

Audits

Objectives

- Partners and ADF staff better understand why audits are useful
- Partners and ADF staff have improved knowledge of common audit findings to avoid
- Partners can better prepare grantees for the audit process
- Grantees, Partners, and Field Staff submit more timely and complete audit responses



Course Content

1. What is an audit?

An audit is an unbiased examination and evaluation of an organization’s financial status; internal controls; and compliance with policies, laws and regulations.

2. Why Conduct an Audit?

- A. For the organization
 - It provides practical training on financial best practices as they apply to your particular situation
 - It helps identify problems in your financial system such as missing funds, biased procurement, or incorrect financial statements
 - It provides an opportunity to identify and reduce risk before a problem arises
 - It is a good management tool for managers without a financial background to have someone with expertise provide an additional level of oversight over the financial officer
- B. For a donor
 - It provides independent, objective accountability for US public funds
 - It identifies deficiencies so that the agency can rely on the accuracy of information presented by the grantee
 - It confirms that projects are executed, and resource use is consistent with the agency mission
 - It provides assurance that ADF is in compliance with applicable laws, regulations, and policy requirements

3. Who is audited?

Who?	How Often?
Grantee	Once during the grant
Partner	Annually
ADF Field Offices	Every Other Year
ADF Washington	Annually

4. Which Grants are Audited?

- A. All grants are subject to audits at any time as stated in the grant agreement.
- B. The standard is that grants are audited once in the life of the grant and that the audit occurs after 40% of the grant is expended.
- C. Grants NOT usually audited
 - EDI grants are not regularly audited
 - Grants under \$50,000 are not regularly audited
- D. All grants can be audited at any time based on a request from the partner and program staff. This usually only happens if there is suspected waste, fraud, or abuse. However, an audit can also be requested if the grantee needs the type of assistance an audit can provide. Requests for special audits will be reviewed by and determined with the ADF Auditor.
- E. The list of grants to be audited each year is referred to as the “audit population”
 - The ADF Auditor chooses which grants to audit and consults with the program team to confirm that there are no outstanding circumstances that warrant delaying the audit.
 - The ADF Auditor reviews the audit population to assess:

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- If the grant meets the requirements for an audit to be performed
- Is provided early enough in the grant to serve as a useful training exercise for the grantee
- If the number of audits in a year is manageable in the field and at ADFW

5. Audit Basics

A. *What is reviewed?*

- All grantee records that relate to ADF funds
- Grantee policies and systems
- Includes ledgers, receipts, invoices, grant budget, Appendix A, asset logs, vehicle logs, bank reconciliations, petty cash, policy manuals, etc.

B. *How long does it take?*

- 5 days on site (average)
- 4-6 months from start to finish

C. *Who are the auditors?*

- A local, in-country, USAID Inspector General approved auditor who has bid for the job and has been selected by ADF as the provider

D. *Which grantee staff needs to be available during the audit?*

- Financial Officer
- Manager
- Other staff involved in funds control

E. *Who coordinates the audit?*

- The ADF Auditor works with the audit firm to ensure the audit is carried out according to US government standards and guidelines. The ADF Auditor is a resource for the program staff, CPC, and partner throughout the audit process.
- The CPC should provide the ADF Auditor with any in-country assistance needed.
- The partner should facilitate scheduling the entrance conference, audit, and exit conference with the auditor and the grantee.

6. Audit Scope

- A. Required audits are ONLY for ADF grant funds

- B. Occasionally, an audit of the full organization can be requested if needed
- C. Internal audits of the grantee can be included in the grant budget if an organization wide audit will be helpful for improving their financial systems. This would be a separate activity from the ADF required audit and would not be coordinated by ADFW.

7. Audit Process

The audit process consists of 7 major steps.

