



CARIBBEAN ORGANIZATION OF SUPREME AUDIT INSTITUTIONS (CAROSAI)

AUDIT OF CAPITAL PROJECTS

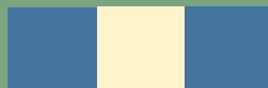


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Foreword

This manual, funded by the World Bank, was prepared by the Caribbean Organization of Supreme Audit Institutions (CAROSAI) to help strengthen Supreme Audit Institutions' (SAIs') capacity to audit capital projects, and to present observed findings and recommendations to Public Accounts Committees (PACs) for their deliberations. The manual does this by providing practical advice on the audit of capital projects and procurement, and drafting the resulting report.

The manual is supported by a generic audit programme that can be used to conduct performance audits of capital projects.

The manual and audit programme were field tested by the SAIs of Grenada, Guyana and Saint Lucia.

The manual and programme are not intended to be authoritative – they are designed to augment, as opposed to replace, the existing manuals and programmes in each SAI.

Each SAI can tailor the manual and audit programme to the extent required to meet its own needs.

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Bernadette Fevriere-George
SECRETARY GENERAL

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Date

Acronyms

CAROSAI	Caribbean Organization of Supreme Audit Institutions
IDEA	A data analysis software. It is the property of CaseWare Analytics
ISSAIs	International Standards of Supreme Audit Institutions
PAC	Public Accounts Committee
SAI	Supreme Audit Institution
VFM	Value for Money

AUDIT OF CAPITAL PROJECTS

Chapter 1: Introduction

Purpose and Scope of Manual

- 1.1. The objective of this manual is to help strengthen Supreme Audit Institutions' (SAIs') capacity to audit capital projects, and to present observed findings and recommendations to Public Accounts Committees (PACs) for their deliberations. The manual does this by providing practical advice on the audit of capital projects and procurement, and drafting the resulting report.
- 1.2. While the manual is focussed on the performance audit of capital projects and procurement, it contains general background information on the various types of audits and the various phases in the audit process.

Outline of Manual

- 1.3. Chapter 2 of the manual is a general chapter that discusses public accountability and the roles that entities and their officials, SAIs and Parliaments (particularly PACs) can play. The role of the PAC is re-visited in Chapter 11.
- 1.4. Chapter 3 looks at the various types of audits that SAIs can perform, the objectives of each, and the related auditing standards. The focus of this chapter is on performance audits, as that is the focus of the remainder of the manual.
- 1.5. Chapter 4 introduces the topic of capital projects. It provides a description of what capital projects are, and then provides an overview of the procurement cycle and a description of the activities that should be undertaken by entity officials at each stage of that process.
- 1.6. Chapter 5 deals with the process by which auditors select the specific capital project(s) to audit.
- 1.7. Chapters 6 through 10 deal with the various phases of the audit of a specific capital project – general audit planning, detailed audit planning, fieldwork, evaluation, and reporting. While each chapter focuses on the performance audit of a capital project, it contains:
 - 1.7.1. An introduction/overview that describes, in general, what the specific phase of the audit process being discussed involves.
 - 1.7.2. Guidance that is relevant to other types of audits.
- 1.8. Once an audit is completed, the report is usually tabled in Parliament and referred to a parliamentary oversight committee – referred to in this manual as the PAC. Chapter 11 discusses how SAIs work with PACs, the process by which findings are presented to PACs, and the process by which PACs issue recommendations.

- 1.9. Chapter 12 then discusses the follow-up phase – a key step in the accountability process.
- 1.10. While each chapter of the manual discusses quality assurance issues (how auditors ensure that the work performed at that phase of the audit process has been properly completed in accordance with the auditing standards), the manual ends with a discussion on quality assurance. Chapter 13 summarises the key quality assurance procedures carried out at each phase of the audit process. It then discusses some general quality assurance procedures for all phases of the audit process, and post-audit quality assurance. The latter includes audit team post-audit self-reviews, post-audit quality reviews by other SAI staff, and peer reviews by other SAIs.
- 1.11. The manual also contains three annexes, as follows:
 - 1.11.1. Annex A is based on a hypothetical capital project to build a new road between two cities. It contains:
 - (a) Possible reasons why the entity may have wanted to build the new road. This would be the end result of the needs assessment described in Chapter 4.
 - (b) A possible audit objective and audit scope, illustrating these concepts from Chapter 6.
 - (c) Possible criteria and supporting questions, illustrating those concepts from Chapter 6.
 - (d) An example of an audit design matrix, illustrating this concept from Chapter 6.
 - (e) A discussion on possible ways to include details with respect to authorities (laws, regulations, rules, policies, etc.) in the audit report.
 - 1.11.2. Annex B expands on the discussion of risk in Chapter 6, including the risk of fraud. It contains possible risks that may exist at each stage of the procurement cycle for a capital project, including risks due to fraud. It also contains red flags that may indicate that fraud might exist at that stage.
 - 1.11.3. Annex C contains possible audit report structures, illustrating many of the concepts from Chapter 10.
- 1.12. This manual is supported by an audit programme for the performance audit of a capital project. The primary purpose of this programme is to provide detailed audit procedures to be performed at the fieldwork phase of the audit in order to assess the entity's performance at each stage of the procurement cycle. The audit programme does, though, contain general procedures to be performed at the planning, evaluation and reporting phases of an audit.
- 1.13. Of necessity, the audit programme is generic – it is not possible to deal with every possible type of capital project, all possible laws and regulations, or all possible

combinations of sources of audit assurance. As such, some tailoring will likely be required. Chapter 7 provides guidance on the tailoring process.

Limitations of the Manual

- 1.14. While the manual deals with every phase in the audit process, it does not contain all the guidance auditors may need to perform that step. For example, while Chapter 6 provides some guidance on various types of risk and the various sources of audit assurance, it does not contain an audit risk model or provide possible parameters that the auditor can use. Similarly, while Chapter 6 and other chapters make mention of sampling, the manual does not contain all the guidance that auditors may require to determine the sample size, select the sample or evaluate the sample results. Such additional guidance is beyond the scope of this manual.

Chapter 2: Public Accountability and Legislative Oversight

Introduction

Note: This manual uses the term “entity” as a generic term for a ministry, agency, state-owned enterprise (Crown corporation) or other similar government-owned organisation, and the divisions, units, etc. within each that are subject to audit.

- 2.1. This chapter provides a definition of public accountability and looks at the roles played by government entities and entity officials, Supreme Audit Institutions (SAIs) and Parliaments. It highlights the facts that:
 - 2.1.1. Entity officials are the ones directly responsible for ensuring that value for money is received for all expenditures, and that all relevant government authorities (laws, regulations, rules, policies, etc.) are complied with.
 - 2.1.2. The SAI provides an independent assessment with respect to the extent to which entity officials have performed their functions.
 - 2.1.3. Parliament (supported by the Public Accounts Committee (PAC)) is the ultimate body that can ensure that public accountability is achieved. While the SAI can report deficiencies and can make recommendations to deal with those deficiencies, only Parliament has the authority to require entity officials to implement those recommendations.

Public Accountability

- 2.2. In modern democratic governments, parliamentarians do not directly manage expenditures, revenues or borrowings. Instead, they entrust their management to entity officials in the executive branch of government. Public accountability means that those in charge of a government programme or ministry are held responsible for the economical, efficient and effective running of that programme or ministry, that resources are used with due regard for economy, efficiency and effectiveness, and that all relevant authorities (laws, regulations, rules, policies, etc.) have been complied with.

