project for its accounting system, identified by AGPR* *E.G. Cash Basis IPSAS/ Financial Reporting under the Cash Basis of Accounting Standard.* and assess its suitability with regards to auditor's understanding of sector.		
1.9.	Obtain progress reports as furnished to development partner by the project to assess the extent of work performed to date.		
1.10.	Perform a preliminary review on the process documentation with reference to the project to highlight or discover any significant finding.		
1.11.	Identify high risk areas in financial statements by performing pre engagement analytical procedures and evaluate its impact on performance of audit.		
1.12.	Obtain a copy of any review report by development partner to evaluate key focus areas as prescribed by development partner.		
1.13.	Obtain a copy of all the instructions sent or received by or to the project, by development partner to assess compliance with any new instructions development partner require implementation on.		
1.14.	Assess all the new changes in applicable financial reporting framework, as adopted by project, have been duly complied with and is reflected in financial statements.		
1.15.	Obtain and evaluate strategic plan of the project and its relevance with development partner's requirement.		
1.16.	Identify all the related parties encompassed in the project to evaluate their impact on disclosures, for transparency in the intervention of project, during the audit.		

Sr. No.	**Audit Plan**
1.	**Compliance Check list with TOR**
1.	Check the title, number and signature on the agreement.
2.	Check the duration of the agreement. Agreement signing date, project initiation date and project completion date.
3.	Check that project is utilizing the finances for the purpose funds were granted, and are in accordance with the TOR of Development Partner.
4.	Check that the project complies with all relevant labor laws.
5.	Ensure that project is carried out in conformity with regulatory and legal requirements of Pakistan environment legislation.
6.	Check that a portion of project's budget allocation contains repair and maintenance of municipal infrastructure and is included in project's work plan.

Sr. No.	Audit Plan
7.	Check that a steering committee is established by the project for smooth and timely implementation for the project's activity, and whether any officials of provincial government are involved in project's implementation oversight.
8.	Ensure that quarterly reports of project's compliance of work plan are furnished by the project to Development Partner in the format as prescribed by Development Partner in TOR.
9.	Ensure that project complies with all the provision of TOR exclusively those provision, non-compliance of such will result in revocation of agreement.
10.	Check that project provides to the Development Partner accounting records and such other information and reports as may be prescribed in the agreement.
11.	Ensure that the accounting records are prepared and maintained in accordance with accounting principles as prevailing in respected Development Partner's country legal requirement.
12.	Check that project has promptly notified Development Partner's engineering representatives, prior to testing of any equipment.
13.	Ensure that all the requests and permissions required are duly given or delivered through specified mediums upon the permitted addresses enlisted in the TOR or other designated address for such purpose.
14.	Identify any amendments in TOR and ensure compliance with the amended TOR by the project.
15.	Ensure that project has made broad public awareness of Development Partner's support for the purpose grant was provided.
16.	Check that line item for project are completed in stipulated time and inquire for delays thereby, encountered during the audit.
17.	Ensure that none of the project funds are used for the purpose other than specified for the project by the Development Partner.
18.	Check whether the project provides bank account information to Development Partner to enable the payment in respected currency of Development Partner.
19.	Check if the risks are insured and mitigated responsibly on a perpetual basis to an acceptable level as prescribed by the Development Partner.
20.	Check whether there are any budget revisions? If yes, obtain revised budget document and Development Partner's approval. Financials should be prepared in line with revised budget, if applicable.
21.	In case of receipt of any additional funding by the Development Partner for the same project, check that following information is submitted by the Agency to project: • Source of funding; • Amount of funding; • Activities covered by the additional funds; and Period that the additional funding is intended to cover.
22.	Check that transfer date of the first installment of funds is as per timeline provided in the Agreement.
23.	Check that no expense is incurred on account of international travel expense and in exceptional circumstances prior approval has been obtained.
24.	Check that personnel cost is not exceeded to the amount approved in the budget of project. In case of any excess amount is spent on such cost obtain sufficient reasoning.
25.	Ensure that the final report submitted by project describes project activities, background, planned objectives, activities and actual accomplishment.
26.	Document the authorities and responsibilities of the management for managing the day to day activities of the organization and consider/ document their effect on the Project activities.

