



Annex 4

Instruction regarding the audit tasks related to activities covered by a Strategic Partnership – to be followed by the Danish auditor and by auditors auditing activities in a partner country funded under the Strategic Partnership

This instruction covers the audit tasks that the Ministry of Foreign Affairs of Denmark (MFA) requires the Strategic Partner's auditor to perform in relation to activities funded under the Strategic Partnership in Denmark and in partner countries. The legal basis for giving instructions in the area of audit is encompassed in the annual finance act and in the partnership agreement, to which this instruction is an annex.

§ 1. The Strategic Partner's auditor is appointed by the Strategic Partner's competent assembly. The audit shall be carried out by a state authorized public accountant.

(2) If the Strategic Partner's auditor is changed, the acceding auditor must contact the leaving auditor who is required to inform the Strategic Partner, MFA and the acceding auditor of the reasons for the termination of the contract.

(3) The audit of activities outside Denmark shall be carried out locally in the recipient country and must be performed by a chartered accountant or certified public accountant from an audit firm of high repute. The Strategic Partner's Danish auditor has the overall supervision of the local audit abroad. (Only in exceptional circumstances can the audit of activities be carried out outside the recipient country).

§ 2. The audit in Denmark is conducted in accordance with the standards for public-sector auditing ("Standarderne for offentlig revision – SOR"). For activities outside Denmark financial as well as performance and compliance audit is conducted according to recognized international standards issued respectively by IFAC and INTOSAI. The local auditor should always be informed of the content of this audit instruction in order to ensure compliance with the audit instruction.

(2) The audit shall verify whether the accounts are accurate and whether the transactions covered by the financial statement are consistent with the grant appropriation, agreements with the MFA, signed contracts and laws and other relevant regulations. The auditor also assesses whether due financial considerations have been taken in the management of the grant and expenses included in the accounts.

§ 3. The scope of the audit depends on the Strategic Partner's structure and practices, including internal control and other matters of importance for the presentation of the financial statement.

§ 4. Audit is conducted throughout the year. As part of the audit, the auditor examines the Strategic Partner's organizational structure and existing administrative procedures with a particular emphasis on accounting, financial management and adequate internal control. Substantive audit is performed as a spot check examination of the vouchers and their correct registration in the bookkeeping based on an assessment of materiality and risk.

(2) The auditor examines whether the local financial statements have been audited according to recognized international standards, include elements of performance and compliance audit and bear the endorsement of the local auditor and a person authorized by the relevant partner responsible for preparing the financial statement. The auditor makes a general assessment of the extent and quality of the local audit, preferably after contact with the local auditor.

(3) The auditor shall ensure that the Strategic Partner sets up the annual financial statements in accordance with the requirements in the administrative guidelines. The auditor shall, in particular but not limited to, examine whether:

- The accounts are fair and do not contain significant errors or omissions,
- The accounts include common cost functions (programme support cost) based on a transparent and reasonable cost allocation mechanism,
- The accounts include personnel costs based on a transparent and reasonable calculation of the hourly rates and well-described internal salary structure in accordance with (not exceeding) the publicly recognized salary level(s) for salaries paid with public funds for comparable work,
- The Strategic Partner conducts and documents back testing of programme support and personnel cost, at least annually,
- The own-financing requirement is met,
- The financial requirements of the Strategic Partnership Agreement and minutes from the annual strategic negotiations with MFA are met,
- The Strategic Partner has an updated plan for follow up on financial recommendations from previous audit and financial monitoring/review reports,
- The transactions covered by the financial statements are in accordance with the appropriations and the overall purpose of their use, as agreed with MFA during the annual strategic meeting.
- The Strategic Partner has received locally audited financial statements annually for all activities outside Denmark. If this is not the case, or if the local audits are deemed non-compliant with these instructions, this must be elaborated in the audit report and there must be a list of outstanding financial statements included as an annex to the overall financial statement. The expenditures for the particular local partner/office will be ineligible until the pending audited financial statements compliant with these instructions have been received. The unaudited expenditures should be included in the financial statement on the basis of transfers and the relevant expenditure figures

should be adjusted in line with the actual figures in the subsequent financial statement..

- The local audit has given rise to significant remarks or a modified opinion, and if it covers the requirements of performance and compliance audit as well as the financial audit. If there is a modified audit opinion or the local audit excludes elements of performance and compliance audit this must be mentioned in the audit report or in the auditor's management letter (or similar format),
- Completed projects are duly documented and specified in the Strategic Partner's internal financial statement,
- The financial statements have been reconciled with the Strategic Partner's annual financial statement.