Entities and Entity Officials

- 2.3. Entities are normally established by legislation. That legislation often specifies:
 - 2.3.1. The entity’s purpose – the reason why it was created and the objectives it is to achieve.
 - 2.3.2. The programmes that the entity is to carry out to achieve its objectives.
 - 2.3.3. The authorities under which the entity is to operate.
- 2.4. The legislation may also specify the organisational structure and the responsibilities of senior entity officials. These responsibilities may include submitting annual reports to

Parliament on the entity's activities and on the extent to which the entity has achieved its objectives.

- 2.5. Each ministry, agency or state-owned enterprise is usually provided with a certain amount of funding (an appropriation) to carry out its activities.
- 2.6. Consistent with the above paragraphs, entity officials are the ones directly responsible for ensuring that value for money is received for all expenditures, and that all relevant authorities (laws, regulations, rules, policies, etc.) are complied with.

Supreme Audit Institutions (SAIs)

- 2.7. The Supreme Audit Institution (SAI) is a part of the legislative branch of government. Its function is to provide an independent assessment of the extent to which entities and entity officials have performed their functions. This includes examining whether public funds are spent economically, efficiently and effectively in compliance with existing laws, regulations, rules, policies, etc.
- 2.8. SAIs carry out their functions by conducting various types of audits (see Chapter 3) and issuing reports to Parliament and to the audited entities. These reports may contain recommendations to improve the entity's performance and thereby better achieve economy, efficiency and effectiveness.

Parliaments and Public Accounts Committees (PACs)

- 2.9. One of Parliament's roles is to ensure public accountability. It passes the legislation under which the entities operate, and approves their annual appropriation.
- 2.10. Under the Westminster system of government, the SAI does not have the power to force entities to implement its recommendations – that power rests with Parliament.
- 2.11. Parliament normally performs this function by referring the reports it receives from the SAI to a committee that, in this manual, is referred to as the PAC. That committee holds hearings on the SAI's report and then issues its own report. That report may call for the entity to implement the SAI's recommendations, or to implement any additional recommendations that the PAC may choose to make.
- 2.12. The role of the PAC is re-visited in Chapter 11.

Chapter 3: Types of Audits and the Related Auditing Standards

Introduction

- 3.1. This chapter looks at the various types of audits that SAIs can perform. It then looks at the International Standards of Supreme Audit Institutions (ISSAIs).
- 3.2. The focus of this chapter is on performance audits, as that is the focus of the remainder of the manual.

Types of Audits

- 3.3. ISSAI 100 groups audits into three main types – financial, performance and compliance. (The term “regularity audit” has been eliminated from ISSAI 100.)
- 3.4. In practice, there are two other widely recognised types of audits:
 - Fraud/forensic audit (which is not explicitly referred to in ISSAI 100); and
 - Audit of internal controls (which is explicitly referred to in ISSAI 100 as an example of another type of audit).
- 3.5. These audit types are not mutually exclusive. For example, as required by the ISSAIs:
 - 3.5.1. On almost all audits, the auditor would need to have a minimum understanding of internal control.
 - 3.5.2. All financial audits need to include a compliance with authorities element and a consideration of fraud.
 - 3.5.3. Performance audits require a consideration of compliance with authorities when compliance matters could significantly impact on the audit objective (which is almost always the case), and for the auditor to be alert to situations or transactions that could be indicative of illegal acts or abuse.
- 3.6. Audits such as audits of capital projects, revenue audits, IT audits, and environmental audits are not types of audits. As part of an audit of a particular capital project, for example, an auditor could:
 - 3.6.1. Audit the expenditures made as part of the audit of the financial statements containing those expenditures (a financial audit);
 - 3.6.2. Look at the tendering stage to ensure that all relevant authorities were complied with (a compliance audit); and/or
 - 3.6.3. Assess the economy, efficiency and effectiveness with which the capital project and the related procurements had been carried out (a performance audit).

- 3.7. Similarly, an environmental audit could involve:
- 3.7.1. Auditing environmental liabilities and contingent liabilities as part of a financial audit;
 - 3.7.2. Auditing compliance with environmental laws and regulations as part of a compliance audit; and/or
 - 3.7.3. Auditing a particular environmental issue (e.g., water quality) as the subject of a performance audit.
- 3.8. Each of those audits would likely also involve a review of internal controls and a consideration of the risk of fraud.
- 3.9. What follows is a general discussion on each type of audit.

Financial Audit

- 3.10. A financial audit is usually synonymous with an audit of an entity's financial statements.
- 3.11. The overall objective of conducting an audit of financial statements is to:
- 3.11.1. Obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework.
 - 3.11.2. Report on the financial statements and communicate in accordance with the auditor's findings.
- 3.12. Put another way, the purpose of a financial audit is to enhance the degree of confidence that intended users have in the completeness and accuracy of the financial statements.
- 3.13. At the end of the audit, the auditor expresses an opinion as to whether the financial statements are presented fairly, in all material respects (or give a true and fair view) in accordance with the applicable financial reporting framework.

Performance Audit

- 3.14. A performance audit (also referred to as a value for money (VFM) audit) is an independent and objective examination of government undertakings, systems, programmes or organisations, with due regard to one or more of the three aspects of economy, efficiency and effectiveness, aiming to lead to improvements.
- 3.15. Put another way, performance audits are concerned with the way in which entities use their resources to achieve their objectives. They are a way for Parliaments and the other users of the audit report (e.g., entity officials, the media, the academic community, special interest groups and the general public) to obtain an insight into how well government programmes are being run and whether value for money is being achieved.

- 3.16. As noted above, performance audits are concerned with the audit of economy, efficiency and effectiveness. Each is discussed below.

Economy

- 3.17. *Economy* relates to inputs. It means minimising the cost of resources used for an activity, having regard to appropriate quality. Put another way, it means obtaining the appropriate quantity and quality of goods and services at the appropriate cost and at the appropriate time.
- 3.18. In the case of the construction of a school, for example, economy would involve acquiring materials and labour that meet the required quality at the lowest possible cost, and at the time they were required.

Efficiency:

- 3.19. *Efficiency* relates to the utilisation of those inputs to produce outputs. It means maximising the output (goods or services produced) from a given level of input, or alternatively minimising the inputs required for a given level of output.
- 3.20. In the case of the school, for example, efficiency would involve ensuring that the school was constructed using the least possible amount of materials and labour, and was constructed on a timely basis.

Effectiveness:

- 3.21. *Effectiveness* relates to the outputs – it deals with the extent to which the output met the objectives and achieved the desired outcome (i.e., the results or benefits for which the expenditures were being incurred).
- 3.22. In the case of the school, for example, effectiveness would involve the extent to which the finished product achieved the objectives for which it had been built.
- 3.23. The legislation under which an SAI operates may give the SAI the authority to directly audit effectiveness, or to audit the extent to which entities have policies and procedures in place to ensure effectiveness. These policies and procedures could include, for example, good management practices, and procedures to ensure the correct and timely delivery of services and the achievement of objectives.
- 3.24. Even if the SAI has the authority to directly audit effectiveness, it may still wish to include, in the scope of its performance audit, an examination of the entity's policies and procedures to ensure effectiveness. The SAI may want to do this to determine if the entity's policies and procedures did, indeed, contribute to the achievement of the desired outcomes. (It is possible that the desired results were achieved *despite* the entity's performance!)
- 3.25. While performance audits deal with the extent to which the objectives were achieved, they normally do not question the objectives themselves. To do so could be seen as questioning government policy (i.e., the intentions and decisions of Parliament).

