CGIAR AUDITING GUIDELINES MANUAL

FINANCIAL GUIDELINES SERIES, NO. 3

July 2001
Financial Guidelines Series

No. 1  CGIAR Financial Management (Revised 1999)
No. 3  CGIAR Auditing Guidelines Manual (Revised 2001)
No. 4  CGIAR Resource Allocation: Developing and Financing the CGIAR Research Agenda (Revised 2005)
No. 5  CGIAR Indirect Cost Allocation Guidelines (August 2001)
No. 6  CGIAR Procurement of Goods, Works and Services (August 2001)

These policy guidelines have been prepared by the CGIAR Secretariat to assist the International Agricultural Research Centers supported by the Consultative Group on International Agricultural Research. Each IARC is encouraged to draw up its own policies and procedures manuals for its internal use.

Questions or suggestions about these guidelines should be sent to:

CGIAR Secretariat
(Attn: Shey Tata, Senior Financial Officer)
1818 H. Street, N.W.
Washington, D.C. 20433, USA

The CGIAR Secretariat approved the Audit Guidelines for publication as an Exposure Draft on January 16, 2001. It was circulated for comments to all the 16 IARC including certain outside organizations such as the World Bank, the Asian Development Bank, the World Food Programme, and the International Fund for Agricultural Development.
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MANDATORY COMPLIANCE REQUIREMENTS

Centers should use the Auditing Guidelines as a reference guide on the best practices of auditing functions. However, at a minimum, Centers are expected to comply with the following *mandatory compliance requirements*:

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INTRODUCTION

The FG3 has been developed to provide a reference guide on the “best practices” of auditing functions. This paper serves as a guide for all members of Centers Boards of Trustees, Audit/Finance Committees of the Boards of Trustees, management, external auditors, and internal auditors of the CGIAR Centers. This new FG3 paper supercedes the 1995 version.

Purpose of the FG3

The primary function of the FG3 is to establish a uniform auditing guideline. A uniform guideline helps to enforce the documentation of best auditing practices. Through such documentation, auditing functions could hence be carried out efficiently, thus minimizing confusion and error.

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<th>Reasons for a uniform audit guideline</th>
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<tr>
<td>• To document the understanding between auditors and the management, including the Board of Trustees of the Center concerning the auditor’s responsibilities.</td>
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<td>• To provide a trail for new incumbents.</td>
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<tr>
<td>• FG3 becomes a uniform reference guide for auditors. Auditing is a systematic process. This ensures that every step is performed during each audit engagement to ensure consistency and objectivity.</td>
</tr>
<tr>
<td>• FG3 will ensure compliance with agreed auditing standards. This is important because auditing standards developed by expert practitioners are proven as optimal for external and internal auditing functions.</td>
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In addition to providing uniformity, this “best practice” reference guide is also to reinforce the following:

a) Standards -- to establish standards of auditing coverage. Such standards help ensure that the work is of the highest quality.
b) Consistency -- to ensure that auditing approaches and activities are consistent throughout the CGIAR Centers.
c) Information – to serve as a centralized pool of auditing information. This information pool helps facilitate and expedite the auditing process.
d) Training – to serve as a helpful training device, especially for new members of the Board of Trustees, Audit/Finance Committee of the Board of Trustees, management, external auditors, and internal auditors.
CHAPTER ONE:
Corporate Governance

Charter
Responsibility & Authority
Mission
Function & Activities
Principles & Standards
Reporting
1.0 CORPORATE GOVERNANCE

About CGIAR and Corporate Governance

1.1 CGIAR is an informal association of over 50 public and private sector members supporting a network of 16 international agricultural research centers. Each Center is autonomous, operating under the authority of a legally constituted board, charged with fiduciary responsibility for the work of the Center. Hence, the effectiveness of each Center rests on the efficacy of its boards.

1.2 Corporate governance is a system by which a Center directs, manages, controls, and monitors its activities. A typical corporate governance structure specifies rights and obligations, responsibilities and accountabilities, and decision-making among the different participants in a Center. The different participants include the Board of Trustees, Director General, management, and other stakeholders.

1.3 Good corporate governance by Center Boards is therefore, crucial to the continued success of the CGIAR system. The CGIAR Secretariat published in August 1997 a series of seven reference guides on the roles and operations of CGIAR Center Boards, which took into account new principles and practices of institutional governance. The seven guides in the series are based on National Center for Non-profit Boards (NCNB) materials and CGIAR reports on Center governance. The guides were reviewed by the Oversight Committee and the Committee of Board Chairs.

Audit/Finance Committee of the Board of Trustee

1.4 The Audit/Finance Committee’s role is critical in promoting good corporate governance. In addition to helping Boards be more efficient, active, and knowledgeable in the area of financial management and risk management, the Committee (typically through the Executive Committee of the Board of Trustees) could also help ensure even work distribution across all Board members.

1.5 The Audit/Finance Committee or equivalent, like the Board, focuses on strategic rather than operational issues. Its concern is to ensure that the Center has in place an ongoing appropriate system on governance and internal control.

1 For example, the US has recently signed into legislation the International Anti-Corruption and Good Governance Act. The Act has made it a primary goal of US aid to assist other countries combat corruption. Recipients of US aid are expected to comply with certain requirements such as reporting on whether they have taken steps to set up anti-corruption programs.
1.6 Specifically, the Audit/Finance Committee has two major roles. First, it provides the Board oversight on the Center’s audit of the annual financial statements by External Auditors.

1.7 Second, the Audit/Finance Committee is responsible for overseeing that the Center’s financial integrity is maintained. To accomplish this, the Committee monitors to ensure that:

- The system of internal control designed by management is adequate and adhered.
- There is fair reporting of financial results.
- Operations and procedures are efficient and effective.
- There is compliance of management policies.

1.8 To effectively accomplish its roles, the Audit/Finance Committee must rely on the work, guidance, and judgment of the internal and external auditors. Typical areas of responsibilities of the Audit/Finance Committee include:

   a) Recommend appointment of External Auditors for approval by the full Board.
   b) Meet with External Auditors to review audited financial statements, significant audit adjustments, management judgments, accounting estimates, significant new accounting policies, and disagreements with management.
   c) Engage in a dialogue with the External Auditors with respect to any disclosed relationships or services that may impact their objectivity and independence.
   d) Review the Internal Audit Charter and the Internal Auditors’ plans and budgets to ensure they support the Internal Audit Unit’s adequately and cost-effectively.
   e) Receive and review reports from External and Internal Auditors on internal control.
   f) Monitor the organization framework of the Internal Auditing Unit, including appointment and removal of Internal Auditors, and the adequacy of staff in terms of academic and professional credentials and information technology experience.

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2 The Reference Guide for CGIAR International Agricultural Research Centers and their Board of Trustees No. 4: Building Effective Board Committees, August 1997.

3 IIA, Inc. Auditing Standard, Section 380: “Communication with Audit/Finance Committees”.

4 Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit/Finance Committees, 1999.

5 Cadbury and Combined Code (Turnbull).
g) Become familiar with the most significant risks that could prevent the Center from achieving its objectives, and take the necessary actions to address them.

h) Promote a culture that values objective and objective analysis of management.

i) Monitor adherence to the Center's policies on conflict of interest and codes of conduct.

j) Report to the Board on the activities of the Audit/Finance Committee and the significant issues that have emerged from these activities as well as conveying concerns, if any, of the Committee.

1.9 Given the variability of roles and responsibilities that could be performed by the Audit/Finance Committee, it is useful, for the Audit/Finance Committee to have a written, specific statement of responsibilities (charter). This would cover all aspects from job definition and its relationships to the full Board, membership requirements, and its relationships with management and staff. See sample Audit/Finance Committee Charter on Appendix 1.

**Definition of Internal Control**

1.10 CGIAR endorsed the definition of internal control as defined by the Internal Control Framework of the Committee of Sponsoring Organizations of the Treadway Commission (COSO). It provides a common definition by which Centers could assess their internal control systems and determine how to improve them.

1.11 Internal control is broadly defined as a process -- effected by the Center’s Board of Trustees, management and other personnel -- designed to provide reasonable assurance regarding the achievement of objectives of the Center. Internal control consists of five inter-related components, which are derived from the way management runs a business, and are integrated with the management process. The five components are:

- Control Environment
- Risk Assessment
- Control Activities
- Information and Communications
- Monitoring

Details of the five components are made available on Appendix 2.

6 More information on COSO is available from [www.coso.org](http://www.coso.org).
1.12 Internal control systems operate at different levels of effectiveness. It could be judged effective if the Board of Trustees and management have reasonable assurance that:

- They understand the extent to which the Center’s operations objectives are being achieved.
- Published financial statements and donor reports are being prepared reliably.
- Applicable laws, regulations, and policies are being complied with.

1.13 Everyone in the Center has some responsibility for internal control, which could be an explicit or implicit part of the job description (or human resource policy or employment contract). However, the Director General is ultimately responsible and assumes ownership of the internal control system.

1.14 The Director General sets the "tone at the top" that affects integrity and ethics and other factors of a positive control environment. Since management is accountable to the Board of Trustees, Board members should discuss with management the state of the entity's internal control system and provide oversight as needed. They should seek input from the internal and external auditors.

1.15 Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in the Center, an internal auditing function often plays a significant monitoring role.

1.16 External auditors, bringing an independent and objective view, contribute directly through the financial statement audit and indirectly by providing information useful to management and the Audit/Finance Committee in carrying out their responsibilities.

**Definition of Internal Auditing**

1.17 The Institute of Internal Auditors, Inc. has defined internal auditing to be “…an independent, objective assurance and consulting activity designed to add value and improve an organization’s operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.”

1.18 The new definition on internal auditing requires internal auditors to add value to management. It therefore aims to make internal auditing a contribution to management effectiveness through the provision of independent and objective reviews of a wide range of activities. The trend towards a broadening of both the subject matter and scope of internal auditing meant that the skills of internal
auditors should be broadened\(^7\). Hence, it adopts a multi-disciplinary approach in staffing the internal auditing function. This multi-disciplinary approach signals that internal auditing is now involved in financial and non-financial areas within the Centers.