Sr. No.	Audit Plan
27.	Inspect the progress review system of the project for tracking the progress on different functions of project.
28.	Document the accountability environment of the organization i.e. internal/ pre-audit. Review internal audit reports for internal audits conducted during the period under AGRP audit for any deficiencies identified.
29.	Ascertain bank accounts of project are in accordance with the certified bank list as prescribed by Development Partner.
30.	Check that treasury function is working within the guidelines set by Development Partner.
31.	Obtain stamped bank statements of the project bank accounts for the period covering all receipts and payments under the project.
32.	Verify policy of currency exchange rates used for reporting project expenditure and check its compliance.
33.	Check the tax amount is properly deducted from all payments made and deposited with tax authorities and ensure amount deducted for tax purpose is allowed by Development Partner agency.
34.	Inquire about periodic reporting process for checking compliance with budgets and feedbacks received as result of that review.
35.	Document the target setting process for project budget and document any variations therein.
36.	Inquire about actual project progress within the organization and obtain the documentation related to such progress reporting.
37.	Obtain copy of approved proposal / concept paper submitted to Development Partner and check the assumptions used are logical and reasonable considering the nature of project.
38.	Verify the budget vs actual project cost and inquire the reasons for such variation keeping in view the limits set by Development Partner's guidelines and contract agreement.
39.	Check that costs incurred prior to or after the project period are not charged to the project
40.	Obtain insurance policy of the employees whose insurance cost is allocated to the project and check that insurance cost allocated to the project is calculated correctly as per the insurance policy documents. And ensure such insurance is allowed by development partner.
41.	In case of any budget variation in personnel costs, such costs should be questioned.
42.	In case of skilled labor hired for the project check that documents are available to verify their skills.
43.	Check time sheets or contract agreement of skilled labor and check that rate charged for skilled labor is as per the approved budget.
44.	Check that numbers of skilled and un-skilled labor workers are as per the approved budget.
45.	Check time sheets or contract agreement of un-skilled labor and check that rate charged for un-skilled labor is as per the approved budget.
46.	Check that numbers of un-skilled labor workers are as per the approved budget.
47.	Document the beneficiaries' identification process and compare it with the process identified in project proposal.
48.	Obtain final list of beneficiaries and check its approval.
49.	Ensure that all the required requisitions and permissions or any sort of agreements made in the project agreement is properly written and documented.

Sr. No.	Audit Plan
50.	Verify that any proposal to amend, suspend or repeal the provisions of charter is promptly notified and communicated. Also ensure this consideration is reviewed before action taken.
51.	Verify that any proposal to amend, suspend or repeal the provisions of charter is promptly notified and communicated. Also ensure this consideration is reviewed before action taken.
52.	Verify that all the resources allocated from the funds to acquire PPE for the project are not being used other than the intended purpose, or be sold, lease or otherwise dispose of any of its assets which may prejudice the operations and efficacy of the project.
53.	Ensure whether all the information required by donor with respect to TOR are furnished transparently.
54.	Check the transparency of flow of information between both the parties that matters relating to projects are being discussed.
55.	Ensure the project is complying and taking all the actions necessary for its corporate existence, operations, renewal of rights, power and privilege essential for carrying out the project feasibly.
56.	Assess that any suspected hindrance or threats to accomplishment of the purpose of project are being promptly reported to the development partner.
57.	Obtain basis of allocating administrative expenses to the project and verify that these basis are consistently followed throughout the project period for allocation of administrative and operational support cost and basis are same as agreed in the contract in TOR.

ANNEXURE E: INHERENT RISK ASSESSMENT FORM

NAME OF AUDIT ENTITY:

AUDIT COMPONENT:

AUDIT PERIOD:

Factor	High	Medium	Low	Project's Response
The number of geographically diverse locations				
Greater management intervention for data collecting and processing				
Significant dealing in cash transactions				
Susceptibility of components of project to fraud, loss or theft				
Accounting policies being used by project				
Capability of staff processing the transactions				
Volume of activity				

Inherent Risk Assessment is (High, moderate or low)