AUDIT PROCESS	1	Preparation
	2	Entrance Conference
	3	Field Work
	4	Exit Conference
	5	Review & Finalization
	6	Corrective Action
	7	Closure

1) Preparation

- a. *Who?* grantee, partner
- b. *What?* Plan and prepare for the audit
- c. *How?*
- The partner should inform the grantee of:
 - When the audit will happen
 - How the audit process works
 - What they will need to do
 - The partner should conduct a Financial Site Visit to find and correct any issues prior to the audit. The site visit should include:
 - Review of policies
 - Review of financial records
 - Review of internal control processes
 - Confirmation that disbursements and expenditures include 3rd party disbursements
 - Inventory of assets bought with ADF funds
 - Review of systems against ADF's list of common audit findings
 - The grantee should make sure their records are available, organized, and accessible.
 - The grantee should work to resolve any known financial systems issues prior to the audit.

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2) Entrance Conference

- a. *Who?* grantee, partner, CPC, auditor
- b. *What?* meet with the auditors
- c. *How?*
 - Auditors explain the objectives of the audit
 - Auditors explain the field work process at the grantee site
 - Grantee asks any questions
 - Partner helps ensure the grantee understands the process

3) Field Work

- a. *Who?* Grantee, auditor
- b. *What?* Review of financial systems
- c. *How?*
 - Auditor goes to the grantee site to examine their records, policies, and systems
 - Auditors will review ADF grant requirements and policies
 - Auditor will interview staff involved in financial systems
 - Grantee staff assists auditor with access to records and explaining systems

4) Exit Conference

- a. *Who?* grantee, partner, CPC, auditor
- b. *What?* Meet with the auditors
- c. *How?*
 - Auditors present the table of findings
 - Auditors provide preliminary recommendations
 - Grantee provides their official comments
 - (a) The grantee should provide written comments in response to each item in the table of findings and to each item in the management letter. The draft audit report will not be provided by the auditors until the grantee comments are received.
 - Partner makes sure any relevant comments are provided and that any misunderstandings are clarified

5) Review & Finalization

- a. *Who?* ADF Auditor, partner, grantee
- b. *What?* Review the draft audit report and management letter from the audit firm

c. *How?*

- Within 2 weeks of receiving the management letter from the auditor, the grantee must provide official comments. The draft audit cannot be released until these comments are provided.
- Grantee confirms draft audit report is received and reviewed
- Grantee reviews for accuracy regarding the grantee situation
- Grantee reviews to implement recommendations
- Partner reviews for accuracy regarding the grantee situation
- Partner reviews to plan for follow-up
- ADF Auditor reviews for completeness
- ADF Auditor reviews for accuracy in references to ADF policy

6) Corrective Action (Follow-up)

- a. *Who?* Grantee, partner, CPC
- b. *What?* Address findings and recommendations from the audit
- c. *How?*
 - Grantee implements recommendations from the audit and resolves any issues
 - Fund accountability issues should be resolved as soon as possible and within a maximum of **30 days** from receiving the final audit report.
 - Other audit findings should be resolved as soon as possible and within a maximum of **90 days** from receiving the final audit report.
 - Partner works with the grantee to ensure all findings are resolved
 - Partner provides additional training to the grantee as needed
 - CPC documents planned follow up action in the Audit Follow up Action Timeline
 - CPC assists with any administrative audit follow up issues such as terminations or collections

7) Closure

- a. *Who?* partner, CPC, ADF Auditor, Grantee

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- b. *What?* Document corrective actions and officially close the audit
- c. *How?*
 - (1) CPC tracks audit status and reminds relevant parties of deadlines
 - (2) Partner documents follow up actions in a draft Audit Closeout Memo. Memo includes:
 - (a) Audit finding description
 - (b) Grantee action taken
 - (c) Partner follow-up/comments
 - (d) CPC follow-up/comments
 - (e) ADF program Analyst comments
 - (f) Recommendation
 - (g) List of attached support documents
 - (h) Signature lines for RPD and ADF Auditor approval
 - (3) CPC reviews the draft Audit Closeout Memo and submits the final Audit Closeout Memo recommending the audit finding be closed to ADFW
 - (4) RPD reviews and concurs with CPC recommendation and forwards the request to the ADF Auditor
 - (5) ADF Auditor approves the recommendation and closes the finding or asks the program team for more support
 - (6) If follow-up action on a particular finding cannot be completed, the ADF Auditor will decide if the finding can be closed
 - (7) Signed copies of the Audit Closeout Memo are provided to the partner for their files
 - (8) The audit is considered closed when all findings have been officially closed by the ADF Auditor

8. Audit Report and Management Letter

The audit report comes in two pieces. The primary report includes the material findings of the audit. A management letter is sent separately which includes immaterial findings.

