**Annex 12A: Supporting note for auditing**

**1. Financial audit**

Financial audits are intended to provide reasonable assurance that the financial statements are presented fairly, in all material respects, in accordance with the financial reporting framework.

**1.1. Objective of the financial audit**

The overall objective of the financial audit is to obtain reasonable assurance about whether financial statements regarding the funds granted through the Ministry of Foreign Affairs of Denmark (DMFA) are free from material misstatements.

Since the financial statements do not cover other activities, the sole objective of the audit is to provide assurance to the DMFA as to whether financial statements are free from material misstatements. The auditor must therefore design the audit to meet this purpose. This includes identification of risks and procedures directly related to the funds granted, assessing the internal controls in relation to preparing financial statements for the engagement, evaluating the applied accounting practices against those set by the DMFA and evaluating whether the structure of the financial statements complies with the reporting requirements set by the DMFA.

**1.2. Scope of the financial audit**

The financial audit must be carried out in accordance with International Standards on Auditing (ISAs).

As part of an audit conducted in accordance with the ISAs, and in order to meet the requirements applicable to audits of funds granted through the DMFA, as regulated by the office of the Danish Auditor General, the work is expected to cover:

* The auditor must identify and assess risks of material misstatement of the financial statements, whether due to fraud or error. Based on the risks identified, the auditor must design and perform relevant audit procedures to obtain sufficient and appropriate audit evidence to serve as the basis for the auditor’s opinion.
* The auditor must obtain an understanding of the internal controls relevant to the audit, in order to design appropriate audit procedures. The purpose is not to express an opinion on the effectiveness of the internal controls, but whether these controls pertain to the project costs.
* The auditor must evaluate the appropriateness of the accounting policies used in the financial statements, including the reasonableness of estimates and related disclosures.
* The auditor must evaluate the overall presentation, structure and content in the financial statements, including that all own contributions are included and documented in the form of an authorised letter from the applicable partners (annex 15). The audit does not include the own contribution.

The audit should be performed on an annual basis, however, under special circumstances, it may be extended by a couple of months with the explicit consent of the DMFA.

**2. Performance and compliance audit**

Performance audits examine the economy, efficiency and effectiveness of the audited activities whereas compliance audits examine whether the activities are compliant with applicable rules, policies, and regulations.

**2.1. Objective of performance and compliance audits**

The overall objective of a compliance audit is to obtain reasonable assurance that transactions covered by the financial statements comply with the appropriations granted, statutes, other regulations, agreements, and usual practice. Similarly, the objective of a performance audit is to make an assessment to 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 DMFA. Sound financial management includes adhering to principles of economy, efficiency and effectiveness in the management of available resources.

Often financial audits will be carried out as an assurance service, and performance and compliance audits as reporting services. For performance and compliance audits the auditor is still expected to obtain a high degree of certainty for the conclusions reported, but typically does not declare him-/herself on the entirety of the financial statements.

**2.2. Scope of performance and compliance audits**

As Danish provisions require the audit to be performed according to public sector auditing standards based on the International Standards of Supreme Audit Institutions (ISSAIs), the audit is required to cover not only financial aspects, but must also include compliance and performance elements. Specifically, the ISSAI 3000-series is used for performance audit and the ISSAI 4000-series is used for compliance audit.

As part of an audit conducted in accordance with ISSAIs, and in order to meet requirements applicable to audits of funds granted through the DMFA, as regulated by the office of the Danish Auditor General, the work is expected to cover:

* The auditor must examine and evaluate the functioning of management systems and business processes with special consideration to compliance and performance audit. Based on the obtained knowledge, the auditor must determine relevant audit objectives and audit approach.
* The auditor must gain an understanding of the audited entity and its environment to identify relevant regulation and legislation; this includes tax legislation, company legislation, labour legislation, etc.
* The auditor must consider the necessity and relevance to perform test of details regarding compliance and the principles of economy, effectiveness and efficiency.

For further guidance on relevant compliance and performance audit procedures, please refer to the template ToR for engaging DMDP audit services.

The audit plan for a multi-year engagement should include considerations about what performance and compliance audit procedures to include and when to include these. Based on an understanding of risk and importance, the auditor can rotate the compliance and performance related audit procedures, as long as relevant performance and compliance are tested during the grant period.

**3. Deliverables - audit report**

Conclusions of the audit, including relevant emphases or qualifications, must be reported in the independent auditor’s opinion, which must be included in the financial statements. The auditor’s opinion should be prepared in accordance with the ISAs depending on the type of financial statements. The auditor’s opinion must be provided together with the audited set of financial statements no later than six months after the end of the financial year.

The methodology of the audit must be described and provided, either in an audit report, included in the financial statements, or via an audit summary memorandum submitted after the audit. In either case, the purpose of providing a description of the methodology of the audit is to provide the DMFA with the basis to assess the scope of the performed audit. The methodology must therefore be as detailed and elaborate as possible and, as a minimum, is expected to contain:

* Identification of the accounting period.
* A detailed description of the scope of the audit, including:
	+ Material account balance and classes of transactions;
	+ Identified risks, and;
	+ Procedures performed to address identified risks.
* A description of the applied audit strategy and the basis therefore.
* The number of samples allocated on physical locations, offices, etc.
* A description of the applied materiality, including:
	+ The basis for setting the materiality level;
	+ Any special considerations made regarding the materiality, and;
	+ The materiality level specified in the currency of the financial statements.
* A description of planned and performed on-site visits.

The exact scope of the description of the methodology should be determined in the Terms of Reference of the audit.

In conjunction with the audit, the auditor is required to prepare and submit a management letter. The management letter must contain observations and findings identified during the audit, which must be communicated to management. These observations can pertain to deficiencies in internal controls, non-compliance with local legislation, specific issues discussed with management, etc.

The observations and findings included may be immaterial for the financial statements as a whole, but relevant for management or relevant stakeholders, including the DMFA. For each observation or finding, the auditor must provide a description of the related risk, the auditor’s recommendation, as well as management’s response to the observation or finding.

**3.1. Audit of stand-alone reporting (special purpose audit)**

The independent auditor’s opinion should be prepared in accordance with ISA 800 or ISSAI 1800 and must refer to the Terms of Reference for the audit.

Since the financial statements only pertain to the specific amount granted through the DMFA in connection with the DMDP, the planned and performed procedures are expected to be directly aimed at obtaining assurance regarding these amounts or engagements. The scope of the description of the methodology is therefore expected to be in accordance with the specific requirements established in the Terms of Reference for the audit.

The purpose of the provided management letter will be to identify findings and observations relating specifically to the funds granted through the DMFA, but also to the organisation as a whole, if applicable. The management letter is therefore expected to contain detailed findings regarding the granted funds as well as observations and findings regarding more general areas, including key internal controls.