ANNEXURE F: PROCEDURES TO ASSESS THE RISK OF MANAGEMENT OVERRIDE OF CONTROLS AS PART OF FRAUD RISK ASSESSMENT

- Examining journal entries and other adjustments. Since, fraudulent journal entries and other adjustments are often made at the end of a reporting period, in designing and performing audit procedures for such tests, we shall select journal entries and other adjustments made at the end of a reporting period. [Source: ISA 240.32(a), Source: ISA 240.32(a)(ii)];
- Evaluating the project purpose for significant unusual transactions. The auditor shall evaluate whether the project purpose (or the lack thereof) of the transactions suggests that they may have been entered into to engage in fraudulent financial reporting or to conceal misappropriation of assets. In carrying out such an evaluation, the auditor shall evaluate whether: [Source: ISA 240.32(c)]
  - The form of the transaction is overly complex (e.g. the transaction involves multiple projects within a single department/EA/IA)
  - The transaction involves other parties, including projects of other EA/IA;
  - The transaction involves other parties that do not appear to have the financial capability to support the transaction without assistance from the project;
  - The transaction lacks commercial or economic substance, or is part of a larger series of connected, linked, or otherwise interdependent arrangements that lack commercial or economic substance individually or in the aggregate (e.g. the transaction is entered into shortly prior to period end and is unwound shortly after period end)
  - The transaction occurs with a party with an ability to negotiate terms that may not be based on market values, or available to other independent parties on an arm's-length basis; and
  - The transaction enables the project's management to achieve compliance with certain loan covenants

ANNEXURE G: LEGAL CONFIRMATION LETTER

Project Name

Reference:

Date:

Dear Sir/Madam,

Our auditors are performing their usual examination of our financial statements. Please furnish to our auditors the information requested below involving matters as to which you have been engaged in form of legal consultation or representation. Please provide the information requested below, taking into consideration matters that existed at **31st December 2016** and for the period from that date to the effective date of your response. Please also specify the effective date of your response if it is other than the date of your reply. Please send your response directly to our auditors at the following address:

Receiving Address of AGPR

Phone:

Fax:

1. **Pending Litigation & Claims**

   Please provide the following information with respect to all litigation, claims and assessment (excluding unasserted claims and assessment) considered by you to be material. Materiality for the purpose of this letter includes items involving amounts, which exceeds Rs. **(Materiality Amount for purpose of letter)** individually or items involving lesser amounts which exceeds Rs. **(Materiality Amount for purpose of letter)** in aggregate.

   - The nature of the litigation,
   - The progress of the case to date,
   - How management is responding or intends to respond to the litigation (e.g. to contest the case vigorously or to seek out-of-court settlement) and
   - An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made of the amount or range of potential loss.

2. **Unasserted Claims & Assessments**

   Please confirm that you have not advised us any unasserted claims and assessment that are probable of assertion and must be disclosed in the financial statements.

3. **Other matters**

Please identify the nature and reason for any limitation on your response. Also, please indicate the amount we were indebted to you for services and expenses as on **Closing period date**

The scheduled completion date of the auditors' examination is such that you should send your letter to Office of AGPR latest by **Required Date for response.**

Thanking you.

Designated authority of project

Yours faithfully.

ANNEXURE H: CONTROL RISK ASSESSMENT FORM

NAME OF AUDIT ENTITY:

AUDIT COMPONENT:

AUDIT PERIOD:

Factors	High	Medium	Low
Control environment			
Project's risk assessment process			
Communications • Between management and EA/IA's Principal Office • Formal job descriptions appropriately addressing finance staff's responsibilities • External communications, such as those with regulatory authorities and development partners.			
Monitoring of Controls			

Control Risk Assessment is (High, moderate or low) | |

ANNEXURE I: MATERIALITY ASSESSMENT FORM

NAME OF AUDIT ENTITY:

AUDIT COMPONENT:

AUDIT PERIOD:

Risk Factor	**Base Amount (from entity officials)**	**Percentage(auditor decides)**	**Materiality Amount (Base Amount*Percentage)**
Percentage of total expenditures(usual range is 2% for small entities to 0.5% for large entities)			

Materiality amount

ANNEXURE J: AUDIT PLAN TEMPLATE

Name of Audited Entity:

Preparation Date:

Prepared By:

Reviewed By:

Reviewed Date:

OVERALL AUDIT STRATEGY

FAP AUDIT OBJECTIVE

SCOPE OF AUDIT OF FAPs

Applicable financial reporting framework, including applicable legislative or regulatory requirements; *Development-partner-specific requirements related to financial reporting;* *Locations covered by FAP's geographical presence that needs to be audited.*

PREVIOUS AUDIT FINDINGS

REPORTING OBJECTIVES

Communication with FAP management *Communications among FAP audit team* *Requirement of resources*

UNDERSTANDING the PROJECT AS AN ENTITY AND ITS OPERATIONS

Understanding the relevant sector and external factors *Understanding the nature of the project* *Understanding the project objectives and strategies, and related project risks* *Measurement and review of project's operational and financial performance*