A. Audit Report

- **Background Information:** Discusses the transmittal letter, objectives, scope, audit

methodology, internal control structure, and general background information

- **Summary:** Provides an overview of the findings
- **Fund Accountability Section:** Discusses the use of funds noting any unallowable or unsupported expenses. The information is summarized in a fund accountability statement.
- **Internal Controls Section:** Discusses the status of the internal controls policies and implementation. Each finding includes a description of the problem, the related risk, a recommendation for improvement, comments from the grantee on the issue and final comments from the auditor.
- **Compliance Section:** Discusses the status of compliance with ADF agreement, budget, and policies, as well as adherence to local laws and regulations. Each finding includes a description of the problem, the related risk, a recommendation for improvement, comments from the grantee on the issue and final comments from the auditor.
- Material Findings are problems or weaknesses found during the audit that the auditors consider to be very important to resolve.
 - (a) all fund accountability items are material
 - (b) compliance and internal controls findings can be either material or immaterial
 - (c) Example: A lack of regular bank reconciliations puts into question whether funds are fully accounted for and so it is a material finding
- Immaterial Findings are problems or weaknesses found during the audit that the auditors recommend the grantee resolve, but that aren't as big of a problem or risk as the material findings.
 - (a) Example: Financial documents are kept, but not filed or cross referenced. This may make it hard

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to ensure all transactions are supported or to trace a transaction and so it presents a risk, but if all documents are kept then one could take the time to fully support every transaction.

B. Management Letter

Includes observations from the audit that are not significant enough to be considered in the formal audit report, but that are still important for the organization to note and fix.

- It is the auditor's judgment to decide whether a finding is significant. ADF can discuss with them and provide further information / clarity that might change their mind, but it cannot tell them what to put in the report.
- Sometimes, as a convenience, the auditors will send the table of findings from the exit conference along with the management letter so that the grantee can plan a comprehensive response to the significant findings (from the table of findings) and insignificant findings (from the management letter)
- Sometimes the auditor will include all finding in the management letter to ensure they receive comments from the grantee on all findings.
- Grantee comments on findings should include a timeframe for follow-up actions.
- Sometimes, findings in the Management Letter are very important to ADF and findings in the audit are less important to ADF. It is an issue of judgment and ADF and the auditors sometimes see the same issue from different perspectives.

9. Audit Timeline

() indicates the duration of each step

- ↓ Audit population decided in August (2-4 months)
- ↓ Entrance interview (1 week)
- ↓ Exit Interview, Table of Findings provided (10 days)

- ↓ Auditor sends Management Letter to Grantee and ADF (1 month)
- ↓ Grantee comments due (2 weeks)
- ↓ Audit draft given to grantee and ADF (2 weeks)
- ↓ ADF provides informal comments to the auditors (4 weeks)
- ↓ Final audit approved by ADF auditor(1 week)
- ↓ Follow-up action timeline provided to Grantee from ADF
 - Closeout memos due for funds accountability findings (0-30 days)
 - Closeout memos due for findings needing time to demonstrate resolution (0-90 days)

10. Partner Role

The partner should be an advocate and communication assistant for the grantee.

- * Without partner support, the grantee's true financial position may not be fairly or completely reflected.
- * Without participation in the audit process, it may be difficult to understand how to fully carry out the follow-up actions.
- * At the exit conference when unsupported costs are identified, the Partner may ask if they can provide documentation to resolve the issue no later than 2 weeks after the exit conference.