Procedures to be performed regarding financial audit could include:

1. Confirm and reconcile amounts received from the MFA
2. Perform substantive testing on a sample basis of expenditure to verify proper allocation to the appropriate budget lines against the approved budget
3. Perform substantive testing on a sample basis to verify the existence of valid third party supporting documents relating to reported expenditure.
 - a. The sample size shall be based on the audit company's professional judgement and should be stated in the methodology description related to the audit.
 - b. All instances of any missing supporting documents must be reported, including the amounts in question.
4. Perform substantive testing on a sample basis of the fixed asset list included in the financial statements as part of the reporting requirements to verify the existence and valuation of assets.
5. Perform procedures to verify the occurrence of transactions related to:
 - a. Any interest earned during the financial period
 - b. Any exchange gain/losses recorded in the accounts.

(4) The compliance audit examines if systems and procedures of the Strategic Partner have been complied with, whether transactions covered by the financial statements comply with the appropriations granted, statutes, other regulations, agreements, and usual practice, whether laws and regulations of the country have been complied with, and examines whether the grant management has met the requirements made for it. Any ineligible and undocumented expenses are stated in the compliance audit. The audit is planned and performed in accordance with SOR 6. Outside Denmark the compliance audit is conducted according to relevant international standards issued by INTOSAI.

Procedures performed in regard to compliance audit could include:

1. Examine, assess, and report on compliance with the terms and conditions of the partnership guidelines, agreements and commitment letters from the MFA and other donors, if relevant
2. Gain an understanding of the legislative and regulative environment in which the entity exist.
 - a. Assess compliance with applicable laws and regulation with special attention to legislation regarding accounting and taxes
3. Gain an understanding of the processes established to ensure compliance with applicable laws and regulations regarding employment of staff. This includes relevant labour legislation as well as regulation regarding social fees, pension, holiday, sick leave, and maternity leave.
4. Reconcile budget amounts included in the financial statements against the approved budget
5. Test on a sample basis that expenses and staff resources funded by grants through the MFA is not funded from other sources as well.

(5) The performance audit examines whether economy, efficiency and effectiveness have been taken into account in the grant administration. The audit in Denmark is conducted in accordance with SOR 7 and based on the Strategic Partner's financial reporting, strategic plan, performance report and other reporting to MFA on goals and results, and on economy, efficiency and effectiveness. Outside Denmark performance audit is conducted according to relevant international standards issued by INTOSAI.

The auditor must obtain reasonable assurance that the systems, processes or transactions examined support the exercise of sound financial management in the administration of the funds granted through the MFA. Sound financial management includes adhering to principles of economy, efficiency and effectiveness in the management of available resources.

Procedures performed in regard to performance audit could include:

1. Perform interviews and walk-throughs to gain an understanding of the business processes
 - a. Identify key controls related to performance. These controls may include:
 - i. Authorisation in connection with the procurement of goods and services.
 - ii. Budget reviews and follow up on costs
 - iii. Managements review of finalised procurement processes
 - iv. Monitoring reviews including evaluation of progress compared to activity description
 - v. Managements review of benchmarks for completion or equivalent
 - b. Perform test of design and implementation of identified key controls

- c. Depending on audit strategy, perform test of the operational effectiveness of controls.
- 2. Substantive testing on a sample basis
 - a. Determine relevant audit criteria for the audit in relation to economy, effectiveness or efficiency. The audit criteria can be qualitative or quantitative, focusing on what is expected or best practice. These may include:
 - i. The quality in which the activity is delivered or completed compared to the description of the activity
 - ii. The quantity of items completed or delivered compared to the description of the activity
 - iii. Cost of procured goods or services compared to expected prices
 - iv. Compliance with established procedures for procurement of goods and services, for instance the number of quotations received
 - v. The level of entertainment costs and travel costs compared to expected levels or levels with peers
 - vi. Proper handling of assets, including liquid assets and fixed assets.
 - b. Perform tests on selected audit criteria and evaluate on findings and conclusion.
- 3. To ensure economy in salary levels, perform test on a sample basis of established policies and procedures for compliance, specifically regarding allowances, advances, staff recruitment/salary scales, and other accounting routines.
- 4. Analytical procedures
 - a. Identify relevant ratios as indicators for economy, effectiveness or efficiency. These ratios may include:
 - i. Ratios between direct costs and output
 - ii. Ratios between administrative costs and output
 - iii. Ratios between scarce resources and output
 - b. Perform analytical reviews of the development of ratios over time.