- 3.26. For example, if one of the reasons for building the new school was to reduce class sizes in the region to no more than 20 students per class, the auditor could comment on whether the new school achieved that objective, and whether building the new school was the most economical, efficient and effective way of achieving that objective. The auditor could also comment on the intended or unintended consequences arising from that policy (e.g., the impact that the policy will have on future operating costs). The auditor, though, would not question the policy itself.
- 3.27. Performance audits are very different from financial and compliance audits for a number of reasons:
- 3.27.1. Aside from a performance audit required by a loan/grant agreement or other similar agreement, they are usually discretionary and are performed on a non-recurring basis.
 - 3.27.2. They are based on decisions made or goals established by Parliament.
 - 3.27.3. They can involve a wide range of complex issues that are not pre-set. In contrast, the scope of a financial audit is normally determined by the financial statements that have been presented for audit, the accounting standards used, and the audit assertions that need to be considered.
 - 3.27.4. Given the previous point, auditors may need to employ a wide selection of investigative and evaluative methods. This means it is often difficult to develop standard audit programmes or checklists for performance audits.
- 3.28. Performance audits are required to include an audit of compliance with the relevant authorities when those authorities are significant to the audit objectives. As this is almost always the case, it would be extremely rare for a performance audit not to include an audit of the relevant authorities. Therefore, when conducting a performance audit of a particular capital project, the auditor will need to determine whether all relevant laws, regulations, rules, policies, etc. contained in procurement and other acts and in relevant supporting documents are being complied with.

Compliance Audit

- 3.29. A compliance audit involves obtaining reasonable assurance about whether particular expenditures, revenues and/or borrowings comply, in all material respects, with the relevant authorities (the laws, regulations, rules, policies, etc. that govern the entity).
- 3.30. The auditor then reports on the degree to which the audited entity has complied with those authorities (i.e., has been accountable for its actions and has exercised good public governance practices).
- 3.31. More specifically, a compliance audit will examine to what extent the audited entity follows:
- The applicable laws, regulations, rules, policies, etc.;
 - Budgetary resolutions;

- Established codes; and/or
 - Agreed upon contractual terms (e.g., the terms of a procurement contract or a funding agreement with an international financial institution).
- 3.32. Compliance audits may be conducted on their own with the objective of expressing an opinion on an entity's compliance with authorities.
- 3.33. Compliance audits are also conducted as part of financial audits. As discussed above, the ISSAIs require public sector auditors to incorporate compliance with authority work into every financial audit.
- 3.34. Similarly, the other types of audits conducted in the public sector normally include a compliance with authorities element. As discussed above, for example, it would be very rare for a performance audit not to include an audit of the relevant authorities.

Fraud/Forensic Audit

- 3.35. Fraud/forensic audits deal with frauds or potential frauds.
- 3.36. Fraud can be defined as an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.
- 3.37. Frauds include theft, false accounting, bribery and corruption, deception and collusion.
- 3.38. There are four basic elements that are necessary for fraud to occur:
- 3.38.1. There must be an incentive or pressure placed on or perceived by management or employees giving them a reason to commit fraud.
 - 3.38.2. There must be assets that are considered valuable enough to be worth attempting to commit fraud to acquire.
 - 3.38.3. The individuals must have an opportunity to commit the fraud. This could involve weaknesses in internal controls. For example, an employee may have access to the assets and may also be in a position whereby he/she could alter the accounting records in an attempt to hide the fraud.
 - 3.38.4. There must be a rationalisation of the act – something that allows the individuals to justify committing the fraud.
- 3.39. There are three basic types of fraud/forensic audits:
- 3.39.1. An audit of the internal controls that have been put in place to prevent and/or detect fraud. This would involve an audit of the internal controls and other management practices that have been put in place to minimise the chances of an individual or group of individuals committing fraud, and to detect frauds that have been committed.

- 3.39.2. A search for potential frauds. The audit could involve, for example, conducting a detailed analysis of data using IDEA or other data mining software to determine if the data indicates a high potential of fraud in certain areas. The investigation could look for unusual patterns in expenditures, evidence of contract splitting and/or evidence of duplicate payments. “Red flags” identified as part of this analysis would then be followed up.
- 3.39.3. A detailed investigation into a particular suspected fraud or financial irregularity. This investigation could be designed to determine, for example, who did what, and could involve examining documentation and conducting interviews with the officials involved.
- 3.40. Like a compliance audit, a forensic audit may be conducted on its own, or as part of another type of audit. With respect to the latter:
- 3.40.1. ISSAI 100 (which applies to all types of audits) requires auditors to identify and assess the risk of fraud relevant to the audit objectives. Auditors should maintain an attitude of professional scepticism and be alert to the possibility of fraud throughout the audit process.
- 3.40.2. ISSAI 1240 for financial audits requires auditors to assess the risk of fraud, and to follow up potential frauds to the point of determining whether there is a monetary error or compliance deviation.
- 3.40.3. ISSAI 300 for performance audits requires auditors to assess the risk of fraud. If the risk of fraud is significant within the context of the audit objectives, the auditor should obtain an understanding of the internal control systems and examine whether there are signs of irregularities that hamper performance.

Audit of Internal Control

- 3.41. Internal controls are often audited as part of a financial, compliance, performance or forensic audit. Auditors obtain the minimum required level of understanding and then:
- If reliance is intended, obtain an additional understanding of the controls on which reliance is intended and then test those controls; or
 - Develop a substantive testing approach to deal with those areas where controls are not reliable or where it is not cost-effective to rely on them.
- 3.42. Similarly, the first type of fraud/forensic audit described above is an audit of the internal controls that have been put in place to prevent and/or detect fraud.
- 3.43. Auditors may, though, conduct a separate audit of internal control for the purpose of expressing an opinion on the controls. While rarely required by the legislation under which SAls operate, such an audit may be required as part of a loan/grant agreement with an international financial institution.

International Standards of Supreme Audit Institutions (ISSAIs)

- 3.44. The International Organization of Supreme Audit Institutions (INTOSAI) provides an institutionalised framework of professional standards and other pronouncements to SAIs.
- 3.45. At present, INTOSAI has issued a series of International Standards of Supreme Audit Institutions (ISSAIs). It has also issued INTOSAI Guidance for Good Governance (INTOSAI GOV).

The Four Levels of the ISSAIs

- 3.46. The ISSAIs are structured in four levels:

Level 1 - Founding Principles

- 3.47. This level contains ISSAI 1 – the Lima Declaration. Issued in 1977, the Declaration calls for the establishment of effective SAIs and provides guidelines on auditing precepts.

Level 2 - Prerequisites for the Functioning of Supreme Audit Institutions (ISSAIs 10 to 99)

- 3.48. This level builds on the Lima Declaration. It contains INTOSAI's pronouncements on the necessary preconditions for the proper functioning and professional conduct of SAIs. These include principles and guidance on independence, transparency and accountability, ethics and quality control.