11. CPC Role

The CPC should ensure that ADF's intentions are well served in the field. This includes:

- * Using their knowledge of the grantee and ADF to ensure that the audit is a fair representation of the grant status
- * Providing additional facilitation as needed to ensure the grantee is getting the most out of the training opportunity the audit provides
- * Tracking and facilitating the process to make sure that the audit is carried from preparation through to closure in a timely and efficient manner
- * Documenting and reviewing the responses to the audit findings to ensure they are

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comprehensive and supported with proper documentation

12. Common Audit Findings

- a) **Ineligible Costs:** costs that are not allowed
- Example- unreasonable costs
 - Example- costs prohibited by the agreements
 - Example- costs prohibited by applicable laws and regulations
 - Example- costs not project related
- b) **Unsupported Costs:** costs that lack authorization or documentation
- Example- budget shifts not approved by ADFW
 - Example- no purchase request form, no pre-numbered receipts and pre-numbered disbursement vouchers, or no final invoice
 - Example- no evidence of competition to ensure best value (no multiple quotes or justification for sole source)
- c) **Lack of Petty Cash Controls:** petty cash is not well protected using financial best practices
- Example- lack of random cash counts
 - Example- incomplete reconciliation of requests against receipts and vouchers
 - Example- no established petty cash threshold for a single expense
 - Example- Cash not kept in a lockbox or safe
- d) **Lack of Separation of Duties:** the same person maintains custody, approves the expense, and records the expense
- e) **Incomplete Cash Deposits:** cash receipts not deposited in full to accurately reflect a period of sales
- f) **Comingling of Funds:** financial transactions related to the grant are mixed with other transactions of the organization
- Example- ADF funds are transferred to the management operational account and grant expenses are paid from the management operational account
- g) **Lack of Bank Reconciliation:** Bank statements are not compared to the organization's ledgers to make sure that all expenses and receivables are fully accounted for
- Example- bank reconciliations are not done monthly
 - Example- bank reconciliations are not reviewed, signed and dated by the manager
 - Example- reconciliation errors are not resolved
- h) **Lack of Compliance with Tax Laws:** Partial or non-compliance with local payroll, income, and other tax requirements
- Example- payroll taxes not withheld or not submitted timely to the tax authorities
 - Example- VAT not collected and submitted to the tax authorities
 - Example- income incorrectly reported to tax authorities
- i) **Poor Asset Management:** Assets are not tracked or cared for to ensure they are fully utilized for the grant purposes
- Example- asset register is incomplete and lacks information on asset location, purchase date, value, ID number, depreciation, or asset condition
 - Example- assets are not labeled as property of the company with an asset ID number
 - Example- assets are not kept in a secure location
 - Example- assets bought with grant funds are not used or not used for the intended purpose
- j) **Lack of Inventory Logs:** Office supplies, materials, and finished goods in stock are not tracked with location, date of acquisition, purchase price, and ID number
- k) **Conflict of Interest in Procurement:** Procurement is not objective with documentation of a competitive process to ensure a reasonable price and avoid fraud, waste, and abuse
- l) **Poor Procurement Management:** Items are not received, installed, and put into use timely
- No "PAID" stamp to reduce risk of duplicate payments