1.19 Further to this goal, the contemporary approaches to internal auditing dictate the scope of the audit role are broadened to include all areas within the Center. Every part of the Center could benefit from a fresh and independent view of operation, and internal auditing could only fulfill this role if the desired skills mix is present.

1.20 In addition, the modern approach to internal auditing means that staff assigned to audit engagements would be dealing with senior management. They would be providing an internal management consultancy service. The move towards a more explicit internal business consultancy role for internal auditing is an important development. It represents a move to diagnose significant problems and develop recommendations and proposals on how best to resolve them. Centers should, therefore, allocate training resources to enhance internal auditors' knowledge, skills, and competencies through continuing professional development.

1.21 The purpose, authority, and responsibility of the internal auditing function should be formally defined, consistent with the definition of internal auditing, and approved by management and/or the Audit/Finance Committee. Internal auditors should report at a level within the Center that allows them to accomplish their responsibilities (e.g., Director General). Also, to enhance the independence of the internal auditing function, Internal Auditors should report to the Director General and have free access to the Audit/Finance Committee of the Board of Trustees.

1.22 Because each Center is independent and have varying expectations from the internal auditing function, it is essential for Internal Auditors to hold discussions with management and the Audit/Finance Committee on their expectations from internal audit. An Internal Audit Charter is one mechanism to formalize the agreement. The charter is a formal written document that defines the purpose, authority, and responsibility of the internal auditing function (see sample Internal Audit Charter on Appendix 3). The Director General and/or the Audit/Finance Committee could approve the charter.

\(^7\) The IIA has developed the Competency Framework for Internal Auditors (CFIA). The CFIA relates to the way an internal auditor uses, assess, and develop knowledge, skills, and attitudes to perform different work tasks.
A typical charter would cover the following:

- Establish the internal auditing function’s reporting position, accountability, and responsibilities within the Center.
- Authorize access to records, personnel, and physical properties relevant to the performance of audits.
- Define the scope of audit activities.

1.23 In addition, Internal Auditors should periodically assess the charter to determine whether the purpose, authority and responsibility defined in the charter continue to be adequate to enable the Internal Auditing Unit to accomplish its objectives. The results of this periodic assessment and any required changes are communicated to Director General and to the Audit/Finance Committee.
CHAPTER TWO: External Auditing

Responsibility & Authority
Objectives
Function & Activities
Coordination
Appointment & Selection
2.0 EXTERNAL AUDITING

Introduction

2.1 External auditors provide independent assurance to the Board of Trustees, the CGIAR Secretariat, and the CG community that the financial statements of Centers are free from material misstatement\(^8\). Specifically, the objective of an external audit is to opine on the fairness of the financial statements and disclosures. **This should be done in accordance with the Generally Accepted Accounting Principles (GAAP) and the CGIAR Financial Guidelines No. 2: Accounting Guidelines (FG2).** The CGIAR Secretariat periodically updates the FG2 to ensure its consistency with the latest authoritative accounting pronouncements issued by the International Accounting Standards and the US Financial Accounting Standards Board\(^9\).

2.2 It is well recognized that national standards on auditing published in many countries differ in form and content. The International Auditing Practices Committee of the International Federation of Accountants\(^{10}\) recognizes such documents and differences. In the light of such knowledge, the body issues International Standards on Auditing (ISA), for international acceptance. A codified core set of international standards on auditing were completed and released in 1994. The release of the core set has led to a growing acceptance of the standards by national standards setters and auditors involved in global reporting and cross-border financing transactions. Centers should, therefore, ensure at the minimum the application and use of ISA by external auditors.

Responsibility for Accuracy of Financial Statements

2.3 Examination of financial records by external auditors (and internal auditors) is not primarily or specifically designed, and cannot be relied upon, to disclose all errors and fraud. The responsibility for safeguarding and maintaining a Center's

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\(^{8}\) A material misstatement includes material errors, material fraud, and certain illegal acts that have a direct and material effect on the determination of line item amounts in the financial statements.

\(^{9}\) At present, the FG2 is more specifically in accordance with the US Financial Accounting Standards for not-for-profit organizations for lack of available authoritative guidance by International Accounting Standards for not-for-profit organizations. The situation however, might change in the next revision of the FG2.

\(^{10}\) The International Federation of Accountants (IFAC) is an organization of national professional accountancy organizations. Most, if not all, of the countries that CGIAR Centers operate in are member bodies of IFAC.
assets, its records, and the prevention and detection of errors and fraud rests with the Center.

2.4 The external auditors however, have a responsibility to plan and perform the audit to obtain reasonable assurance that the financial statements are free of material misstatement, whether caused by error or fraud. Because of the nature of audit evidence and the characteristics of fraud, the external auditor is able to obtain reasonable, but not absolute, assurance that material misstatements are detected.

2.5 The auditor has no responsibility to plan and perform the audit to obtain reasonable assurance on misstatements, whether caused by errors or fraud, that are not material to the financial statements. They have a reasonable expectation of detecting material misstatements in the financial statements resulting from fraud. If fraud is discovered, they must report either to the Board of Trustees or the management of the Center, as appropriate.

Scope and Objectives of an External Audit

2.6 The scope of an external audit is to examine each Center's financial statements, underlying financial records, and internal control systems necessary to opine on the financial statements. External auditors report to the Board of Trustees on the financial statements presented. The extent of the matters to be considered cannot be limited, either by the Center or by the Board. Thus, no provision in the Center's incorporation legislatures could restrict the scope, duties, and rights of the external auditors.\textsuperscript{11}

2.7 The desired outcome of an external audit is to provide an assurance that the financial statements comprising the Statement of Financial Position, Statement of Activities, Statement of Cash Flows, and the accompanying notes and schedules (exhibits) to the financial statements for the current and corresponding years, present fairly the results and financial position of the Center.

\textsuperscript{11} They can, however, be extended. For example, external auditors can be asked to make a more detailed examination of certain aspects of the activities than they would normally make for the purpose of their audit, or to examine records, which do not come within the scope of their audit.
2.8 Further, to fulfill their obligations in a mandated professional manner, Centers should recognize that external auditors are accorded certain rights to carry out their duties for the Board.

The rights include:

a) A right of access to the accounting records, accounts, and vouchers of the Center at all times.

b) A right to acquire from the Center's officers such information and explanations as the auditors consider necessary to perform their duties. The right to require information and explanations are left to the discretion of the auditors rather than to the Center. If such information and explanations as they consider necessary for the audit are refused, they must state this in their audit report and consider qualifying their opinion as to whether the accounts show a fair view.

c) A right to be heard at any Board annual meeting, which concerns them as external auditors. Further, an auditor who is removed or replaced has certain rights to make representations.

d) A right to visit the Center offices at any time, without formal prior notice, to inspect the Center's accounting records or to carry out surprise checks. Normally, the auditors arrange to carry out their audit work at a time convenient to them and the Center.

2.9 At all times, the external auditors are expected to exercise due professional care in the planning and performance of the audit and the preparation of the audit report.

**Typical Areas of Audit**

- Identify, **test**, and **appraise** the system of internal controls as it relates to the preparation of financial statements.
- **Ascertain** the extent of **compliance** with the relevant policies and procedures.
- **Ascertain** the extent to which **assets** are properly controlled and safeguarded from losses.
- **Ascertain** the **reliability** of the accounting and other records used in preparing the financial statements.
- **Ascertain** that the internal control systems are **effective** to prevent material misstatements and fraud.
2.10 A Center should have written engagement letters that outlines the mutual understanding for each audit engagement. This understanding reduces the risk that either the external auditor or the Center may misinterpret the needs or expectations of the other party. For example, it reduces the risk that the Center may rely on the external auditor to protect it against certain risks or to perform certain functions that are the Center’s responsibility.

2.11 Such understanding should include the objectives of the engagement, management’s responsibilities, the external auditor’s responsibilities, and limitations of the engagement. The duties of the external auditors should be clearly stated in an engagement letter (see sample Letter of Engagement in Appendix 4).

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<th>Points to cover in an engagement letter</th>
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<td>- Audit scope and objectives</td>
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<td>- Respective duties and responsibilities</td>
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<td>- Communications protocols and confidentiality</td>
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<td>- Timetable, hours, fees, and expenses</td>
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<td>- Deliverables and outcomes of the audit</td>
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<td>- Other work and consultations</td>
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<td>- Designation of a partner responsible for the audit</td>
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2.12 The external auditors’ report, including the audited financial statements, is usually presented to the Board of Trustees. The report should opine on the fairness of the financial position of the Center as shown in the Statement of Financial Position, the financial performance as shown in the Statement of Activities, the movement in cash and cash equivalents as shown in the Statement of Cash Flows, and the accompanying notes and schedules (exhibits) in support of the financial statements.

\[12\] In addition to the financial statement audit, some donors may require Centers for an external audit of the restricted funds administered by Center to ensure that the funds have been properly applied to those purposes and, if relevant, managed in accordance with relevant regulations and procedures.
Typical schedules that form part of the Center’s audited financial statements could include:

- Statement of Grant Revenue
- Schedule of Restricted Projects
- Schedule of Fixed Assets
- Details of Operating Expenses
- Statement of Movement of Net Assets

2.13 To encourage compliance with the FG2, the CGIAR Secretariat commissions a public accounting firm\(^\text{13}\) to review the Centers audited financial statements to ensure that the accounting standards promulgated in the FG2 are applied consistently by all Centers. Also, such compliance review assists the CGIAR Secretariat in keeping the FG2 up-to-date with new authoritative accounting pronouncements for non-profit organizations.

### Unqualified Audit Opinion

2.14 An unqualified ("clean") opinion in the external auditors’ report would state the scope, standards of the audit, and the audit opinion. In deciding on their audit opinion, external auditors would take into account the materiality of the point at issue in the context of the true and fair view of the financial statements on which they are proposing to report. An unqualified audit report is one in which the external auditors are able to report the following:

- a) That the financial statements have been audited in accordance with the International Standards on Auditing.
- b) That the financial statements give a fair view of the financial position, activities, and cash flows.
- c) That the financial statements were prepared in accordance with generally accepted accounting principles and the FG2.
- d) Are satisfied that proper accounting records, including records and reports from field (outreach, country, or regional) offices, have been kept.
- e) All the information and explanations required have been obtained.