Level 3 - Fundamental Auditing Principles (ISSAIs 100 to 999)

- 3.49. This level contains the generally recognised auditing principles that underpin effective, independent auditing of public sector entities.
- 3.50. ISSAI 100 (Fundamental Principles of Public-Sector Auditing) presents a definition of public sector auditing and provides the essential concepts, elements and principles that apply to all public sector audits. These include:
- The purpose and authority of ISSAIs;
 - The framework for public sector auditing;
 - The elements of public-sector auditing; and
 - The principles to be applied in public-sector auditing.
- 3.51. ISSAIs 200, 300 and 400 then build on the principles in ISSAI 100 for financial, performance and compliance auditing respectively.

Level 4 - Auditing Guidelines (ISSAIs 1000 to 5999)

- 3.52. The Auditing Guidelines “operationalise” the fundamental auditing principles. They provide detailed guidance on how to apply the fundamental principles on individual audits.

- 3.53. ISSAIs 1000 to 4999 contain the requirements of financial, performance and compliance auditing and provide further guidance to the auditor.
- 3.54. ISSAIs 5000 to 5999 contain supplementary guidance on specific subject matters or other important issues which may require the special attention of SAIs.
- 3.55. The auditing guidelines for financial audits are contained in ISSAIs 1000 to 2999. These guidelines are based on the International Standards on Auditing (ISAs) issued by the International Federation of Accountants. ISSAIs 1000 to 2999 incorporate the ISAs in their entirety and then include Practice Notes which provide guidance on how the ISAs are to be applied for public sector auditing.
- 3.56. The auditing guidelines for performance audits are contained in ISSAIs 3000 and 3100. ISSAI 3000 (Standards and Guidelines for Performance Auditing Based on INTOSAI's Auditing Standards and Practical Experience) provides a definition of performance auditing and a detailed discussion on how one is usually conducted. ISSAI 3100 (Performance Audit Guidelines – Key Principles) then provides additional guidance on such key principles as:
- Definitions;
 - Performance audit objective;
 - Selecting audit topics;
 - The audit process (planning, conducting, reporting and follow up); and
 - Quality control.
- 3.57. The ISSAIs for performance audits are currently being updated. Three exposure drafts were issued. The comment period ended in September 2015, and they may be approved in late 2016.
- 3.58. The auditing guidelines for compliance audits are contained in ISSAIs 4000, 4100 and 4200. These guidelines contain extensive references back to the related financial audit guidelines – the basic concepts and how they are to be applied on a financial audit and on a compliance audit are essentially the same.

Reporting Against the ISSAIs

- 3.59. Auditors may refer to the ISSAIs in their reports in one of two principal ways:
- 3.59.1. The audit report states that the audit was conducted in accordance with a national standard that is based on or consistent with the Fundamental Auditing Principles (ISSAIs 100-999). To use this option:
- (a) The SAI needs to have developed its own standards or adopted standards from a recognised standard-setting body; and
 - (b) Those standards need to be based on or consistent with ISSAIs 100 to 999.

3.59.2. The audit report states that the audit was conducted in accordance with the ISSAIs. To use this option, the SAI needs to have complied with all relevant guidelines in ISSAIs 1000-4999.

Chapter 4: Capital Projects and Procurement

Introduction

- 4.1. This chapter provides a definition of capital projects and a description of what capital projects are. It then provides an overview of the procurement cycle and a description of the activities that should be undertaken by entity officials at each stage of the process. In doing so, it helps the auditor to obtain a better understanding of:
 - 4.1.1. Capital projects and the procurement cycle; and
 - 4.1.2. The activities that entity officials should undertake at each stage of the procurement cycle.

Definition and Nature of Capital Projects

- 4.2. A capital project is a project of a relatively large size involving the construction or development of new government assets or major additions to or upgrades of existing government assets. Such projects are typically non-recurring, take a long time to be completed, and the completed assets are expected to have a long life. Typical examples of capital projects are the construction of roads, bridges, schools, hospitals, airports and other large government assets.
- 4.3. The end result of a capital project is a capital asset. These are expenditures that, under accrual accounting, would need to be capitalised (i.e., included in the balance sheet as a long-term asset). In order to meet this definition, the asset needs to be:
 - 4.3.1. Relatively large. International accounting standards permit the expensing of immaterial expenditures. As such, the procurement of routine, low value items such as pens, paper and printer ink do not qualify as capital assets.
 - 4.3.2. Expected to provide a benefit for more than one year (i.e., have a long life). Assets with an estimated useful life of one year or less would be fully depreciated/amortised after that one year, which would effectively provide the same end result as expensing the amount in the first place.
- 4.4. Further to 4.3, as used in this manual capital projects involve very large expenditures. It would normally not be cost-effective for an entity to go through the process outlined in this chapter for very small procurements.
- 4.5. Governments, like almost all other organisations, only have limited funds and there is a need to use those funds as economically, efficiently and effectively as possible.
- 4.6. This is particularly important for capital projects. Given the large amounts of money involved, even a small percentage of wastage can be large in absolute amount. Similarly, projects that are not completed to the desired quality can result in significant additional expenditures in future years. And projects that are completed much later than planned may not be able to meet the needs for which they were designed.

- 4.7. For many Caribbean countries, large capital projects often share one other attribute – they are often financed, in whole or in part, by an international financial institution such as the World Bank or the Inter-American Development Bank. Loan/grant agreements are often not finalised until after the entity is able to convince the institution that:
- 4.7.1. There is a real need for the capital project.
 - 4.7.2. It has in place all controls and procedures required to ensure that the project will be carried out in accordance with the requirements of the loan/grant agreement and the applicable government authorities, and that it will be carried out as economically, efficiently and effectively as possible.
- 4.8. With respect to 4.7.2, loan/grant agreements often contain specific controls that the entity must have in place and specific procedures that entity officials must follow in order to ensure that the capital project is carried out as economically, efficiently and effectively as possible. The agreements also usually contain requirements for the project's financial statements to be audited by the SAI in order to ensure that the accounting records for the project are complete and accurate. The agreements may also call for the SAI to express an opinion on (or comment on) whether the required controls were in place, the required procedures were followed, and/or whether the project was, indeed, carried out as economically, efficiently and effectively as possible.

Definition and Nature of Procurement

- 4.9. Procurement is the process by which goods and services are acquired from third parties. It includes the entire process from the initial identification of the need for the good or service through to the final acceptance of the good or service and the final payment for the good or service. It involves ensuring that the good or service is acquired as economically, efficiently and effectively as possible.
- 4.10. It is also essential that the procurement cycle itself be conducted as economically, efficiently and effectively as possible. This requires entities to weigh the costs and benefits of instituting specific controls and following specific procedures.
- 4.11. For small, recurring procurements, the costs of procurement are normally kept low as there is little risk of large losses to the government. Entity officials may be able to make these procurements without going through a competitive bidding process or obtaining written quotes. For larger monetary procurements, though, such as those associated with capital projects, governments normally institute very detailed procurement procedures that must be followed. These often involve most or all of the procedures outlined in the next section.

The Procurement Cycle for Capital Projects

- 4.12. The procurement cycle comprises three main stages:
- 4.12.1. Pre-tendering. This includes the needs assessment, the definition of requirements, the choice of procedures, and planning and budgeting. If there is more than one to meet the needs, all options should be considered.