Assessment of inherent risk:

Factor	High	Medium	Low	Project's Response
The number of geographically diverse locations				
Greater management intervention for data collecting and processing				
Significant dealing in cash transactions				
Susceptibility of components of project to fraud, loss or theft				
Accounting policies being used by project				
Capability of staff processing the transactions				

Volume of activity				

Inherent Risk assessed (High, medium, low)

UNDERSTANDING THE PROJECT'S CONTROL FRAMEWORK

Control environment
Project risk assessment process
Monitoring of controls by FAP management
Existence of control processes
Assessment of the risk of fraud
Involvement of the internal audit function
Existence of litigation and claims

AUDITOR'S CONCLUSION OF THE CONTROL RISK

Design and implementation of controls
Control deficiencies
Impact of control deficiencies

Assessment of control risk

Factors	High	Medium	Low
Control environment			
Project's risk assessment process			
Communications with FAP management			
Monitoring of Controls by FAP management			
Auditor's assessment of processes			
Risk of Fraud			
Involvement of internal audit function			
Existence of litigation and claims			

Control Risk Assessment is (High, moderate or low)

MATERIALITY

Materiality level for the financial statements as a whole
Performance materiality level

AUDITOR'S ASSESSMENT OF THE RISK OF MATERIAL MISSTATEMENT

Risk factors
Risk assessment
Analytical review procedures performed
Results of the analytical review

ANNEXURE K: AUDIT RISK ASSESSMENT

NAME OF AUDIT ENTITY:

AUDIT COMPONENT:

AUDIT PERIOD:

Risk Category	Applicable Risk Factor
Inherent Risk (IR) (from Inherent Risk Assessment Form)	
Control Risk (CR) (from Control Risk Assessment Form)	
Risk of material misstatement(RoMM)	
Audit Risk (AR)	
Detection Risk	

ANNEXURE L: AUDIT PROGRAMS

Sr. No.	Audit procedure
Compliance Check list for procurement procedures	
1.	Check that procurement plan is prepared and furnished to the donor agency for its approval, setting forth; • The particular contracts for the goods, works and services required to carry out the project • The proposed methods of procurement that are permitted under loan agreement
2.	Check that payment for the supply of goods is made on the delivery and inspection, except for contracts involving installation and commissioning in which a portion of payment be made after the supplier has complied with all its obligations under the contract.
3.	Check the sample of vouchers to verify that; purchasing requirements are properly carried out Voucher is mathematically correct Payment was authorized by a competent authority Goods are specifically for project use
4.	Procurement transaction is recorded in proper fiscal year
5.	Check that the goods procured are actually received and utilized by the project.
6.	Reconcile the amount recorded in ledger with the amount mentioned on the invoice.
7.	Check that purchase requisition was generated by authorized personnel of project and requisition is authorized and approved by project's official designated for the task and ensure all the procurement carried out is in accordance with project's procurement plan.
8.	Check that any discrepancies noted on physical verification have been investigated and properly accounted for.
9.	Inspect and run analysis over past year's pattern of procurement against the current year to identify and highlight any unusual procurements.
Compliance Check list for appointment of consultant	
10.	Check that basis of estimating cost of staff time is realistic
11.	Check that management has prepared a list of expected consulting assignments and has presented it to the donor.
12.	Check that management has given first consideration to those that possess the relevant qualification.
13.	Verify that no amendments after submitting of proposal is accepted by project.
14.	Ensure that all proposal received after deadline have been declared late and rejected.
15.	Check that letter of incitation states the management intention to enter into a contract for the provision of consulting services and the date time and address for submission of proposals.
16.	Check that the proposals received are kept in safe custody and opened only by a committee of officials to maintain their secrecy.
17.	Check the evaluation criteria which may include; a. The consultant relevant experience b. The quality of methodology proposed c. Qualification of key staff proposed