\(^\text{13}\) The CGIAR Secretariat initiated the compliance review in the years 1998 and 1999 using a Big-5 public accounting firm.
2.15 The absence of any comment in the audit report with respect to these matters is equivalent to a positive affirmation by the auditors. An unqualified opinion in the audit report, therefore, would mean the external auditor could provide reasonable assurance that the financial statements represent a true and fair view of the activities of the Center, which include the absence of material misstatements. See sample External Auditors’ Unqualified Audit Report on Appendix 5.

2.16 However, in exceptional cases, the auditor may modify the audit report by adding an “emphasis of matter” paragraph to highlight a matter affecting the financial statements. This could be included in a note to the financial statements that more extensively discusses the matter. The addition of an emphasis of matter paragraph does not affect the auditor’s unqualified opinion. For example, an emphasis of matter could be used to highlight ongoing concern issues whose outcome depends on future actions or events not under the direct control of the Center but that may affect the financial statements.

### Qualified Audit Opinion

2.17 A qualified opinion in the external auditors’ report would mean that the external auditor is not satisfied with one or more of the conditions for an unqualified report.

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<th>A qualified report would comprise:</th>
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<tr>
<td>• <strong>Scope</strong></td>
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<td>• <strong>Qualification</strong> -- if the report is qualified in more than one respect, each qualification should normally be dealt with in a separate paragraph.</td>
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<td>• The qualified <strong>opinion</strong></td>
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2.18 Auditors qualify their audit opinions when they conclude the following:

a) That there is a limitation on the scope of the auditor’s work.

b) That there is a disagreement with management regarding the acceptability of the accounting policies selected, the method of their application, or the adequacy of financial statement disclosures.

2.19 There are **three categories of qualified opinions** that the auditors could express:

a) An **“except for” opinion** is expressed when the auditor concludes that the effect of any disagreement with management, or limitation on scope is not so material and pervasive as to require an adverse
opinion or a disclaimer of opinion. A qualified opinion is expressed as being “except for” the effects of the matter to which the qualification relates.

b) A **disclaimer of opinion** is expressed when the possible effect of a limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.

c) An **adverse opinion** is expressed when the effect of a disagreement 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.

### Management and Board of Trustees Letter

2.20 After the completion of each audit, the external auditors should report promptly to the Board of Trustees and the Center any significant financial accounting and control issues arising during the audit by way of a management letter (or internal control letter). External auditors should issue the letter, with appropriate management responses, to the Audit/Finance Committee in time for the Board of Trustees annual meeting, typically no later than two months after issuing an opinion on the financial statements. Further, the management letter could be used as a communication tool to provide Centers with constructive advice on: (a) enhanced use of information technology tools and applications, (b) use of web-based and electronic tools, and (c) efficiency gains in reducing indirect costs.

2.21 **Also, external auditors should be invited to attend the Audit/Finance Committee meetings to discuss the conduct and findings of the audit.** External auditors may be required to discuss certain information relating to the auditor’s judgments about the quality, and not just the acceptability of the accounting principles. Further, the Audit/Finance Committee could request external auditors for a memorandum for the Board of Trustees, in addition to the management letter, which summarizes or highlights major issues that came to the auditors’ attention during the audit as a standard output for the audit.

### Coordination with Internal Auditors

2.22 **Centers should ensure that the external auditors work closely with the Center’s internal auditors to help achieve cost efficiency.** This would in effect reduce the time and effort expended in areas that are of common interest to both
auditors (e.g., audit of field offices). Coordination between the external and internal auditors should be translated into specific areas and procedures, outlining the actions and respective responsibilities. Also, the coordination, which may include reviewing the work of internal auditors, could be incorporated in the external auditors’ audit planning document before the external auditors commence the audit.

2.23 Further, the external auditors should consult the internal audit reports to identify areas needing greater focus, where internal control systems are inadequate. Such consultation would help the external auditors plan the audit work more effectively.

2.24 At each annual meeting of the Board of Trustees, at which the Center’s audited financial statements are presented, the Center should recommend the appointment of an external auditor to hold office from the conclusion of that meeting until the next annual meeting. A retiring external auditor may be reappointed at the annual meeting.

2.25 All external auditors of the Centers must be from one of the internationally recognized (e.g. Big-5) public accounting firms.

2.26 Should the external auditor position becomes vacant before the expiry of the term, the Center may, in consultation with the Audit/Finance Committee, appoint another external auditor to fill the "casual vacancy".

2.27 In selecting an external auditor, Centers may wish to consider the following selection criteria:

   a) The personnel size and qualifications of the firm in the host country.
   b) The firm’s clientele.
   c) The firm’s proven and demonstrated experience in auditing international non-profit organizations in the host country.
   d) The firm’s audit methodology, approach, and use of information technology audit tools.

2.28 The rules of professional conduct relating to the resignation and removal of external auditors are designed to protect the interest of the Board of Trustees. It is the right of the Board to appoint the external auditor of their choice. This right is
protected by preventing the possibility of the auditor being removed without the Board's assent, or the auditor resigning.

2.29 A Center’s external auditors may resign with a written notice of resignation at the Center’s head office. The notice would finalize the external auditors' last day of service. The external auditors’ notice of resignation would not be effective unless it contains the following:

a) A statement that there are no circumstances connected with the resignation of the external auditors which they consider should be brought to the notice of the Center's creditors, donors, or the CGIAR Secretariat; or

b) A statement of any circumstances connected with the resignation.

2.30 Within 14 days of receipt of a notice of resignation, the Center must send a copy of the notice to the Audit/Finance Committee and the CGIAR Secretariat. The external auditors may call the Board of Trustees or its Audit/Finance Committee to convene a meeting to receive and consider any explanation of the circumstance connected with the resignation. External auditors who have resigned are entitled to attend and to be heard at any part of the Board of Trustees meeting that concerns them as former external auditors of the Center.

2.31 Typically, the authority for the removal of external auditors rests solely with the Board of Trustees. The reasons for this are to preserve the right of the Board of Trustees to appoint the external auditors of their choice. Additionally, this would ensure the external auditors' independence of management by not permitting management, who may be in disagreement with the auditors, to dismiss them.

2.32 Where it is proposed that auditors be removed before the expiry of their term, the external auditors have the right to make representations. Any notice to the Board of Trustees resolutions to remove the external auditor must be copied to the CGIAR Secretariat within 14 days.

**Rotation of External Auditors**

2.33 *All Centers should have a formal Board-approved policy on the rotation of external auditors once in five or seven years.* The rotation of auditors means changing the current external auditor to another new external auditor (see paragraph 2.25) through competitive bidding.
2.34 The purpose of this section is not to replicate all the rules on professional independence and ethics of the accounting profession. External auditors typically belong to national and international\textsuperscript{14} accounting associations with committees that establish standards promoting professional independence and ethics for their members.

2.35 Such standards could range from and include guidelines essential to maintaining auditor’s independence, such as:

- The official, professional and personal relationships causing the auditor to limit the extent or character of the audit.
- Any responsibility in the executive management at the Center.
- Any interest, financial or non-financial, direct or indirect, in the Center.

2.36 \textbf{On the issue of internal audit outsourcing, a Center’s external auditor cannot assume significant responsibilities for performing internal auditing when the auditor has to retain independence in both fact and appearance.} Public interest requires that external auditors’ independence be protected, and situations jeopardizing that independence be reported publicly.

2.37 Similarly, the Institute of Internal Auditors, Inc.\textsuperscript{15} (IIA) has opined that outsourcing the entire internal auditing function to a Center’s external auditors impairs independence.

2.38 \textbf{Therefore, Centers that do not have in-house internal auditors should avoid total outsourcing of the internal auditing function to the Center’s external auditors.} However, outsourcing individual audit engagements or a well-defined portion of the internal auditing function, under the management and direction of the Center’s internal auditor, does not necessarily impair independence. It is well recognized that such arrangements with outside internal auditing service providers have been effective in helping internal auditing functions contribute to management’s strategic objectives.

\textsuperscript{14} For example, the International Federation of Accountants (IFAC) and the American Institute of Certified Public Accountants (AICPA) have set standards dealing with auditor independence.

\textsuperscript{15} IIA, Inc., serves as the internal auditing profession’s watchdog and resource on significant auditing issues around the globe.
CHAPTER THREE: Internal Auditing

Function & Activities
Standards
Planning
Risk Assessment
Fraud Investigations
Managing & Monitoring
Audit Software
Electronic Commerce

3.0 INTERNAL AUDITING
3.1 With increased attention to the governance and accountabilities of Boards and management, there have been significant developments in the role of the internal auditing function. The audit focus has changed from the verification of transactions with detection of irregularities as a major objective, to a more comprehensive consultative process. This process includes evaluation of operations based on the adequacy of the internal control systems designed by management\(^\text{16}\).

3.2 There has been noted emphasis on expanding the role of the internal auditing function in many Centers. Center management has upgraded the internal auditing function to provide a systematic and independent review of all activities. In so doing, internal auditing could provide assessment and advice to management regarding the Center’s efficiency and economy, as well as the effectiveness of the internal control system.

3.3 Further, internal auditors could assist a Center achieve its goals by reviewing programs to evaluate the following:

| Goals and objectives have been established and are consistent with those of the organization. |
| Adequate performance criteria have been established to measure accomplishment. |
| The manner in which goals and objectives are met is consistent with organizational values. |
| Accountability has been established. |

3.4 Since Center Boards are responsible for making and monitoring policies within the Center, the auditing function could provide independent assurance to the Center Board, typically through the Audit/Finance Committee. Such a role would ensure internal audit provide high-level reviews of the governance and internal control structure of Centers.

3.5 Further, an internal auditing function carried out with a professional approach could serve an important function in promoting the integrity of the activities and corporate accountability. Improved efficiency, effectiveness, and economy are also expected to accrue to the Center through this exercise. The

\(^{16}\) Adequate control is present if management has planned and organized (designed) in a manner, which provides reasonable assurance that the Center’s objective will be achieved efficiently and economically.
relationship between internal auditing and the Audit/Finance Committee itself could also support the desired independence and objectivity of the internal auditing function.

3.6 Center Boards should ensure that management establishes an internal auditing function. Further, Center Boards and management should retain the internal auditing function in-house or outsource the function in whole or in part, subject to the restriction in paragraph 2.38.