- 4.12.2. Tendering. This includes the invitation to tender, evaluation of tenders received, and the award of the contract.
- 4.12.3. Post-Contract Award. This includes managing the contract as the work progresses, making payments, and ensuring that the finished product meets all of the requirements contained in the contract.
- 4.13. Most countries have procurement acts and regulations that outline the specific steps that need to be followed and the level of approval required depending on the nature and size of the procurement and/or the project to which it relates. These laws and regulations might specify, for example:
 - 4.13.1. The maximum monetary amount of a procurement that can be approved by an individual ministry. Procurements of larger amounts may require approval by a central agency such as a treasury board. Large procurements may even need to be handled by a central procurement agency.
 - 4.13.2. The minimum number of tenders that are required to be submitted. Often at least three tenders are required.
 - 4.13.3. The minimum qualifications that contractors must possess in order to submit tenders. This is to ensure that unqualified contractors are not awarded the contracts, thereby reducing the risk of improperly performed work.
 - 4.13.4. The length of time bidders are given to submit tenders. This is to help ensure that all qualified contractors have the time required to perform whatever they need to do before submitting tenders.
 - 4.13.5. The process by which tenders are to be evaluated. Some evaluations are based on lowest price; others on a combination of price and quality.
 - 4.13.6. Who has the authority to approve contracts of a specific size.
 - 4.13.7. The procedures that need to be followed to monitor the work being performed.
 - 4.13.8. The procedures that need to be followed before signing off on the work performed and/or making the final payment.
- 4.14. What follows is a discussion on each step of the procurement cycle and the work that entity officials should usually perform in each stage.

Pre-Tendering

- 4.15. The pre-tendering stage can be seen as the preparation stage of contracting. This includes a needs assessment, definition of requirements, choice of procedures, and planning and budgeting. If there is more than one way to meet the needs, all options should be considered.

Needs Assessment

- 4.16. This step is critical – there must be clear documented reasons why the capital project is required.
- 4.17. In the case of new school, for example, government officials may identify the need to:
 - 4.17.1. Reduce overcrowding in existing schools;
 - 4.17.2. Reduce the distance students need to travel to get to school;
 - 4.17.3. Provide facilities with the equipment required to teach specialised courses; and/or
 - 4.17.4. Provide classrooms and classes that can meet the special needs of some students.
- 4.18. Similarly, in the case of building a new road between two cities, entity officials may identify the need to:
 - 4.18.1. Reduce traffic congestion;
 - 4.18.2. Reduce accidents; and/or
 - 4.18.3. Reduce the ongoing costs of maintaining the existing road between the two cities.
- 4.19. Annex A takes this second example and expands on the needs assessment. It then goes on to illustrate what the audit objective, scope, criteria and supporting questions could look like.

Definition of Requirements

- 4.20. This follows directly from the needs assessment. During this step, entity officials determine precisely what must be constructed to meet the needs that have been identified.
- 4.21. Each capital project is different and the time and effort required to complete this step could be significantly different from one project to another. In addition, different entities may operate under different authorities (different procurement acts, etc.) that contain specific requirements with respect to what needs to be done at this stage.
- 4.22. Given the above, the definition of requirements may be performed differently from entity to entity and from project to project. That being said, though, the definition of requirements is often done at two (or more) levels. There is usually a general (high level) definition of requirements during which general specifications are determined and costed. There is then a much more detailed level during which very detailed specifications are determined and costed. These detailed specifications are often referred as “engineer’s estimates”.
- 4.23. In the case of a new road, for example, entity officials will first assess such things as how many lanes it needs to have and the route it will take. They may also determine if

there are significant ancillary costs, such as the cost of acquiring land and relocating utilities. They will then prepare an estimate of the total costs involved based on those general specifications.

- 4.24. Once the general specifications are determined, detailed architectural drawings, blueprints, etc. can be developed. These will contain the detailed specifications.
- 4.25. The more detailed the specifications, the better entity officials will be able to evaluate tenders received and identify reasons for higher or lower total costs than those anticipated.

Choice of Procedures

- 4.26. There are numerous ways in which the capital project could be carried out. The entity can do all the work itself, using its own staff, or it could contract with a third party or parties.
- 4.27. For capital projects, the entity normally cannot do all the work itself as it does not have the required number of employees with the required skills. It therefore normally needs to contract the work out to others.
- 4.28. Further to the previous paragraph, in the case of most large capital projects it would be rare for one contractor to have the required number of employees with the required skills. In the case of the construction of a school, for example, there is the need for excavations, foundation work, electrical and plumbing services, brickwork, windows and doors, etc. The entity could choose to hire a large number of individual contractors and oversee the work of each contractor. Alternatively, it could engage a general contractor who will then sub-contract the work out to others.

Planning and Budgeting

- 4.29. This step involves developing a timeline for the performance of each of the remaining steps in the procurement cycle, and a budget for the total cost associated with the project.
- 4.30. The budget should not only include the estimated amount to be paid to any third parties engaged to do the work, but also the cost in terms of time and expenditures being incurred by entity officials to oversee the project. It could also reflect any grants or loans expected to be received from international financial institutions.
- 4.31. Ideally there will also be estimates of the recurring operating costs that will be required to maintain the asset after the procurement cycle has been completed. Taking the full life cycle costs into account is usually the best way to evaluate different options.

Consideration of Options

- 4.32. Part of the pre-tendering stage should involve a consideration of all possible ways in which the identified needs can be achieved. In the case of the need for improved transportation, for example, the need may be met by building a new road or by improving one or more of the existing roads.

- 4.33. Each option will likely have its own advantages and disadvantages, and each will have different timelines and costs. All should be considered when determining the most appropriate option to take.
- 4.34. Further to 4.22, the development of costed detailed specifications may be a lengthy and costly exercise. If that is the case, the entity may use the costed general specifications or another approximation to estimate the cost of each potential option when selecting its preferred option. Costed detailed specifications will then be prepared at a later date for the selected option.
- 4.35. If the detailed specifications prepared at a later date cost out at a substantially higher amount than the estimate used when making the selection, it would be prudent for the entity to go back and re-consider the other options.

Tendering

- 4.36. Tendering involves the invitation to tender, the evaluation of tenders and awarding the project to the winning contractor.
- 4.37. Tendering is a critical step. If it is done poorly, there is an increased risk that the finished product will not be of the required quality, will have cost much more than it should have cost, will not be completed on time, and/or will require increased ongoing costs. The finished product may not even meet the needs for which it was designed to meet.

Invitation to Tender

- 4.38. This is the process by which contractors are invited to submit tenders for the performance of the project.
- 4.39. The first step is to determine who should be invited to submit tenders. Some projects may be open to everyone; others may only be open to a few selected contractors; still others may be sole-sourced. If the project is not open to every contractor who has the qualifications required to do the work (and especially if it is sole-sourced), it is critical that the entity have controls in place to ensure that the selection does not exclude contractors who could do the best possible job at the lowest possible price.
- 4.40. Many procurement acts place very clear limitations on the use of sole-sourcing. These restrictions may include, for example, the need for the entity to show that:
 - 4.40.1. There is an emergency and the work needs to be done on an urgent basis. Following a competitive bidding process would take so long that the urgent need could not be met.
 - 4.40.2. There is only one contractor with the required skills and experience to do the work.
- 4.41. Conversely, not restricting the list of who can submit tenders has its own risks. Unless the entity conducts a detailed check to ensure that each contractor meets the required qualifications, the contract could be awarded to a contractor who will not be able to perform the work to the standards required.