18.	Check the contract agreed by management with consultant.
19.	Check accounting records being maintained for payments made to consultant for accuracy and completeness.
Compliance checklist for payroll	
20.	Check that salaries are authorized according to an approved scale.
21.	Calculate all the deductions made from salary for accuracy and completion.
22.	Check that whether wages payments are in accordance with records of work performed, e.g. time, output, commissions on sales.
23.	Ensure that tax deducted is paid to tax authorities on timely basis.
24.	Check that authorized person approves total payroll.
25.	Verify that employee receiving the pay signs payroll register as an acknowledgement.
26.	Check the accounting treatment of payroll
27.	Compare the total salaries paid to other months of the year and investigate variances.
28.	Obtain a list of joiners and leavers to ensure that proper induction procedures are followed for joiners and no salary is paid to leavers. Similarly names of leavers is removed from payroll list.
29.	Ensure that segregation of duties in all the departments exists.
Compliance checklist for inventory management	
30.	Check that a realistic annual plan for procurement of equipment is prepared and procurement of inventory is made considering this plan.
31.	Ensure that procurement procedures followed by management are cost effective.
32.	Check that material is received after proper inspection and any deficiencies are timely communicated and reconciled.
33.	Check that defective stock is not accounted for in the stock books and replacement of same is made by supplier according to terms and conditions of purchase order.
34.	Check that material damaged during warranty period is replaced by supplier in accordance with terms and conditions of purchase order.
35.	Verify that proper justification for acquisition exists and is approved from competent authority.
36.	Ensure that management has controls to prevent repurchasing of already existing stock
37.	Check that disposal of materials is approved by competent authority.
38.	Check existing customers are allocated a credit limit and it is ascertained whether this limit is to be exceeded if the new order is accepted.
Compliance checklist for Fixed Assets	
39.	Check that the entity has maintained fixed asset register.
40.	Ensure that sufficient controls are in place for ensuring security and safeguarding of assets.
41.	Scrutinize the fixed assets register for items that should not be capitalized but expensed instead.
42.	Select a sample from fixed asset register and check that assets physically exist and that they comply with information in the register regarding location, asset identification number, description, classification and other relevant information.
43.	Check that all additions and deletions have been properly incorporated in fixed asset register.
44.	Determine the reasons for nonfunctional state for items in storage.

45.	Identify cases where payment for asset has been made and recorded in books but asset is not delivered. Identify reasons for non-delivery.
46.	For large procurements, check that tendering process is carried out.
47.	Ensure that appropriate price was obtained in case of asset deletion, deletion was properly accounted for in the accounting records and all the accounts related to assets have been closed.
48.	Check that depreciation has been calculated in accordance with applicable standards.
49.	Ensure that sufficient controls are in place for ensuring security and safeguarding of assets.
Compliance checklist for Accounts Compilation	
50.	Obtain categories of disbursements understatement of expenditure (SOE) from loan agreement. Check that all disbursements by SOE fall under this category and same is signed by appropriate authority.
51.	Reconcile the total reimbursement by SOE as shown on the summary of withdrawal application to the monthly disbursement summary.
52.	Check that expenditures mentioned in SOE are supported by documentation and are eligible under the loan agreement.
53.	Ensure that no expenditures related to previous year have been included in current year
1. Bank Accounts and Cash	
54.	Obtain bank confirmations from all bank accounts and agree balances to accounting records.
55.	Verify mathematical accuracy of bank reconciliation statements
56.	Trace the deposits in transit at the end of the period to ensure that they are recorded in proper accounts.
57.	Trace outstanding cheques at year end to subsequent bank statement to check that they are actually outstanding and are not simply recorded in wrong accounting period.
58.	Count cash in hand and agree the amount to ledger.
59.	Check the gains or losses on the foreign exchange transactions for accuracy.
Compliance checklist for Project Verification	
60.	Check that strategy is properly implemented and expenditures are incurred on relevant areas necessary for achieving goals of project
61.	Obtain loan agreement and extract terms and conditions of funds to be paid and dates on which they will be paid.
62.	Check that procedures specified for the withdrawal of funds are followed
63.	Obtain an explanation of the refusal by the lender where there is a difference between the amount claimed and amount received.
64.	Trace each deposit of the proceeds to the relevant bank account
65.	Obtain loan balance confirmation from the lender
66.	Compare the balance as per the confirmation received from the lender to the balance per the accounting records
67.	Check the ratio of expenditures between; Those areas contributing directly towards the achievement of goals of the project and; Office expenditures

ANNEXURE M: SAMPLE SELECTION CHECKLIST

NAME OF AUDIT ENTITY:

AUDIT COMPONENT:

AUDIT PERIOD:

TYPE OF SAMPLE	SAMPLE SELECTED	DATE
High Value Items		
Key Items		
Tests of Internal Control		
Substantive Tests of Details		

ANNEXURE N: BANK CONFIRMATION TEMPLATE

Name of Designated Authority
Designation
Address:

Date:

Dear Sir/Madam

Name of project

Standard request for bank report for audit purposes

In accordance with your above-named customer's instructions given hereon, please send DIRECT to us at the above address, as auditors of your customer, the following information relating to their affairs at your branch as at the close of business on **Period Closing date** and, in the case of items 2, 4 and 11 during the period since **Period starting date**, the end of the previous accounting period.