(6) Performance audit may include reviewing the Danish Strategic Partner's overall established procedures for measuring and reporting on productivity and efficiency goals. To the extent that the Strategic Partner makes concrete actual measurements of productivity and efficiency, it is expected that the auditor will assess the reliability of such measurements and report on it in the management letter. Where such concrete measurements are not available, the auditor must assess whether the Strategic Partner otherwise (often on a more qualitative basis) makes reasonable assessments of the performance, and the auditor may propose appropriate measurement methods and indicators. The auditor may report lack of reliable measurements of productivity and efficiency, etc. in the management letter without making reservations or providing additional information in the audit report on the accounts. If there are no measurements of productivity and efficiency or the available measurements are of such a nature that

they cannot form the basis of the performance audit, the auditor shall report on this in the audit report.

(7) The auditor must verify that grant funds are segregated from other funds either in the Strategic Partner's accounting system or using a separate bank account, and that there is no mix of the funds granted under the Strategic Partnership and other funds.

§ 5. In accordance with the provisions of the Strategic Partnership Agreement, the management of the Strategic Partner shall provide the auditor with the information that may be considered to be of importance for the assessment of the financial statement and for the auditor's assessment of the management, including objectives and results achieved. The Strategic Partner's management shall allow the auditor to conduct the investigations deemed necessary by the auditor and ensure that the auditor receives the information and assistance that may be deemed necessary for the performance of the audit.

§ 6. If the auditor becomes aware of any sign of fraud or material breaches of the Strategic Partnership Agreement and the administrative guidelines, it is the responsibility of the auditor to immediately inform the Strategic Partner's management and competent assembly and to ensure that notification of the findings are shared with the MFA within 2 weeks. Otherwise, it is the duty of the auditor to inform the MFA.

(2) The same shall apply if, during the audit or otherwise, the auditor becomes aware that the continuation of operations is uncertain for economic or other reasons.

§ 7. The audited financial statements shall be accompanied by an audit statement in accordance with the guidelines in SOR5, which shall state that the accounts have been audited in accordance with the rules in this instruction.

(2) The auditor shall submit a management letter (or long form audit, protocol or similar format). The letter shall include but not necessarily be limited to information about:

- Which audit actions have been carried out and the result thereof, including regarding supervision of the local audits conducted abroad.
- Significant uncertainty, errors, ineligible or un-documented expenses, or omissions regarding the Strategic Partner's accounting or internal control,
- Compliance audit carried out, including any observations concerning lack of compliance with applicable guidelines, laws and regulations, lack of compliance with the systems, policies and procedures of the Strategic Partner.
- The Strategic Partner's fulfilment of the own-financing requirement, including whether the funds are provided and used in accordance with the guidelines,
- The performance audit carried out, including the auditor's assessments and conclusions regarding economy, efficiency, and effectiveness as well as dispositions that fall outside the framework cooperation with MFA,

- Auditor's assessment of the local audit and audit reports, including outstanding financial statements, accounting records with modification, missing elements of performance and compliance audit, and significant remarks in the audit reports for the local audits,
- The auditor's assessment of the quality of the financial monitoring of local partners, including systems to ensure that all local partners receive financial monitoring visits and the quality of the financial monitoring visit reports as well as follow-up on the observations and recommendations in the local financial monitoring visit reports.
- The auditor's observations and recommendations about compliance and performance audit

(3) The management letter should state whether the auditor complies with the legislation's eligibility rules, whether the auditor has received all the information requested during the audit, and whether the auditor has commented on the use of the grant. The management letter shall report on any special reports or statements, submission of special reports, advice and assistance provided.

(4) The MFA expects the audit to add value in terms of identifying areas for potential capacity building by identifying the gaps or weaknesses in financial systems, procedures and controls as compared to best practice. It is expected that the audit provides recommendations regarding the identified gaps or weaknesses. The auditor's detailed reporting of the audit may appear in the Strategic Partners' management letter, or in a separate report outside of the management letter's continuous page number, provided that reference is made to such separate reports in the management letter itself and that significant remarks are reflected in the management letter itself.

(5) A copy of the audit report and management letter shall be submitted by the Strategic Partner to MFA together with the audited financial statement. The same applies to the overall audited financial statement of the Strategic Partner with management letter as soon as this is approved by the Strategic Partner's Executive Committee or Competent Assembly.

§ 8. It is the responsibility of the Strategic Partner to obtain the auditor's written consent to audit the grant in accordance with this instruction. This should be obtained in a timely manner prior to the start of the audit process.