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- m) **Lack of Audit Trail:** Documentation for expenses, receipts, payroll, and petty cash transactions are incomplete
- Example- ledgers and journals are not up to date
 - Example- invoices, receipts, vouchers, and other support documents are not kept on file for every transaction
- n) **Lack of Adequate Accounting System:** Staff do not have the capacity to prepare accurate financial statements and ADF required reports
- Example- Financial records are not cross referenced to ease investigation of any losses or mistakes
 - Example- staff are not fully trained on the accounting system
 - Example- backups of the financial system are not done regularly
- o) **Lack of Written Manuals:** No manuals to document policies and procedures for financial management, human resources, payroll, procurement, and administrative activities
- Example- policies on attendance, payroll processes, and other staff policies are not documented
 - Example- petty cash procedures are not documented with maximum petty cash expense limit, petty cash account maximum, threshold for replenishing the petty cash account, etc.
- p) **Lack of Compliance with Internal Policies:** The organization's policies are not being followed or fully implemented.
- q) **Lack of Payroll Records:** Payments to staff are not supported by timesheets, receipts for payment, tax withholdings, and other core documentation
- r) **ADF Reporting Requirements Not Met:** Quarterly reports are not submitted timely, accurately, or completely.
- Example- quarterly report does not include all of parts I and II
 - Example- Bank reconciliations not submitted with the quarterly report
- Example- data submitted on performance indicators is inaccurate or incomplete
 - Example- reports are not submitted within 30 days from the end of the quarter
 - Example- reports are not reviewed and approved by management
- s) **Lack of Adherence to CRG Commitment:** Community reinvestment contributions are not made timely according to the schedule agreed at the ADF grant signing
- ### 13. Partner Audits
- A. Partner audits are conducted annually based on their company's fiscal year.
- B. Audits are organization wide, not just on ADF funds.
- This is because most countries required companies to have a complete audit each year
 - An organization wide audit also gives ADF a full understanding of the organization they are working with. (This is the same reason ADF asks for past audits when it searches for partner organizations to work with.)
- C. Unlike grantee audits, Partner audits are managed by the partner, not by the ADF Auditor
- D. Audits must be completed no more than 9 months after the end of the partner's fiscal year
- E. The audit is due to ADF 30 days after the audit is complete
- The ADF auditor will periodically ask for updates on the audit status using the Partner Status Chart
- F. ADF Auditor will review the draft audit and give authorization to finalize the report
- The report should be submitted to the RPD who will share it with the ADF Auditor
- ### 14. Field Office Audits and Formal Reviews
- A. **Field Office Audits**
- a) Audits are conducted every other year
- b) Audits may be done internally by ADF audit staff or by an USAID IG approved audit firm
- c) Audits are conducted in October (after the end of the ADF fiscal year)
- B. **Field Office Formal Review**
- a) At the end of each fiscal year, the Audit Department will choose a test sample from

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- the CPC offices not undergoing an audit who will instead receive a formal review of their use of funds.
- b) The Audit Department will compare the Finance Department's financial records for the Field Office with the budget report, bank statement, and expense report provided by the field office.
 - c) The Audit Department will ask the CPCs to fill out a questionnaire on the implementation of internal controls, ADF policies and procedures, and local laws and regulations.
 - d) The CPC will draft a memo with one paragraph to address each of the following:
 - (1) Identify weakness and risks from the questionnaire,
 - (2) Provide a response of how those issues will be addressed,
 - (3) Explain how the CPC office is complying with local labor law, and
 - (4) Provide a statement of assurance that all policies and procedures are being followed.
 - e) The CPC will submit an excerpt of local laws relevant to their compliance.
 - f) The Audit Department will review the submission and concur with the contents or ask for additional follow-up.
 - g) A copy of the completed questionnaire, local law excerpt, and memo as concurred by the auditor will be kept at the field office and by the Audit Department.

15. ADF Audits

- A. ADF is audited annually, but these rarely impact the partner or field offices.
- B. Irregularly, the ADF program is audited by the USAID Inspector General (IG). This usually entails an extensive look at the grants,

partner, and field office in a specific country. The ADF Auditor will facilitate any IG audits and work with any partners, CPCs, or program staff involved. During these audits, The IG usually requests documents related to a sample population of grants in country, visits the grantees, and meets with the partner and CPC to discuss monitoring. IG audits often lead to agency wide policy changes, trainings, or other widely implemented responses that impact programs in all countries.

16. Advice from the Experts

- Fixing financial problems always takes longer than noting and improving the financial systems before a problem occurs. Include a spot check of some part of the financial systems in each visit to the grantee.
- The audit process can be intimidating and cumbersome for grantees, so the partner and CPC should make sure communication is clear throughout the process.
- The two most common delays in the audit process come from 1) waiting for written grantee comments in response to the table of findings and the management letter and 2) waiting for the grantee to confirm that they have reviewed the draft audit report. The partner can play a key role in reminding the grantee of these requirements.
- Audits are all about risk reduction. When working with the grantee emphasis how improvements will help build the strength of their organization and reduce long term problems.

Handouts

Audit Course Notes

Common Audit Findings Table

Audit Closeout Memo Form

Sample Partner Status Chart

Audit Process Timeline

Sample Audit

Sample Audit Follow up Action Timeline

Sample Audit Closeout Memo & Support