3.7 Outsourcing is a management tool that could be used to either delegate all or part of the internal auditing function by: (a) seeking assistance from internal auditors of other CGIAR Centers, (b) co-sharing the internal audit function with other Centers, or (c) buying from third party service provider (e.g., Big-5 public accounting firm).

3.8 Reasons behind outsourcing or co-sharing include reducing and controlling indirect costs, improving institutional focus, and gaining access to world-class capabilities. Outsourcing/co-sharing the internal auditing function or a specific internal auditing activity could be a deliberate management strategy. In co-sharing a specific activity, the Center internal auditor would need to: (a) assess the resources required to achieve the Annual Auditing Plan with optimal coverage and (b) manage the co-sourcing arrangement to ensure delivery of quality internal auditing service.

### Internal Auditing Standards

3.9 The internal auditing profession is in a period of change. In June 2000, the Institute of Internal Auditors, Inc. (IIA) approved the issuance of a new Code of Ethics. Further, the IIA plans to issue a great deal of additional professional guidance in the next several years. This guidance would cover a wide range of subjects and would include major changes to the Standards for the Professional Practice of Internal Auditing (“Standards” or commonly known as the “Red Book”). The existing Standards were originally approved in 1978.

3.10 The new IIA Standards consist of Attribute Standards, Performance Standards, and Implementation Standards.

- a) The **Attribute Standards** address the characteristics of organizations and individuals performing internal auditing activities.

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b) The Performance Standards describe the nature of internal auditing activities and provide quality criteria against which the performance of these services could be measured. The Attribute and Performance Standards apply to internal auditing services in general.

c) The Implementation Standards apply the Attribute and Performance Standards to specific types of engagements for example, a compliance audit, a fraud investigation, or a control self-assessment project. While there would be one set of Attribute and Performance Standards, there could be multiple sets of Implementation Standards: a set for each of the major types of internal auditing activity.

3.11 Internal auditors should comply with the IIA Standards. The present standards shall apply until the newly issued standards become effective on 1 January 2002, however, their earlier use is encouraged.

| Multi-Year Strategic and Annual Auditing Plan |

3.12 Preparing an auditing plan, whether a multi-year strategic or one-year annual plan, is probably one of the most important activities for internal auditors. Internal auditors should establish risk-based plans to accomplish the objectives of the internal auditing activity. This is not only consistent with the Center’s goals, but also goes to ensure that the plans are driven by the Center’s needs. Internal auditors could be most at-risk in the Center if such plans fail to be relevant to the needs of the Center.

3.13 The first step towards ensuring relevancy is to expand the focus on control activities to include the entire internal control system. Doing so requires internal auditors to consider all risks the Center may face. From here, the risk assessment could be used to direct the limited internal auditing resources to the critical areas identified by Center management and Audit/Finance Committee. Only when internal auditors expand their thinking from control activities to evaluation of internal control system, can true value be added to the organization.

3.14 Second, valuable internal auditing services are well suited to the Center if they are closely aligned with the Center’s objectives, strategies, work processes, and circumstances. Suitability also depends largely on whether the internal auditing services cover the Center’s significant functions, and the contexts and changing conditions within which the Center operates.

3.15 Further, internal auditing services could add substantive value to the Center by providing assurance that its risk exposures are understood and managed appropriately. This puts the Center in control of its risk exposures under changing conditions. Substantive internal auditing services, therefore, promote organizational understanding about and focus on risk exposures and
their management. In addition, the services contribute to the improvement of risk management and control systems.

3.16 In preparing the auditing plan, internal auditors may wish to consider these strategies for managing the risk of irrelevance\(^\text{18}\):

a) Consult with Center management (and Audit/Finance Committee) to determine the services required from internal auditors. This is to assure that risk exposures are understood and managed appropriately in changing contexts.

b) Determine the capabilities required by the internal auditing function. Capabilities range from employed and contracted staff, tools, techniques, and infrastructure, with the understanding that those needs would develop and change over time to meet the Center’s requirements.

c) Recognize the dynamics of internal auditing external and organizational environments to identify the source of risk to the internal auditing function.

d) Develop an appropriate risk management plan for the internal auditing function.

e) Create opportunities for internal auditing by negotiating and/or constructing the contexts within which internal auditing work is conducted.

3.17 The intent of the FG3 is not to prescribe the format, content, timeline or form of the auditing plan, since it is be driven by the needs of each Center. More important, however, is the recognition that an auditing plan serves the following purposes:

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<thead>
<tr>
<th>Auditing Plan</th>
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<tbody>
<tr>
<td>- Highlights key activities to be reviewed.</td>
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<tr>
<td>- Incorporates input from management to ensure that the plan accords with the priorities of Center management.</td>
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<tr>
<td>- Allows comparisons between work completed and the scheduled assignment.</td>
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<tr>
<td>- Provides direction and control on the internal auditing activities.</td>
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<tr>
<td>- Facilitates communication with other review activities, e.g., external auditing.</td>
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\(^{18}\) As suggested by the Competency Framework for Internal Auditors (CFIA).
3.18 Internal auditors typically evaluate the internal control system of Center to assess the extent by which the system may be relied upon to:

a) Ensure the integrity of management data  
b) Ensure compliance with policies, plans, procedures, standards, laws, and regulations.  
c) Promote effectiveness, efficiency, and economy in organizational practices.

3.19 One important aspect of assessing the Center's internal control system is to understand and better evaluate its control environment and governance. Control Environment is one of the five essential components of an effective internal control system as it establishes the foundation for the internal control system by providing fundamental discipline and structure\(^\text{19}\). Control environment factors include the integrity, ethical values and competence of the Center's staff; Center management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the Board of Trustees.

3.20 Often, the evaluation of Control Environment is based on the following criteria, or control factors:

| a) Are our principles of integrity and ethical values shared and practiced? |
| b) Are our people rewarded fairly according to the Center's objectives and values? |
| c) Do we clearly understand what we are accountable for, and do we have a clear definition of our authority and responsibilities? |
| d) Are critical decisions made with the necessary expertise, knowledge, and authority? |
| e) Are levels of trust sufficient to support the open flow of information and effective performance? |
| f) Do we have the right people, skills, tools and resources? |

\(^{19}\) The other four components are: (a) Risk Assessment, which involves the identification and analysis by management, not the internal auditor, of relevant risks to achieving predetermined objectives, (b) Control Activities, or the policies, procedures, and practices that ensure management objectives are achieved and risk mitigation strategies are carried out, (c) Information and Communication, which support all other control components by communicating control responsibilities to staff and by providing information in a form and time frame that allows people to carry out their duties, and (d) Monitoring, which covers the internal and external oversight of internal controls by management or other parties outside the process.
3.21 The evaluation of Control Environment can also be divided into hard and soft controls. Hard controls are typically the organizational structure, assignment of authority and responsibility, and human resources policies and practices. These are the typical areas examined by most internal auditors. Soft controls, on the other hand, include ethics, commitment to competence, and management operating style. Such controls are often overlooked in audits because documented evidence of the audit condition is difficult to obtain and test. One tool and technique that could be used for evaluating soft controls is Control Self Assessment (CSA).

| Risk Assessment |

3.22 Because a Center’s objectives, its internal organizational structure, and the environment in which it operates are continuously evolving, the risks it faces are always changing. A sound internal control system therefore depends on a regular evaluation of risks to which the Center is exposed. The purpose of internal control is to help manage and control risk rather than to eliminate it. Even though it is not possible to provide complete assurance, the internal control system could be designed and applied to manage the nature and extent of risk to acceptable levels. (e.g., relating the cost of control^20 to the significance of risk).

3.23 Significant organizational risks. After which the risks could be assessed, during the course of audit engagement, to improve the risk management process.

3.24 While there is much published literature, including software packages, on risk assessment approaches and methodologies, often neither management nor the internal auditors really know where or how to begin. Since risk assessment is key for a sound system of internal control and governance, getting it right from the start is important. Therefore, selecting the correct approach for performing the risk assessment suitable for the Center is important.

3.25 The approaches on risk assessment could range from more structured approaches (e.g., database, algorithm, or matrix methods) to less structured, informal approaches. No single approach is considered standard or universally favored by internal auditors or risk assessment professionals. Whatever approach the Center adopts would depend on the intent of the assessment information and the difficulty level the Center is willing to accept. Therefore, obtaining an understanding on the strengths and weaknesses of each approach

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^20 Control is any action taken by management to enhance the likelihood that established objectives and goals would be achieved. Management plans, organizes, and directs the performance of sufficient actions to provide reasonable assurance that objectives and goals will be achieved. Thus, control is the result of proper planning, organizing, and directing by management.
is essential in determining the technique that would provide the most value to the Center.

**Internal Auditing Process for an Assurance Services Engagement**

3.26 Audit engagements should be performed with proficiency and due professional care. Even though each audit engagement\(^{21}\) may differ in terms of content, substance, and timing; internal auditors generally adhere to a common auditing process. The auditing process for assurance services\(^{22}\) engagement could be grouped into four distinct phases:

- Engagement Planning
- Performing the Engagement
- Communicating Results
- Monitoring the Progress

3.27 The auditing process described below (See sample Internal Auditing Process on Appendix 6) has the following salient features:

- a) It has a strong client focus.
- b) It is compatible with IIA standards.
- c) It focuses on management control process\(^{23}\), not individual controls.
- d) It has built-in quality control.
- e) It is driven by the professional judgment of the internal auditor.
- f) It encourages auditors to only do the minimum to arrive at a conclusion, as opposed to “wall-to-wall” testing.
- g) It could be applied on any audit engagement.

\(^{21}\) A specific internal auditing assignment, task, or review activity, such as an internal audit, Control Self-Assessment review, fraud examination, or consultancy. An engagement may include multiple tasks or activities designed to accomplish a specific set of related objectives.

\(^{22}\) Assurance service is an objective examination of evidence for the purpose of providing an independent assessment on risk management, control, or governance processes for the Center. Examples may include financial, performance, compliance, system security, and due diligence engagements.