- 4.42. The contractors who are invited to tender are sent a document (often referred to an invitation to tender) that usually contains, among other things:
- The objectives of the project;
 - The minimum qualifications the contractor must possess;
 - The minimum specifications (or the precise specifications) that the completed capital asset must meet;
 - The required timeline and completion date for the project;
 - The deadline date for the submission of the tenders;
 - The evaluation grid to be used to evaluate the tenders;
 - Whether it will be fixed price or cost-plus contract;
 - The payment schedule and the conditions to be met to receive the payment; and
 - Any assumptions behind the specifications or other material in the document.
- 4.43. The contractors may also be provided with an amount that their tenders are not permitted to exceed.
- 4.44. The more detailed the invitation to tender, the less chance there will be for the tenders received not to meet the minimum requirements and not to be prepared on the same basis as the other tenders. There will also be a reduced risk of there being disagreements after the contract has been awarded.
- 4.45. At the same time, though, government officials need to ensure that they do not make the specifications unduly specific. If they do so, they could needlessly disqualify contractors whose proposals will meet all the needs and achieve all the objectives.
- 4.46. As an example, in the case of a school the specifications could note that it is to be air conditioned, and that the air conditioning system must be able to keep the temperature in the school at no more than 24 degrees. The bidders would then be free to select the system that they believe would most cost-effectively meet that requirement. Going beyond this to require all bidders to use a particular brand could result in a higher overall cost and give one bidder a competitive advantage.

Evaluation of Tenders

- 4.47. Once the tenders are received from the contractors, the tenders need to be evaluated. To ensure consistency and fairness:
- 4.47.1. Those performing the evaluation need to have the knowledge, skills and experience required to do so.
- 4.47.2. Entity officials should use the same pre-set evaluation grid to evaluate all received tenders.

- 4.48. The first step is to ensure that each tender meets the minimum requirements. Those that do not should be excluded from further consideration.
- 4.49. If there is only one bidder, or only one bidder that meets the minimum requirements, some procurement laws and regulations require the entity to carry out additional procedures. In some cases, those procedures may require the entity to seek additional tenders, or to treat the project as being sole-sourced.
- 4.50. Assuming that the required number of tenders are received and meet the minimum requirements, there are two options that are usually employed:
 - 4.50.1. The evaluation is based solely on price. This option would result in the contract being awarded to the lowest cost bidder who met the minimum requirements.
 - 4.50.2. The evaluation is based on a combination of price and quality. This option would permit the entity to select a contractor other than the one who submitted the lowest cost tender if the quality of the proposed work was in excess of that being proposed by the lowest cost bidder. To ensure objectivity, there should be a pre-determined weighting given to quality and price.
- 4.51. In some cases, the evaluation may result in no contractors being selected. This could occur, for example, when none of the tenders submitted met the minimum requirements, or when all of the bidders submitted amounts that exceeded the funds that had been approved to do the work.

Awarding the Contract

- 4.52. This involves signing a contract with the winning contractor.
- 4.53. The contract should specify:
 - 4.53.1. Exactly what is to be performed and how it is to be performed. This is often done by including, as an annex to the contract, the detailed specifications that were included in the invitation to tender and in the contractor's tender documents.
 - 4.53.2. The time period allotted for the completion of each stage of the work and the date by which all of the work is to be completed.
 - 4.53.3. The terms of payment, including any retentions (holdbacks) on those payments.
 - 4.53.4. The amount and conditions of any performance bonds that the contractor needs to submit.
- 4.54. Many contracts are fixed price. Under this type of contract, the contractor is paid the same amount of money regardless of the actual amount of materials and labour used, and the actual cost of those materials and labour. Under these contracts, the contractor needs to absorb any increases in costs, but can benefit from any decreases in costs.

- 4.55. Other contracts are cost-plus. In this case, the contract will be based on the actual amount of materials and labour used and the actual cost of those materials and labour. There will then be an added amount to cover overhead and profit. Under these contracts, the government entity takes the risks of increased amounts or costs, and benefits from any decreases.
- 4.56. Once the contractor is selected to provide the goods, works and/or services, the entity should have adequate standards and controls to ensure that the work is carried out as efficiently and effectively as possible. To allow entity officials to do so, the contract should specify the controls that the entity is permitted to exercise while the work progresses.

Post-Contract Award

- 4.57. The post-contract award stage involves contract administration, project controls and making the required payments to the contractor.

Contract Administration and Controls

- 4.58. This involves overseeing the project, approving changes, and signing off on the finished product.
- 4.59. A poorly managed project can result in higher costs, wasted resources, impaired performance, and considerable public concern about the entire process and the end result. Conversely, a well-managed project can deliver the results required by all parties concerned with minimum cost and time.
- 4.60. It is almost always essential that entity officials be actively involved in overseeing a project throughout its life, and not just getting involved at the end of the process. In the case of a school, for example, it would be very difficult for entity officials to ensure that the school foundation met the minimum requirements after the school had been completed. Also, if it was determined that the school foundation did not meet the minimum requirements, it could be extremely difficult to rectify the shortfall after the school had been constructed.
- 4.61. Often there are changes required as the work proceeds. Many of these fall into two categories:
 - 4.61.1. Unforeseen problems. When digging the foundation of a school, for example, the contractor may discover that there is an underground stream that will significantly increase the cost of the foundation.
 - 4.61.2. Changes to the specifications to enhance the project. These are often “add-ons” not envisaged in the original request. For example, in the case of a new road being built to reduce travel times and accidents, the contractor may suggest that an overpass be used at a key intersection instead of having traffic lights or a roundabout.
- 4.62. Entity officials will need to assess each of these and to approve any needed changes to the contract. As part of this process they would need to consider if:

- 4.62.1. The “unforeseen problem” really could not have been foreseen before the tenders were submitted.
- 4.62.2. The enhancement:
 - (a) Was required to meet the identified needs; or
 - (b) Would result in the needs being met so much better that the additional costs were justified.
- 4.62.3. The changes are so significant that the entire project should re-tendered, or the additional work should be tendered as a separate project.
- 4.63. At the end of the project, there should be a very clear process by which the entity signs off on the work. This may involve obtaining an independent performance evaluation.

Making Payments

- 4.64. The entity should pay the contractor in accordance with the terms of the contract. If the contract calls for retentions (holdbacks), the required amounts should be withheld. Similarly, if the contract calls for penalties for, say, the late completion of the work, the amount of the penalty should be deducted from the amounts paid.
- 4.65. The final payment for the contract should not be made until after entity officials have ensured that all work has been completed to the required standards, and all terms of the contract have been met.
- 4.66. A contract may also have called for a performance bond. This bond should not be released until after all the required conditions have been met.

Audit of Capital Projects

- 4.67. Further to 4.8, the SAI can help ensure that, for a particular capital project:
 - 4.67.1. The accounting records and financial reports for the project are complete and accurate;
 - 4.67.2. The controls and procedures required by any loan/grant agreements and by the applicable authorities were in place and were followed; and
 - 4.67.3. The project was carried out as economically, efficiently and effectively as possible.
- 4.68. The SAI could also make recommendations to help improve the procurement cycle in the future.
- 4.69. The rest of this manual deals with conducting performance audits of capital projects.