Please state against each item any factors which may limit the completeness of your reply; if there is nothing to report, state 'NONE'.

It is understood that any replies given are in strict confidence, for the purposes of audit.

Information Requested		Response
Bank accounts		
(1)	Full titles of all accounts together with the account numbers and balances therein, including NIL balances:	
	(a) where your customer's name is the sole name in the title; (b) where your customer's name is joined with that of other parties; (c) where the account is in a trade name.	

Information Requested		Response
	Notes (i) Where the amount is subject to any restriction (e.g. a garnishee order or arrestment) or exchange control considerations (e.g. 'blocked account') information regarding nature and extent of the restriction should be stated. (ii) where the authority upon which you are providing this information does not cover any amounts held jointly with other parties, please refer to your customer in order to obtain the requisite authority of the other parties with a copy to us.	
(2)	Full titles and dates of closure of all accounts closed during the period.	
(3)	The separate amounts accrued but not charged or credited as at the above date, of	
	(a) mark-up / interest; and (b) provisional charges (including commitment fees)	
(4)	The amount of mark-up / interest charged during the period if not specified separately in the customer's statement of account.	
(5)	Particulars (i.e. date, type of document and accounts covered) of any written acknowledgement of set-off, either by specific letter of set-off, or incorporated in some other document or security.	
Facilities		
(6)	Details of leasing facilities, loans, overdrafts, cash credit facilities (including standby facilities), and associated guarantees / indemnities specifying agreed limits, unused facilities, mark-up/interest terms, overdue rentals / instalments and in the case of term loans, date for repayment or review.	

Contingent liabilities		
(7)	Nature, currency, amount and extent of any facilities limits and details of period of availability of agreed facility of all contingent liabilities, viz.:- (a) Total of bills discounted with recourse to the customer or any subsidiary or related party of the customer;	
	(b) Details of any guarantees, comfort letters, letter of undertakings, bonds, endorsements or indemnities given to you by the customer in favour of third parties (separately specifying any such items in favour of any subsidiary or related party of the customer);	
	(c) Details of any guarantees, bonds or indemnities given by you, on your customer's behalf, stating where there is recourse to your customer and/or to its holding, parent or any other company within the group;	
	(d) Total of acceptances;	
	(e) Total of outstanding liabilities under documentary credits;	
	(f) Others (please give details)	
Additional Banking Relationships		
(9)	A list of other banks, or branches of your bank, where you are aware that a relationship has been established during the period.	
(10)	Other Information.	

ANNEXURE O: TAX CONFIRMATION TEMPLATE

Name of Recipient Organization.

Date:
Ref:

Dear Sir/Madam,
Our auditors are performing their usual examination of our Financial Statements. Please furnish to our auditors the information requested below involving matters as to which you have been engaged and to which you have devoted substantive attention on behalf of the company in the form of tax & legal consultation or representation. Please provide the information requested below, taking into consideration matters that existed at **Closing Period Date** and from the period from that date to effective date of your response if it is other than the date of reply. Your response should be sent to our auditors:

Address of Office of AGPR
Fax NO.

PENDING OR THEREATENED LITIGATION EXCLUDING UNASSERTED CLAIMS AND TAX ASSESSMENTS
Please provide our auditors the following information with respect to all litigation claims and assessments (excluding unasserted claims and assessments) considered by management of the company to be material.

The nature of the litigation and tax cases.

The progress of the tax cases to date.

How management is responding or intends to respond to the litigation (i.e. to contest the case vigorously or to seek out of court settlement) and your evaluation of the likelihood of an outcome and an estimate.

Also, please identify any pending or threatened litigation and tax cases with respect to which you have been engaged and to which you have not devoted substantive attention.

UNASSERTED CLAIMS AND ASSESSMENT
Please confirm to our auditors that you have not advised us any unasserted claims and assessments that are probable of assertion and must be disclosed in the financial statements.

OTHER MATTERS
Please identify the nature of and any reason and for any limitation on your response.
Also indicate the amount we were indebted to you for services and expenses on **Closing Period Date**.
The schedule completion date of the auditor's examination is such that you should send your letter to Office of AGPR as soon as possible.