\(^{23}\) The policies, procedures and activities, which are part of an internal control framework.
3.28 Internal auditors should develop and record a plan for each audit engagement. The essential step in the planning phase is to reconfirm the relevance of the engagement with the client and the deliverables for this phase is usually the engagement terms of reference (see sample Terms of Reference for an Audit Engagement on Appendix 7). Key elements for the planning phase include:

a) Deciding on the client of the engagement is probably one of the most important activity in the initial stages of the planning phase. The client is usually a person/s at the Center who is the primary person responsible or held accountable for the process, function, or activity. For example, the client for an audit of the human resource function could be the Human Resource Manager and/or the immediate supervisor, usually at Director-level.

b) Meeting with the client to reconfirm the relevance and rationale for the engagement to ensure that there have not been significant changes since the development of the engagement during the Annual Auditing Plan that would negate the reasons for engagement. Further, the same meeting could establish a foundation for taking the engagement forward.

c) Agreeing with the client the terms of reference for the engagement. A typical terms of reference for an audit engagement includes:

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**Engagement Planning**

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i. Audit or engagement objectives, which addresses clients’ concerns, risks, and controls associated with the activity under review.

ii. Scope of the engagement, which defines the way in which the audit is carried out to satisfy the engagement objectives.

d) Reporting arrangements that define the reporting and other administrative arrangements pertaining to the audit.

e) Developing audit programs\(^\text{24}\) to identify, analyze, evaluate, and record information during the engagement.

f) Determining appropriate resources to achieve the engagement objectives. This could be based on an evaluation of the nature and complexity of each engagement, time constraints, and available resources.

### Performing the Engagement

3.29 Internal auditors should identify, analyze, evaluate, and record sufficient information to achieve the engagement’s objectives. During this phase, internal auditors execute the audit program and obtain evidence that meet the basic tests of sufficiency, competence and relevance. Evidence obtained during the engagement should form part of the working papers\(^\text{25}\), which the internal auditors rely upon for conclusions and engagement results. The decision on how much information is enough and what type to seek requires the exercise of the internal auditor’s judgment based on experience, education, reasoning, and intuition.

3.30 Further, throughout the performance of the engagement, the internal auditors would be:

a) Updating the engagement clients on the progress of the engagement.

b) Preparing an action plan as one basis for discussing with clients the issues and concerns arising from the engagement. The action plan (see sample Action Plan on Appendix 8), which could form part of the audit engagement report, would typically include:

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\(^{24}\) For samples of audit programs, refer to the Internet website -- [www.auditnet.org](http://www.auditnet.org) -- which provides information links, tools, and resources developed for the benefit of the internal auditing profession.

\(^{25}\) Working papers provide: (a) the evidential material to support opinions expressed in engagement reports, (b) evidence of the achievement of the required standard of internal auditing performance, (c) an effective link between successive audit engagements; and (d) a basis for quality assurance reviews.
Communicating Results

3.31 Internal auditors should communicate and disseminate the engagement results to the individuals agreed with their clients during the engagement-planning phase. This is to be done according to the reporting arrangements indicated in the terms of reference of the audit engagement. It is important to note that the purpose of communicating the results is to inform, persuade, and effect positive change. The criteria for communicating the results should include the engagement’s objectives and scope as well as applicable conclusions, recommendations, and action plans. Specifically, each audit engagement report should:

a) Be clear, concise and complete.
b) Explain clearly, where applicable, the objectives and scope of the audit engagement
c) Present findings, conclusions and recommendations in an objective and dispassionate manner
d) Include only factual information and findings and conclusions adequately supported by evidence. Detail supporting data could be included to allow for a convincing presentation.
e) Reflect the balance between critical comments and recognition of management-initiated improvements
f) Recognize client comments in the final engagement report.

3.32 Obtaining feedback from clients after each audit engagement is helpful for the internal auditor. The feedback could be obtained informally or in writing using a client satisfaction questionnaire. A client satisfaction survey is a generic questionnaire about internal audit's performance on the audit engagement. The use of a client service questionnaire would increase the client awareness and client service orientation of the internal auditing team. It would also communicate to the clients that feedback and suggestions are welcomed and important. By surveying client satisfaction, the internal auditing team sends a message that it is constantly improving to add value to the Center.

3.33 The internal audit team should distribute the questionnaire to the clients after the issuance of the final engagement report. Further, collection, tracking,
and summarizing client feedback can help the internal auditing team understand how their work is perceived, how effective they have been, and how they could improve their services. See sample Client Evaluation Form on Appendix 9.

### Monitoring the Progress

3.34 Implementation of audit recommendations is a management responsibility; however, a key element in the scope of work for an internal auditor is to follow-up with management on the implementation of the external and internal auditors’ recommendations. The objectives of follow-up are to ascertain that corrective actions have been taken by clients to address the audit engagement results, and to advise the Director General and the Audit/Finance Committee on the implementation status and conclusions.

3.35 The key task is to determine whether corrective action previously agreed to by clients on the action plan has been taken and the desired results, achieved. This could be done by implementing either the agreed actions or other suitable solutions. If implementation of the agreed corrective action is not planned, further work would be required to ensure that the agreed actions were understood and the Center has assumed the risk of not taking corrective action.

3.36 Typical activities in monitoring the progress of the agreed actions are carried out at a reasonable time after the issuance of the final engagement report. The activities include:

   a) Checking the outcome of agreed actions.
   b) Evaluating the results of the agreed actions.
   c) Preparation of audit documentation.
   d) If appropriate, issuing a report summarizing audit conclusions.

### Communication with the Audit/Finance Committee and Management

3.37 There is an increasing awareness by Center Board members of their responsibilities and the need to be better informed about the quality of internal controls. **Internal auditors should report periodically to the Audit/Finance Committee (and Center management) on the internal auditing activity’s purpose, authority, responsibility, and performance relative to its Annual Auditing Plan and Internal Audit Charter.** Reporting may include significant risks and control issues, corporate governance issues, planned audit/consulting engagements, results of completed engagements, implementation of audit recommendations by management, and other matters needed or requested by the Audit/Finance Committee (and Center management).
3.38 In addition to providing an assurance role, internal auditors are often called upon to provide a variety of consulting services\(^\text{28}\). The Institute of Internal Auditors, Inc. (IIA), and other organizations, have developed or are developing guidance on a variety of consulting topics to help guide internal auditors. Although not mandatory, the IIA has and would be issuing guidance materials, such as the authoritative Practice Advisories\(^\text{29}\), research studies, books, seminars, conferences, and other development and practice aids\(^\text{30}\) related to the professional practice of internal auditing. The other organizations include the Information Systems Audit and Control Association\(^\text{31}\), the Association of Certified Fraud Examiners\(^\text{32}\), the International Federation of Accountants\(^\text{33}\), and the US General Accounting Office\(^\text{34}\). The purpose of this section is not to cover all the consulting services but rather to focus on common consulting services, namely information technology system development, and fraud investigations.

3.39 Information Technology (IT) system development is a process that includes the development, acquisition, and maintenance of information systems. IT should attempt to achieve system effectiveness, economy and efficiency, data integrity, resource safeguarding, and compliance with laws and regulations. The use of an effective IT system development methodology should provide senior management of Centers with a reasonable assurance that these objectives would be achieved.

3.40 There are usually several phases\(^\text{35}\) in an IT system development that internal auditors should be aware, as these would require specific intervention from management. In addition, a comprehensive review -- after the IT system has been implemented -- of each development or modification project would ensure that the system meets the user needs and stated objectives. This would also highlight that the program has realized its anticipated benefits, and adhere to the requirements of the systems development methodology.

\(^\text{28}\) The range of services, beyond internal auditing’s assurance services, provided to assist management in meeting its objectives. The nature and scope of work are specified by an agreement between the internal auditor and the client. Examples may include facilitation, process design, training, and advisory services.

\(^\text{29}\) For example, Consulting Services - Considerations for Internal Auditors.

\(^\text{30}\) For example, Auditing Accounts Payable for Fraud.

\(^\text{31}\) Internet website: [www.isaca.org](http://www.isaca.org)

\(^\text{32}\) Internet website: [www.cfenet.com](http://www.cfenet.com)

\(^\text{33}\) Internet website: [www.ifac.org](http://www.ifac.org)

\(^\text{34}\) Internet website: [www.gao.org](http://www.gao.org)

\(^\text{35}\) The six phases are: (a) Project Initiation, (b) Feasibility Study, (c) Design Phase, (d) Development and Implementation, (e) Operation and Maintenance, and (f) Post-Implementation Review.
3.41 It is important to note that the responsibility for specifying and including appropriate controls in an IT system rests with management. It is not the internal auditor’s role to assume that responsibility and to program audit reviews so as to ‘sign-off’ system specifications or particular development activities. Management would have developed appropriate internal procedures to ensure that its responsibilities are met. This does not preclude management from seeking appropriate guidance or advice from internal auditors to assist it in meeting those responsibilities.

3.42 The role of the internal auditor in IT system development is critical. Audit activities should typically include participation on a steering committee and a review of the processes in place to ensure that:

- a) Management has ascertained the system to be cost effective.
- b) Management has identified and evaluated all the risks and options prior to the implementation.
- c) The nature of the data to be processed and the required outputs have been adequately considered so that the system is designed in the most efficient and effective manner, having regard to the nature of the hardware and control software available.
- d) User views have been taken into account and management has, at an appropriate level, approved the system specifications after considering user requirements.
- e) The specifications include control provisions adequate to the nature of the system.
- f) The system is being programmed (or purchased) and tested in a controlled and effective manner.
- g) The system is not “handed over” to users until such time as management is satisfied that it has been tested, all errors and known faults have been corrected and user staff trained in its operation.
- h) Appropriate procedures and lines of communication have been established for the notification of required system changes or corrections.

Fraud Investigations

3.43 Fraud\textsuperscript{36} investigation is a special type of audit. Therefore, the standards for conducting an assurance services engagement are generally applicable. Fraud investigations conducted by internal auditors are expected to comply with relevant standards set forth by appropriate sets of law such as federal and state civil and criminal procedure and rules of evidence. They should also be conducted in compliance with applicable standards set forth by professional

\textsuperscript{36} Fraud encompasses an array of irregularities and illegal acts characterized by intentional deception.
bodies representing internal auditors (the Institute of Internal Auditors, Inc.) and fraud examiners (the Association of Certified Fraud Examiners).