Chapter 5: Strategic Planning – Selecting Capital Projects to Audit

Introduction

- 5.1. Most financial audits are non-discretionary – the SAI has a specific mandate to do those audits on an annual basis. For performance audits, though, the auditor usually has a great deal of discretion.
- 5.2. The strategic planning phase is the phase during which the auditor selects the specific performance audits to be conducted.
- 5.3. This phase involves:
 - 5.3.1. Determining the universe of potential capital projects to audit.
 - 5.3.2. Establishing criteria to use to make the selection.
 - 5.3.3. Making the selection.
- 5.4. The SAI often selects audit topics for more than one future year. The SAI could, for example, select audit topics for a two or three year period commencing with the year following the year during which the plan is being developed. Attempting to select performance audit topics more than two or three years in advance is normally not advisable, particularly if there is a high probability of there being significant changes within the entities subject to audit.
- 5.5. The following material assumes that the SAI has decided to conduct a performance audit of a capital project, and describes the process to be followed to select the specific capital project to audit.

The Level of Required Knowledge

- 5.6. To complete the selection process, the SAI will need to have a sufficient knowledge of each entity and its activities to identify all the capital projects that should be included in the list of potential projects to audit, and then to make the selection.
- 5.7. Often auditors already have a great deal of knowledge about each entity and its capital projects. If this is the case, auditors responsible for a particular entity should be able to identify potential capital projects without doing much additional work – a single brainstorming session may be all that is needed.
- 5.8. In other cases, more work may be required. This could involve reviewing documents such as:
 - 5.8.1. Annual reports (including financial statements) issued by the entity.

- 5.8.2. Audit opinions and management letters issued by the SAI. These could include opinions and letters relating to financial audits performed on specific capital projects at the request of international financial institutions.
 - 5.8.3. Media reports or other publications dealing with the entity.
 - 5.8.4. Previous performance audit reports and PAC reports.
 - 5.8.5. Internal audit reports.
- 5.9. In order to fully assess all of the factors described in 5.16 and 5.17 below, the auditor would likely need to acquire even more knowledge. For example, the auditor might need to conduct a detailed analysis of each potential capital project looking for such things as sole-sourcing, significant cost overruns and/or significant delays in the completion of the project.
- 5.10. It is normally not appropriate or advisable to attempt to acquire a detailed knowledge of every potential capital project. The time and effort would likely be considerable and, unless the auditor intends to audit a large percentage of the capital projects under consideration, much of that work will not be useable on the actual audits that are to be conducted.
- 5.11. What the auditor should have is enough knowledge and understanding to make an informed decision. Once the specific capital project is selected, the auditor will commence the process of obtaining the additional information needed to properly plan, conduct, evaluate and report on the selected audit. At that time, the auditor could make a further assessment of the factors and could decide to expand, contract or even cancel the audit. This process is discussed more fully in Chapter 6.

Determining Universe of Potential Capital Projects to Audit

- 5.12. This step would involve developing a list of the capital projects that could be subject to audit.
- 5.13. The intent at this phase is not to narrow the choices down too much – it is solely to eliminate those capital projects that will definitely *not* be the subject of a performance audit during that time period covered by this exercise (see 5.4).
- 5.14. The capital projects to exclude could be:
- 5.14.1. Those that had been the subject of a performance audit in the previous year or two. However, follow-up audits of those performance audits would likely need to be performed during the years covered by the plan.
 - 5.14.2. Capital projects that had been completed more than, say, two years previously. This is because audit reports dealing with matters that took place many years ago will often not be of much interest to the PAC, the media or the other intended users. They also may not be of much use in helping entity officials to improve their performance.

- 5.14.3. Very small capital projects and/or those that have little impact on the general public.

Establishing Criteria to Make the Selection

- 5.15. There are various factors that the auditor could consider when deciding which capital project to audit. In general, they can be broken down into two categories – the potential significance of the capital project and its auditability.
- 5.16. Factors affecting the significance of the capital project include:
 - 5.16.1. The total amount to be spent (or that has been spent) on the project. Projects that involve a large amount of government expenditures should usually be given greater weight than those that involve little expenditure.
 - 5.16.2. The importance of the project relative to the entity's mandate. Projects that are central to the entity's mandate (and whose success or failure could therefore have a major impact on the overall performance of the entity) should be given greater weight than those that are less critical.
 - 5.16.3. The number of users of the project (those who the project is intended to serve) and the impact that the project will have on them. Projects that will significantly affect a large number of users should be given more weight than those that will only have a limited impact on a small number of users.
 - 5.16.4. The "profile" of the capital project. Some projects are high profile – they are highlighted by the government and receive a lot of media attention. Audit reports dealing with such projects may also be highlighted by the government and receive a lot of media attention. As such, they may have a better chance of making a difference than reports expected to receive little attention.
 - 5.16.5. The expected number of users and the expected level of user interest in the report. As for the previous point, such reports may receive a lot of parliamentary and public interest.
 - 5.16.6. Requests by entity officials and/or parliamentarians. While the decision as to which projects to audit should be made without undue outside pressure, requests from entity officials and from Parliament are often considered.
 - 5.16.7. The expected impact that the audit could have on future operations. Audits that have a good chance of significantly improving the economy, efficiency and effectiveness of government operations, significantly improving compliance with authorities, significantly strengthening internal controls and/or significantly reducing fraud and corruption should be given more weight than those where the audit is expected to only have a limited impact.
 - 5.16.8. The potential for significant audit findings. Auditors normally do not conduct performance audits with the intention of reporting that all is well; rather, auditors usually conduct audits to find reportable matters and to make recommendations to improve the situation. If this is the case, they could bias their selection to large, complex capital projects and/or ones where there are

already known issues (sole-sourcing, significant delays and cost overruns, etc.).

5.17. Factors affecting auditability include:

5.17.1. The expected ease of auditing. The SAI will need to have, for example, the skills required to conduct the audit, and sufficient and appropriate audit evidence to support any conclusions reached. Audits where these will be hard to obtain should be given less weight than those where these will be easy to obtain.

5.17.2. The expected cost of the audit. Audits need to be conducted with value for money in mind and huge, expensive audits should usually be given less weight than those that can be performed relatively inexpensively and yet have the same impact.

5.17.3. The existence of other audit work dealing with the project. Many large capital projects are funded, in whole or in part, by international financial institutions, and the terms of the loan or grant agreement may call for a financial audit, compliance audit and/or an audit of internal control to be conducted. In these cases, the auditor would likely already have a good understanding of the project and the risks associated with its success or failure. As such, it may be possible to conduct a performance audit of the capital project relatively easily.

Making the Selection

5.18. Once the auditor has considered all of the above factors, the auditor will select the capital project(s) for audit. Those audits, and the expected associated costs, should then be incorporated into the SAI's strategic and/or annual operational plans.

5.19. It should be noted that there is, in theory, no need to audit an entire capital project. The auditor could decide, for example, to restrict the audit to:

5.19.1. Only some of the stages in the procurement cycle. The audit could focus on, say, the pre-tendering stage or the tendering stage.

5.19.2. Only some of the specific procurements. For example, in the case of a huge capital project involving the construction of numerous bridges or roads, the auditor could decide to focus on a few bridges or roads, as opposed to trying to audit the entire project.

5.19.3. A less than full consideration of all three of economy, efficiency and effectiveness.

5.20. One situation where the auditor may decide to audit only a part of a project is where the project is still ongoing and there are known (or rumoured) significant problems at the pre-tendering stage and/or tendering stage. In this case, the SAI may decide to conduct an audit of these stages before the project is completed. Such an audit would be very timely, and could help improve the economy, efficiency and effectiveness of the remainder of the project. The SAI might be able to prevent significant problems, as opposed to reporting them later.