Regards,

ANNEXURE P: REPRESENTATION LETTER

Auditor General of Pakistan
Constitution Ave.
Islamabad 44000

[*Date of financial statements*]

Dear Sirs,

This representation letter is provided in connection with your audit of the financial statements of (project name) for the year ended 30 June 20XX, for the purpose of expressing an opinion as to whether these financial statements give a true and fair view of the state of project's affairs as at 30 June 20XX and of its loss and cash flows for the year then ended in accordance with Approved Accounting Standards as applicable in Pakistan.

We confirm that the representations we make in this letter are in accordance with the definitions set out in the Appendix to this letter.

We confirm that to the best of our knowledge and belief, having made such inquiries as we considered necessary for the purpose of appropriately informing ourselves:

Financial Statements

1. We have fulfilled our responsibilities, as set out in the terms of the audit engagement referenced _____ dated _____, for the preparation and fair presentation of the financial statements (or preparation of financial statements that give a true and fair view) in accordance with Approved Accounting Standards as applicable in Pakistan.

2. We confirm that proper books of account have been kept by the project as required by applicable laws and regulations

3. We confirm that the balance sheet, receipts and expenditure account together with the notes thereon have been drawn up in conformity with the applicable laws and regulations and are in agreement with the books of account.

4. We confirm that the expenditure incurred during the year was for the purpose of the project's business.

5. We confirm that the activities conducted and the expenditure incurred during the year were in accordance with the objects of the project. All the transactions entered during the period have been approved at appropriate levels according to materiality levels approved by the EA/IA

6. We confirm that no Zakat was deductible at source under the Zakat and Ushr Ordinance, 1980 (XVIII of 1980).

7. All events subsequent to the date of the financial statements and for which Approved Accounting Standards as applicable in Pakistan require adjustment or disclosure have been adjusted or disclosed, wherever applicable.

8. We believe there are no uncorrected misstatements.

Information Provided

9. We have provided you with:

- access to all information of which we are aware that is relevant to the preparation of the financial statements, such as records, documentation and other matters;
- additional information that you have requested from us for the purpose of the audit; and
- unrestricted access to persons within the project from whom you determined it necessary to obtain audit evidence. All transactions have been recorded in the accounting records and are reflected in the financial statements. We acknowledge our responsibility for such internal control as we determine necessary for the preparation of financial statements that are free from material misstatement, whether due to fraud or error. In particular, we acknowledge our responsibility for the design, implementation and maintenance of internal control to prevent and detect fraud and error.

10. We have disclosed to you the results of our assessment of the risk that the financial statements may be materially misstated as a result of fraud.

Included in the Appendix to this letter are the definitions of fraud, including misstatements arising from fraudulent financial reporting and from misappropriation of assets.

11. We have disclosed to you all information in relation to:

(a) There have been no instances of fraud or suspected fraud that we are aware of and that affect the project and involve:

- Management;
- Employees who have significant roles in internal control; or
- Others where the fraud could have a material effect on the financial statements.

(b) There have been no allegations of fraud, or suspected fraud, affecting the Company's financial statements communicated by employees, former employees, analysts, regulators or others

12. There have been no instances of non-compliance or suspected non-compliance with laws and regulations whose effects should be considered when preparing the financial statements. Further, we have disclosed to you and have appropriately accounted for and/or disclosed in the financial statements in accordance with Approved Accounting Standards as applicable in Pakistan all known actual or possible litigation and claims whose effects should be considered when preparing the financial statements.

13. We have disclosed to you the identity of the project's related parties and all the related party relationships and transactions of which we are aware and all related party relationships and transactions have been appropriately accounted for and disclosed in accordance with applicable laws and regulations.

Included in the Appendix to this letter are the definitions of both a related party and a related party transaction.

14. The project has complied with all aspects of contractual agreements that could have a material effect on the financial statements in the event of non-compliance, for example debt covenants.

15. There are no formal or informal compensating balance arrangements with any of our cash and investment accounts. We have no line of credit arrangements.

16. We have no plans or intentions that may affect the carrying value or classification of assets and liabilities.

17. We have no plans to abandon lines of product or other plans or intentions on behalf of the project.

18. The project have satisfactory title to all assets. We confirm that we have completely and accurately recognised all transactions during the year involving expenditure incurred during the year.

19. We confirm that there are no unrecorded liabilities and all liabilities have been properly recorded / accrued at the balance sheet date.