3.44 Fraud investigation standards shall apply for an internal audit engagement when:
   a) The primary purpose is to gather, develop, examine and/or evaluate evidence to determine if there has been an improper act (as defined herein) committed by a person or entity.
   b) Allegations of an improper act, which carry the possibility of legal action, whether in the form of hearings, litigation, or criminal proceedings.
   c) It is expected that such an engagement would also determine the techniques used in committing the improper act, the extent of damage caused by the improper act and the causal factors permitting or contributing to the improper act (including internal control or policy violations or deficiencies).

**Managing the Internal Auditing Activity**

3.45 The Chief Audit Executive\(^{37}\) of each Center is responsible for managing the Internal Auditing Activity\(^{38}\) to add value to the Center. In this regard, according to the IIA Standards, the chief audit executive should:
   a) Establish risk-based plans to accomplish the objectives of the internal auditing activity, consistent with the Center's goals.
   b) Communicate the internal auditing activity’s plans and resource requirements, including significant interim changes, to Center management and to the Audit/Finance Committee for appropriate review and approval. The chief audit executive should also communicate the impact of any resource limitations.
   c) Ensure that internal auditing resources are appropriate, sufficient, and effectively deployed.
   d) Establish policies and procedures to guide the internal auditing activity.
   e) Coordinate with other internal and external providers of assurance and relevant consulting services to ensure proper coverage and minimize duplication\(^{39}\).

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37 Chief Audit Executive is the top position within the Center responsible for internal auditing activities. In some Centers, this would be the Internal Audit Manager. Where internal auditing activities are obtained from third-party services providers, the chief audit executive is the person responsible for: overseeing the service contract, the overall quality assurance of these activities, reporting to management and the Audit/Finance Committee regarding internal auditing activities, and follow-up of engagement results.

38 Internal Auditing Activity is a department, division, team of consultants, or other group of internal audit practitioners that perform the internal auditing function for an organization.
f) Report periodically to the Audit/Finance Committee and Center management on the internal auditing activity’s purpose, authority, responsibility, and performance relative to its plan. Reporting should also include significant risks and control issues, corporate governance issues, and other matters needed or requested by the Audit/Finance Committee and Center management.

Quality Assurance and Compliance

3.46 The chief audit executive of Centers should develop and maintain a quality assurance program designed to achieve compliance with the IIA Standards and the Code of Ethics. The program should provide assurance that the internal auditing activity adds value and improves the Center’s activities. A quality assurance program could be achieved by:

a) Periodic internal reviews through self-assessment or by persons within the Center and outside the internal auditing activity or an internal auditor from another Center. Such internal reviews should be performed by persons with knowledge of internal auditing practices.

b) Independent reviews to ensure that the internal auditing activity’s compliance with the Standards and the Code of Ethics should be evaluated at least once every five years by a qualified, independent, outside reviewer, using appropriate guidelines and tools.

3.47 Further, the quality assurance program should consist of supervisory procedures and internal reviews with elements of quality assurance embedded into the internal auditing process rather than existing as separate processes. In addition, the chief audit executive should ensure that internal auditing staff receives the appropriate guidance to perform the audit work in a quality manner. Therefore, enrollment of all Center internal auditors (or at the least, the Center’s chief audit executive) with the IIA should be a Center corporate policy.

3.48 Other techniques for evaluating the quality of internal auditing services include:

a) Total Quality Management (TQM) is an approach that the human, administrative, and technical factors affecting quality would be under control and be able to deliver internal auditing services with a high level of consistency. This could lead to the development and

39 Center management often appoints external consultants and experts to perform internal reviews (e.g., Center-Commissioned External Reviews) and their recommendations could highly influence the Center's organizational environment, policies, and procedures.

40 The CGIAR has a community of internal auditors that comprise of internal auditors from all the Centers with in-house internal auditing function.
implementation of a quality internal auditing system and procedures appropriate to the internal auditing activities or services being offered. For example, the International Standards Organization (ISO) Standard 9001 and 9002 Series sets out the methods by which internal auditors could incorporate and implement all the activities associated with quality to ensure that all the specified performance requirements and that the needs of the clients are fully met.

b) Benchmarking is a process that enables an Internal Auditing Activity to establish the reasonableness of its procedures and practices. Every Internal Auditing Activity has strengths and weaknesses in areas where it exceeds the standard and areas where it falls short. Benchmarking involves comparing a given Internal Auditing Activity with other Internal Auditing Activity with similar characteristics. For example, the IIA has sponsored the Global Auditing Information Network or GAIN. GAIN is a pool of Internal Auditing Activity from all industries and worldwide. This provides a repository information about activities and procedures that could be used to find out the respective strengths, weaknesses, and tools to enhance productivity.

<table>
<thead>
<tr>
<th>Internal Auditing Tools</th>
</tr>
</thead>
<tbody>
<tr>
<td>3.49 There are a variety of internal auditing tools available to assist internal auditors in discharging their responsibilities. Because each Center is unique and its clients have varying expectations, this list may not meet every requirement.</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Control Self-Assessment</th>
</tr>
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<tbody>
<tr>
<td>3.50 Control Self-Assessment (CSA) can be defined simply as the involvement of management and staff in assessing the system of internal control within their work group. There are a number of ways to accomplish this purpose, from highly interactive workshops based on behavioral models at one end of the spectrum to prepackaged self-auditing internal control questionnaires on the other end, and a number of techniques in between. CSA could be the right thing at the right time, for the following reasons:</td>
</tr>
<tr>
<td>a) The main impetus for choosing CSA was the constraint on internal auditing resources due to downsizing and budget constraints. Internal auditors had to seek alternative methods for internal control reviews.</td>
</tr>
<tr>
<td>b) CSA is an internal auditor's dream comes true as management finally accepts full responsibility for internal control. Anything that fosters that kind of thinking would gain quick support among internal auditors, and internal auditors have been the main advocates of CSA.</td>
</tr>
</tbody>
</table>
c) Some implementations of CSA are collaborative and empowering. These are two very powerful tools, which have gained a lot of support with both internal auditors and management.

d) Some models of internal control and organizational development point to a process like CSA as a natural evolution of management control.

3.51 There are six methods\(^{41}\) for CSA in use today. The methods range from the most mechanical, (least human contact possible) self-administered audit by Internal Control Questionnaire (ICQ), to the most behavioral (most human contact) group workshops. A lot of publicity has been given to the behavioral side of CSA, but there are CSA practitioners getting good results from methods other than group processes.

3.52 For internal auditors interested in conducting facilitated self-assessment, sessions require the following:

a) A thorough understanding of the principles of CSA.

b) The use of a control framework such as COSO for evaluation.

c) An explicit use of risk assessment in the evaluation.

d) Best practices gained from implementation efforts of others.

e) Teamwork, change management and facilitation skills.

f) An understanding of both "low-tech" and "high-tech" supports for CSA.

The most frequently used off-the-shelf software package is Option Finder.

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Audit Software

3.53 Audit software play an increasing role for internal auditors as audit challenges continue to grow more technological in nature and the methods required to address them must be responsive to the increased demands. Technology, therefore, continue to offer new options for improving audit efficiency and effectiveness.

3.54 ACL Software is one the most widely used data extraction and analysis tool used by internal auditors, others include: spreadsheet and database software such as: Excel, Quattro Pro, and Lotus 1-2-3, and Access. Interactive Data Extraction and Analysis (IDEA) and ACL are two other popular audit software with internal auditors. ACL Software, like IDEA, is a data extraction and analysis tools for auditors. Its most common applications include selecting data samples for detailed analysis, testing entire populations for exceptions, analyzing results and exceptions found, and detecting fraud. Other uses include financial ratio analysis and risk assessment. One of the potential drawbacks of using data extraction and analysis software is the amount of training required.

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\(^{41}\) The six methods are: (a) Internal Control Questionnaire Self Audit, (b) Customized Questionnaires, (c) Control Guides, (d) Interview Techniques, (e) Control Model Workshops, and (f) Interactive Workshops.
3.55 Other audit software includes data mining techniques such as WizRule and Digital Analysis. WizRule is a data auditing and cleansing software that automatically reveals all the rules in a given data, and points at the deviations from the set of the discovered rules as suspected errors. Digital Analysis, however, is an audit technology designed to find abnormal duplications of specific digits, digit combinations, specific numbers, and round numbers in corporate data. Digital Analysis is based on a mathematical phenomenon known as Bendford's Law\(^{42}\).

3.56 In the future, internal auditors may need to rely on Artificial Intelligence (AI) and Expert Systems (ES) as audit tools\(^{43}\) to carry out audit engagements. With such expert systems, internal auditors could perform unimaginable tests and analysis on a given set of data; the auditor merely needs to use judgment and skills to pursue further findings.

### Use of the Internet as an Auditing Tool

3.57 Internal auditors have discovered the Internet to be a tremendous audit tool that could assist in performing assurance and consulting engagements. The Internet offers several opportunities for the auditors such as:

- a) Email discussion lists\(^{44}\).
- b) Research and access to the wealth of information on the Internet could enhance internal auditors' knowledge and information on emerging issues affecting the internal auditing profession.
- c) Exchange of documents.
- d) Online training.

### Electronic Commerce

3.58 Electronic commerce (or e-commerce) provides a new way of conducting commercial transactions. This ushers in new procedures for conducting business and similarly the audit process for the effectiveness of such business transactions would have to be revised. Further, e-commerce is a relatively new

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\(^{42}\) Benford’s Law provides auditors with the expected digit frequencies in tabulated data. By examining the digit and the number frequencies, auditors can gain data insights that might be missed using traditional analytical procedures and sampling methods. The digit and number patterns could point to number invention, systematic frauds, data errors, or biases in the data.

\(^{43}\) Artificial Intelligence (AI) and Expert Systems (ES) are electronic tools for analyzing systems and transactions. Simply put, AI is computer software designed to perceive, reason and understand; whereas ES, a subset of AI, is what extends a computer’s ability to process mass data to make decisions in a human way.

\(^{44}\) For example, the CGIAR Internal Auditors Community e-groups mailing and discussion list.
activity and internal auditors are now confronted with new tools\footnote{Some of the new tools include: (a) CobiT and Control Objectives for Net Centric Technology by the Information Systems Audit and Control Association (ISACA), and (b) Webtrust by the American Institute of Certified Public Accountants (AICPA).} and risks. These risks include:

a) Lack of audit trail and transactions integrity.
b) Non-repudiation of transaction (since paper trail is limited).
c) Access to data from anytime, anywhere around the world.
d) Loss of privacy/confidentiality.
e) Lack of authentication (e.g., unauthorized ordering or approving of a transaction).
f) Business interruptions.
APPENDIX 1: SAMPLE AUDIT/FINANCE COMMITTEE CHARTER

Source: CIAT

THE AUDIT COMMITTEE (AC)

Membership and Meetings

The members and chairperson of the Audit Committee are nominated annually by the Board Chairperson for Board approval.

The total membership will normally be three or four, with members having competencies in the management, financial and scientific disciplines. At least one member will have expertise in financial management and business administration. To assure objectivity the Director General should not be a member of the Audit Committee.

The Audit Committee may meet by gathering on one location or it may conduct its business by electronic or telephone conferencing.

Purpose

The Audit Committee has two major roles.

1. To provide Board oversight of CIAT’s annual financial audit, and
2. To be responsible for seeing that CIAT’s integrity is maintained by establishing and monitoring:
   2.1 The internal financial controls and the truthful reporting of financial results; and
   2.2 The approved management policies and CIAT’s systems and procedures.

Differentiation of Roles

While the Audit Committee works closely with the Executive and Finance Committee in its financial function, the difference in responsibilities between the two committees is clear.

Auditing is concerned with monitoring compliance and controls using information about past and present performance.

The Finance Committee functions are forward looking and focus on budgets, financial planning and funding prospects.

Tasks:

1. The Audit Committee reviews CIAT’s interim audit reports and annual audit statements.
2. The Audit Committee recommends for approval by the full Board an independent accounting firm to conduct the audit of CIAT’s financial statements, and serves as a liaison to the external auditor.
3. The Audit Committee, or delegated representatives of the committee, may if considered appropriate, meet with the auditors in advance to discuss the process the external auditors will employ.

4. A post audit meeting allows committee members to review the financial statements, significant audit findings and the independent auditor’s suggestions as to how to improve CIAT’s internal control structure and to cover these matters in its annual report to the board.

5. The Audit Committee will report annually on the performance of the external auditor, any terms contained in the proposals for the coming year’s audit, and on the external audit fees.

6. The Audit Committee, or delegated representatives of the committee, will meet as required with the external and internal auditors, either with, or without other staff members as appropriate, to consider matters required for its reports to the Board.

The Audit Committee may hold regular meetings with the internal auditor to:

1. Review and approve the internal audit charter, defining the person (or unit’s) purpose, responsibility and reporting relationships.

2. Review internal audit plans and budgets to ensure that they support the unit’s objectives adequately and cost effectively.

3. Review the results of internal audits and related recommendations for improvements to the internal control structure.

4. Request special studies or investigations, such as an investigation of potential fraud or other irregularities or a review of compliance with laws and regulations of the host country; and

5. Monitor the organizational framework of the internal audit unit, including the appointment or removal of the internal auditor, and the adequacy of staff in terms of academic and professional credentials and information technology experience.

Upon completing the review and evaluation of external and internal audit materials, the Audit Committee presents and explains these audits to the full Board. Responsibility for the preparation and presentation of these reports lies with the committee rather than the CIAT’s financial staff.

When the audit reveals the need for improved financial management or reporting procedures, the Audit Committee monitors the implementation of the necessary changes. In addition, the Audit Committee often monitors adherence to CIAT’s policies on such topics as conflict of interest, codes of conduct, and the handling of intellectual property matters.

APPENDIX 2: DETAILS OF THE FIVE COSO COMPONENTS

Source: Committee of Sponsoring Organizations of the Treadway Commission

Internal control consists of five interrelated components. Although the components apply to all Centers, small Centers may implement them differently than large Centers. Controls may be less formal and less structured, yet a small Center can still have effective internal control. The five components are:

**Control Environment**

Control environment sets the tone of a Center, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the Center's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the Board of Trustees.

**Risk Assessment**

Every Center faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is the establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

**Control Activities**

Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the Center's objectives. Control activities occur throughout the Center, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

**Information and Communication**

Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the research activities. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to informed decision-making and external reporting. Effective
communication also must occur in a broader sense, flowing down, across and up the Center. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as donors, collaborators, and other shareholders.

**Monitoring**

Internal control systems need to be monitored, a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the Board of Trustees.
Establishment of the Internal Audit Function

It is the policy of the International Rice Research Institute (IRRI) to support Internal Audit as an independent, objective, assurance, and consulting activity to examine and evaluate the activities of IRRI as a service to management and the Board of Trustees.

Reporting Relationships

The Internal Audit Team is headed by the Director of Internal Audit who reports functionally to the Director of Finance, and administratively to the Director General and the Finance and Audit Committee of the Board of Trustees of IRRI.

Authority Granted to Internal Audit

Internal Audit has full, free, and unrestricted access to all the records (manual and electronic), property, and personnel of IRRI. Documents and information given to internal auditors are handled in the same prudent manner as by those employees normally accountable for them.

Objective of the Internal Audit Activity

The primary objective of the Internal Audit activity is to help management and the Board of Trustees of IRRI discharge their responsibilities and accomplish the objectives of IRRI by bringing a systematic, disciplined approach to evaluate and improve effectiveness of risk management, control, and governance processes. Internal Audit furnishes them with analyses, recommendations, counsel, and information concerning the activities reviewed.

Scope of Work of Internal Audit

Internal Audit will review the business units within IRRI at appropriate intervals to determine whether the functions of planning, organizing, directing, and controlling are efficiently and effectively carried out according to management instructions, policies, and procedures, and in a manner consistent with the objectives of IRRI. To this end, the Internal Audit Team shall:

- Assess the reliability and integrity of financial and control information and the means to identify, measure, classify, and report such information.
- Assess the effectiveness of the management controls and systems used to account for and safeguard from losses IRRI assets, and as appropriate, verify the existence of assets.
- Determine the internal control systems established to ensure compliance with IRRI policies, procedures, and guidelines, and assess the degree of compliance of IRRI business units with such systems.
- Assess the economy and efficiency with which IRRI resources are employed pursuant to the internal control systems of IRRI.
• Review the operations and programs of IRRI to ascertain whether from the viewpoint of internal control systems, results are consistent with established objectives and goals, and whether the operations and programs are being (or have been) carried out as planned.

Internal Audit will carry out any specific audit requests or investigation upon the request of management and the Board of Trustees.

Internal Audit will carry out its work according to the Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors, Inc.

Responsibility of Internal Audit

Internal Audit will develop an annual internal audit plan for the review and approval of management and the Board of Trustees. The audit plan shall:

• Be developed for the audit cycle using an accepted risk assessment process that is based on an evaluation of the risks associated with each business unit.

• Update the audit plan annually and submit it to the management and the Board of Trustees for approval.

• Provide a segment of special requests by management.

• Require written approval of the management and the Board of Trustees on any major changes in the audit plan.

Internal Audit will prepare reports on results of projects and provide recommendations for improvement, comment on whether appropriate action has been taken on audit findings, and follow up on audit findings, including the timing for corrective action to be taken on reported weaknesses.

Internal Audit is responsible for maintaining a team that collectively possesses the necessary knowledge, skills, and disciplines for the achievement of the Internal Audit activities.

Under normal conditions, Internal Audit work is to be carried out by the Internal Audit Team. In cases of special need, Internal Audit resources may be supplemented by: (a) assistance of other suitable staff within IRRI, and (b) the engagement of consulting services.

Internal Audit will coordinate efforts with the external auditors of IRRI.
APPENDIX 4: SAMPLE LETTER OF ENGAGEMENT

Source: ICLARM

Dear Sirs:

Appointment of Auditors

Thank you for your letter on the above-mentioned topic.

We hereby consent to act as auditors of your Center. This consent is to remain valid until it is withdrawn, amended or superseded.

We also take this opportunity to set out below our responsibilities as external auditors.

1. Our function as external auditors is to examine and report on the Center’s accounts, accounting and other records as presented to us by the Management of the Center. As external auditors, we are not responsible for the preparation of the accounts nor for the maintenance of the accounting records of the Center which duties are imposed on the Management of the Center. We shall of course be pleased to provide any additional services you may require from time to time, but you will appreciate that these are distinct from our function as external auditors.

2. We shall, as required, report to the Management and the Board of Trustees whether, in our opinion, the accounts give a true and fair view of the state of affairs of the Center as at the balance sheet date and of the results and the cash flows for the year ended on that date, and comply with the generally accepted accounting principles.

3. We will also report to the Management and the Board of Trustees any defect, irregularity or omission in the accounts without regard to which a true and fair view will not be obtained.

4. If we are not satisfied as to any matter referred to in paragraphs (1) to (2) above, we will report to the Management and the Board of Trustees the reasons for not being so satisfied.

5. We are empowered to have access at all reasonable times to the accounting and other records of the Center and that we are entitled to such information and explanations as we require for the purposes of our audit from any officer of the Center or any auditor of a related Center.

6. We are also required to ascertain that the accounts are drawn up to comply standards and policies stipulated in the Accounting Policies and Reporting Practices Manual of CGIAR (The CGIAR Manual is consistent with the International Accounting Standards (“IAS”), US Generally Accepted Accounting Standards (“US GAAP”) applicable to the non-profit organization). If the accounts do not comply with Accounting Policies and Reporting Practices Manual of CGIAR the effect of such non-compliance shall be stated in the accounts, and our audit report will be modified to make reference for the non-compliance.

7. Our examination will be made in accordance with approved auditing standards and will include such tests and enquiries we consider necessary for the purposes of our audit.

The nature and extent of such tests will vary according to our assessment of the Center’s system of internal control and may cover all aspects of the business, including direct confirmation with third parties.

8. In the absence of expressed instructions to the contrary, our audit will not include a check on every transaction and accounting entry, but is designed to give us reasonable assurance that the information contained in the underlying records and the supporting evidence is reliable and sufficient as the basis for the preparation of the accounts. Accordingly, you will appreciate that reliance must be placed on an adequate system of internal control as your principal safeguard against irregularities which a test examination may not disclose.
9. Our work will not be directed specifically to identifying weaknesses in the internal control system. However, we shall report to the Management and the Board of Trustees any material weaknesses in the Center’s system, which comes to our notice in the course of our audit. You will appreciate, however, that the establishment and maintenance of an adequate system of internal control remains the responsibility of the Management of the Center.