20. We confirm that during the period there have not been any externally imposed capital requirements. We further confirm that to the best of our information and estimate and cash flow projections the project is expected to remain as a going concern in the foreseeable future.

21. Deferred tax is measured at the tax rates enacted or substantively enacted at the period end and represent those amounts that are probable of realization taking into account management's estimates of future taxable profit. In determining estimates of future taxable profit against which the deductible amounts can be utilized, management has considered the existence of taxable temporary differences that will reverse in the same period that deductible amounts will reverse and also has considered appropriate tax planning opportunities that the project is more likely than not to take advantage of in order to generate future taxable profit.

    The project is able to control the timing of reversal of all temporary differences in relation to investments in subsidiaries, branches and associates and investments in joint ventures for which deferred taxes have not been recognized, and it is probable that those temporary differences will not reverse in the foreseeable future,

    We have not received any advice or opinion that contradicts the project's support for accounting for income taxes, that contradicts the financial statement amounts and presentations in respect of tax, or that is necessary to understand the project's tax accrual and related matters and has not been disclosed to you.

    We confirm that impact of recognition of deferred tax relating to income under normal tax regime would be immaterial in context of overall financial statements.

22. We confirm that income tax and all other duties, taxes and government levies have been recorded completely and accurately, taking into account all the information available at the balance sheet date and no additional significant liabilities are expected to arise in respect of current or prior year with relation to the above-mentioned items.

23. We confirm that accounting policies have been consistently applied

24. We have considered which currency is the currency of the primary economic environment in which the project operates (the "functional currency"). In making this assessment, we have used our judgment to determine the functional currency that most faithfully represents the underlying transactions, events and conditions of the project. We confirm that Pak Rupee is the functional currency of the project as substantial expenses are incurred in Rupees.

Yours truly,

[Head of Project] [Head of Finance]

Appendix to the Management Representation Letter (Project Name)

Definitions

Material Matters

Certain representations in this letter are described as being limited to matters that are material.

Material omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.

Fraud

Fraudulent financial reporting involves intentional misstatements including omissions of amounts or disclosures in financial statements to deceive financial statement users. [ISA 570.A2]

Misappropriation of assets involves the theft of an entity's assets. It is often accompanied by false or misleading records or documents in order to conceal the fact that the assets are missing or have been pledged without proper authorization. [ISA 570.A5]

Error

An error is an unintentional misstatement in financial statements, including the omission of an amount or a disclosure. [IFAC Glossary of Terms].

Prior period errors are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

a) was available when financial statements for those periods were authorized for issue; and

b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud. [IAS 8.5]

Management

For the purposes of this letter, references to "management" should be read as "management and, where appropriate, those charged with governance". [ISA 580.8]

Related party

Related party - A party is related to an entity if:

a) directly, or indirectly through one or more intermediaries, the party:

   i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);

   ii) has an interest in the entity that gives it significant influence over the entity; or

   iii) has joint control over the entity;

b) the party is an associate (as defined in IAS 28 *Investments in Associates*) of the entity;

c) the party is a joint venture in which the entity is a venture (see IAS 31 *Interests in Joint Ventures*);

d) the party is a member of the key management personnel of the entity or its parent;

e) the party is a close member of the family of any individual referred to in (a) or (d);

f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or

g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

Related party transaction - A transfer of resources, services or obligations between related parties, regardless of whether a price is charged.

ANNEXURE Q: MANAGEMENT LETTER

[Office of Director General]
Audit of [Project title and number]
[Development Partner]
Audit for the period [start date] till [end date]

[Date]

Dear Sir,

During the audit of the [FAP title] for the period [start date] till [end date], following deficiencies were noted in the internal control systems in place at the PMU and therefore need to be addressed:

1. [Title of observation]
   - *Area of expenditure;*
   - *Criteria;*
   - *Conditions;*
   - *Causes and consequences, where possible;*
   - *Recommendations;*
   - *Management response;*
   - *Auditor's comments;*
   - *DAC recommendations*
   - *Conclusion by the Auditor.*

We await your response (filled in the section "management's response") to the aforementioned findings. Please note the responses should be annexed with appropriate supporting in order to enable us to effectively conclude the findings. A final draft of the management letter will be presented to the DAC for follow-up over the findings. In order to ensure timely completion of audit, and finalization of the audit reporting pack for submission to the development partner, your utmost cooperation is requested.

Undersigned:

[Name]
[Designation]