10. As the responsibility for the preparation of the accounts including adequate disclosure is that of the Management of the Center, we shall require the Management of the Center to provide us with a written representation concerning their responsibilities in connection with the accounts and confirming the representations made to us during the course of our audit.

11. Because of the importance of management’s representations to the effective performance of our services, the Center will release [name of the firm] and its personnel from any liabilities, costs and expenses relating to our services under this letter attributable to any misrepresentations made to us during the engagement.

12. Our fees, which may be billed as the work progresses, are based on the time required by the individuals assigned to the engagement plus the reimbursement of our direct out-of-pocket expenses. Individual hourly rates vary according to the degree of responsibility involved and the experience and skill required. In respect of the audit for the year ending 31 December 2000, our fee will be [XXX] (excluding taxes and our out-pocket-expenses) as stipulated in our original proposal.

13. In order to keep our time and costs to a minimum, we shall arrange for your staff to prepare as many schedules as practicable, and shall discuss these with the appropriate officer at an early date.

14. Our partners and staff are under obligations not to disclose to third parties confidential information relating to our clients.

With the exception of our audit report and other reports which we expressly agree may be provided to your donor, the reports, letters, information and advice we provide to the Center during this engagement are given in confidence and are provided on the condition that the Center undertakes that they are not for general circulation or publication nor are to be reproduced either in part or in full for any other purpose and the Center further undertakes not to disclose these or any other confidential information, to any third party (being a party other than those to whom any report, letter, information or advice is addressed and your donor) made available to it by us during the course of our work without our prior written consent. Our audit report will be addressed to the Board and Management of the Center as at the date on which the opinion is signed.

15. It is the usual practice to retain documents relating to client engagements for six (6) years after the end of the relevant engagement. Thereafter, unless separate arrangements have been made, the documents or papers may be destroyed by us without reference to the Center.

16. Neither we nor the Center shall be liable in any way for failure or delay in performing our obligations under this engagement if the failure or delay is due to causes outside the reasonable control of the party in default.

17. Either party may terminate our appointment as auditors by giving adequate notice to either party not exceeding 60 days.

We shall be grateful if you will kindly acknowledge receipt of this letter by signing the attached copy in the space provided and returning it to us, to indicate that it is in accordance with your understanding of the arrangements for our audit of the statutory accounts.

Yours faithfully,

We hereby agree to the terms and conditions as set out above

Partner

Secretary/Director

On behalf of the Board
APPENDIX 5: SAMPLE EXTERNAL AUDITORS’ UNQUALIFIED AUDIT REPORT

Source: ICLARM

Report of Independent Accountants

To the Board of Trustees
International Center for Living Aquatic Resources Management

We have audited the accompanying statements of financial position of the International Center for Living Aquatic Resources Management (a nonstock, nonprofit organization) as at December 31, XXXX and XXXX and the related statements of activities and of cash flows for the years then ended. These financial statements are the responsibility of the Center’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards in conformity with international audit guidelines as issued by the International Federation of Accountants. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As explained in Note 2, the Center’s financial statement are prepared on the basis of accounting practices prescribed for international agricultural research centers seeking assistance from the Consultative group on International Agricultural Research (CGIAR). We concur that such practices conform with generally accepted accounting principles.

In our opinion, the financial statements present fairly the financial position of the International Center for Living Aquatic Resources Management as at December 31, XXXX and XXXX and its activities and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary schedule as shown on Exhibit I to IV for the year ended December 31, XXXX is presented for purposes of additional analysis and is not a required part of the basic financial statements. The information on Exhibit I to IV has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly presented in all material aspects when considered in relation to the basic financial statements taken as a whole.
APPENDIX 6: SAMPLE INTERNAL AUDITING PROCESS

Source: IRRI

<table>
<thead>
<tr>
<th>Internal Auditing Process</th>
<th>IRRI Internal Auditing Unit</th>
<th>Audit Client</th>
<th>Director General &amp; Director for Finance</th>
<th>Audit &amp; Finance Committee (BOT)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ENGAGEMENT PLANNING:</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Re-confirm relevance of audit(^1) with client</td>
<td>✓</td>
<td>✓</td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Agree audit dates with client</td>
<td>✓</td>
<td>✓</td>
<td></td>
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<tr>
<td>• Carry out preliminary survey (e.g., policies)</td>
<td>✓</td>
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<tr>
<td>• Interview client</td>
<td>✓</td>
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<tr>
<td>• Agree with client the terms of reference(^2) for the audit</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>• Prepare audit program</td>
<td>✓</td>
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<tr>
<td>• Other administrative tasks (e.g., travel, filing)</td>
<td>✓</td>
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<tr>
<td><strong>PERFORMING THE ENGAGEMENT:</strong></td>
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<tr>
<td>• Execute audit program</td>
<td>✓</td>
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<tr>
<td>• Evaluate audit results</td>
<td>✓</td>
<td></td>
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<tr>
<td>• Provide feedback to client</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>• Discuss with client an Action Plan(^3)</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td><strong>COMMUNICATING RESULTS:</strong></td>
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<tr>
<td>• Discuss with client a working draft report</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>• Issue to client a draft report(^4) for comments</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>• Issue the final report</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>• Request feedback from client(^5)</td>
<td>✓</td>
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<td><strong>MONITORING THE PROGRESS:</strong></td>
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<tr>
<td>• Follow-up with client on the implementation of the agreed actions stated in the Action Plan</td>
<td>✓</td>
<td>✓</td>
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<tr>
<td>• Report the implementation status of the Action Plan</td>
<td>✓</td>
<td></td>
<td>✓</td>
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<tr>
<td>• Re-assess risk based on audit results</td>
<td>✓</td>
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</table>

\(^1\) Internal auditing assignment as stated in the Internal Audit Annual Plan.

\(^2\) Typically, the term of reference for an audit includes (a) audit objectives, (b) scope of the audit, and (c) reporting arrangements.

\(^3\) An Action Plan is an agreement by the audit client to carry out certain activities to rectify the audit issues. Typically, an Audit Plan states what needs to be done, who will be doing it, and when will it be done.

\(^4\) Typically, an audit report consists of (a) Executive Brief, (b) Action Plan, (c) Annexes, one of which will be the terms of reference for the audit.

\(^5\) Obtaining feedback from client is to gauge the success of the audit assignment; typical questions include: (a) Were the audit findings factually accurate? (b) Were the recommendations or solutions appropriate? (c) Did the recommendations add value? (d) Did the audit assist in the control of risk?
APPENDIX 7: SAMPLE TERMS OF REFERENCE FOR AN AUDIT ENGAGEMENT

Source: IPGRI

TERMS OF REFERENCE

As part of the Year 2000 Internal Audit Plan for IPGRI, the Internal Auditing Unit will carry out an audit of the XXX [name of the audit].

Audit Objectives

The objective of the audit is to review the adequacy of the internal control systems operating in XXX [process, function, or business unit], to ensure achievement of the research objectives in the following categories:

- Reliability and integrity of information
- Compliance with policies, plans, procedures, laws and regulations.
- Safeguarding of assets.
- Economical and efficient use of resources.
- Accomplishment of established objectives and goals for operations or programs.

Scope of the Audit

The scope of the audit will involve a review of the following: [state what you plan to do, where you plan to do it, and broadly how you plan to carry out the audit to achieve the audit objectives].

The scope of the audit could be expanded as appropriate.

Audit Administration and Reporting

XX [name of internal auditor] will carry out the audit from March 6 to March 14, 2000 and an exit meeting will be held with the XX [client] on March 15, 2000 to discuss the Action Plan.

The draft report will be issued to the XX [client] for comments by March 22, 2000, and the final report will be issued to the Director General copied to the XX [client] by April 5, 2000.
APPENDIX 8: SAMPLE ACTION PLAN

Source: IRRI

<table>
<thead>
<tr>
<th>No.</th>
<th>Action/Recommendation</th>
<th>Management Comments</th>
<th>Implement By</th>
<th>Due Date</th>
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<tbody>
<tr>
<td>1.</td>
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<td>2.</td>
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<td>6.</td>
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**Legend:**

The Internal Auditors write-up the “Action/Recommendation” while, Center Management (i.e., the Audit Client) completes the “Management Comments”, “Implement By”, and “Due Date”.
APPENDIX 9: SAMPLE CLIENT EVALUATION FORM

Source: IPGRI

Audit:
Audit Team:
Completed by:          Date: _______________

Please circle the description that best reflects your evaluation of the manner in which
the audit was conducted. *SD = strongly disagree, D = disagree, N = neutral, A = agree,
SA = strongly agree.

<table>
<thead>
<tr>
<th></th>
<th>SD*</th>
<th>D</th>
<th>N</th>
<th>A</th>
<th>SA</th>
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<tbody>
<tr>
<td>1. The objectives of the audit were clearly communicated.</td>
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<td>2. The audit examined what I consider to be the most important areas.</td>
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<td>3. My business concerns were adequately considered.</td>
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<td>4. I received feedback on emerging issues during the audit.</td>
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<td>5. The duration of the audit was reasonable.</td>
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<td>6. I felt comfortable sharing information.</td>
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<td>7. The disruption of daily activities was minimized.</td>
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<td>8. The audit team:</td>
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<td>• understood my business;</td>
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<td>• was courteous and professional;</td>
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<td>• had a constructive and positive attitude;</td>
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<td>• had logical conclusions and opinions; and</td>
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<td>• demonstrated technical proficiency.</td>
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<td>9. The audit report:</td>
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<td>• was clearly written;</td>
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<td>• had an appropriate tone;</td>
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<td>• was issued in a timely manner; and</td>
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<td>• was accurate.</td>
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<td>10. Audit recommendations were constructive and actionable.</td>
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<td>11. The audit was useful in improving processes and controls.</td>
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<td>12. Overall, the audit provided “added value” for my unit.</td>
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Please provide any other comments you would wish to share on the audit.

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