- 5.21. Since this audit would only have dealt with the procurement cycle up to the contract award stage, and since the project will still be ongoing, the auditor would not be able to do a full audit of effectiveness – the final outcome would not be known. However, the auditor would be able to comment on the possible impact that his/her findings could have on the effectiveness of the completed project.

Liaison with Entity Officials

- 5.22. Once a particular performance audit is selected, SAI management should inform the relevant entity officials of the decision. To the extent possible, SAI management should also inform entity officials of the timing of the audit. This could be done informally or through a formal letter.
- 5.23. This process will not only help to ensure that the entity is prepared for the audit, but could also provide some quality assurance. This could be achieved by discussing, with entity officials, the factors taken into consideration when selecting the particular project, and obtaining their views on those factors.

Quality Assurance

- 5.24. As noted immediately above, liaison with entity officials can provide some quality assurance. Other ways to ensure quality at this phase include:
- 5.24.1. The work should be properly supervised.
 - 5.24.2. All of the capital projects being considered, the factors relating to each project and the basis for the final selection should be documented.
 - 5.24.3. The working papers should be reviewed by SAI management.
 - 5.24.4. The final decision(s) should be approved by senior SAI management.
- 5.25. To assist in ensuring quality, some SAIs employ a panel of experts at various phases of the audit – notably at the end of the planning phase, at the end of the evaluation phase and during the reporting phase. (These phases are discussed in Chapters 6, 9 and 10 respectively.) These individuals are experts in the areas subject to audit and can help to ensure the quality of the work conducted during those phases. They can, for example, add credence to the auditor’s choice of criteria, and to the auditor’s findings, conclusions and recommendations.
- 5.26. If an SAI does not have a lot of experience with performance audits in general and with the audit of capital projects in particular, a similar panel could be used at this phase to review the assessments made and the final decisions.

Chapter 6: General Audit Planning

Introduction

- 6.1. Audit planning is the process by which an auditor develops an audit plan. For a performance audit, this phase is also referred to as the pre-study phase or the preliminary study phase.
- 6.2. The key document prepared at the end of the planning process is an audit planning memorandum which, for a performance audit, is often referred to as the main study proposal. That document should contain the key planning decisions determined by following the process described below. It should also contain, or be supported by, an audit programme, budget, time schedule and resourcing schedule. These other documents are discussed in Chapter 7.
- 6.3. The general audit planning phase involves:
 - 6.3.1. Defining the audit objective(s) and the scope of the audit.
 - 6.3.2. Obtaining an understanding of the entity and the specific capital project.
 - 6.3.3. Obtaining an understanding of the internal controls.
 - 6.3.4. Assessing materiality (and aggregate expected error and performance materiality).
 - 6.3.5. Setting the overall level of assurance.
 - 6.3.6. Determining criteria.
 - 6.3.7. Assessing risks, including the risk of fraud.
 - 6.3.8. Determining sources of audit assurance for each criterion.
- 6.4. Some of these steps will have been considered, to some extent, when determining which capital projects to audit – see Chapter 5. For example, the auditor may have obtained some knowledge of the entity and its capital projects, and may have performed some preliminary risk assessments when assessing the likelihood of coming up with significant audit findings.
- 6.5. Throughout the planning process, the needs and interests of the intended users should be kept in mind. This could influence the audit objective and the criteria, and the level of audit effort devoted to each criterion.
- 6.6. The primary intended user is Parliament as Parliament is the body to whom the SAI is mandated to report. Other users would be the entity officials responsible for the capital project being audited, the media, the academic community, special interest groups and the general public.

One Step or Two (and the Stop or Go Decision)

- 6.7. At the strategic planning phase, the SAI will have come up with a list of specific capital projects to audit. As discussed in Chapter 5, though, the selection is usually made without having a full knowledge of each project being considered. The time and effort required to do so would likely be considerable and, unless the SAI intends to audit a large percentage of the capital projects under consideration, much of that work will not be useable on the actual audits that are to be conducted.
- 6.8. Given the above, it is possible that a capital project that was selected for audit because the audit was expected to generate significant audit findings may turn out to be much better managed than had been expected. In cases such as these, the SAI may decide to reduce the scope of the audit, or to cancel it entirely.
- 6.9. Conversely, it is also possible that a capital project that was perceived to contain only a few significant findings may turn out to be much less well managed than had been expected. If that is the case, the SAI may decide to expand the scope of the audit.
- 6.10. For an extremely large, complex capital project, such as one involving the reconstruction of numerous bridges, roads and buildings following a hurricane, it may be best to split the general planning phase into two phases, as follows:
 - 6.10.1. An overview/survey phase. During this phase, the audit team would acquire more knowledge of the capital project, the risks involved, and the potential audit findings. The team could then prepare an overview paper containing a summary of its work and offering a number of options for the scope, focus and budget of the audit. This paper would be submitted to senior SAI management who would make a decision on which option to take, and on the level of effort (time and expenses) to be invested in the audit.
 - 6.10.2. A more detailed general planning phase. This would be based on the decisions reached at the overview/survey phase and would include all steps discussed below. That work, and the work performed during the detailed planning phase (see Chapter 7) would result in an audit plan, an audit programme containing detailed audit procedures, a budget, a time schedule, a staffing schedule, and working paper files supporting the key decisions.
- 6.11. For most capital projects, the above approach is normally not required, and the overview/survey phase could be skipped. However, even here there is no reason to wait until the end of the general and detailed planning phases to suggest changes to the scope of an audit. As the audit team works its way through the general and detailed planning phases, it will acquire an increasing level of knowledge. Any some point during the process the team could conclude that the audit should be larger or smaller than originally expected, or cancelled altogether. At that time, the audit team could present the results of its work to date and its tentative conclusions to senior SAI management, and a decision could be made to expand, contract or cancel the audit. If the decision is taken to continue with the audit but with an expanded or reduced scope, the rest of the general and detailed planning phases could then be based on the expanded or reduced scope.

Defining the Audit Objective(s) and the Scope of the Audit

- 6.12. This step may have been performed, to at least some extent, when the particular capital project was selected for audit – see Chapter 5. What is required at this phase is to refine the objectives and scope to the extent required to state them clearly and unambiguously.

Audit Objective

- 6.13. The audit objective answers the question “Why is this audit being conducted?”
- 6.14. The audit objective normally makes mention of economy, efficiency and effectiveness. In addition, if authorities are significant to the audit objective (and they normally are), the audit objective could also make mention of compliance with the relevant authorities.
- 6.15. For focussed performance audits (such as the audit of a specific capital project), there is often one audit objective. For wider-scoped performance audits, such as performance audits of an entire ministry, there may be several audit objectives.
- 6.16. Audit objectives are often worded in the form of what it is the auditor wants to accomplish. The auditor would use phrases such as “to determine whether” or “to assess whether”. Alternatively, the audit objective could be framed as an overall audit question.

Scope of the Audit

- 6.17. The scope answers the question “What is the subject matter to be audited?”
- 6.18. There are two aspects – the specific capital project to be audited, and the time period to be covered.
- 6.19. As noted in Chapter 5, it is not necessary to audit an entire capital project. The audit could deal with only a portion of the procurement cycle, or with a subset of the procurements within a large project. It could also not fully cover all of economy, efficiency and effectiveness.
- 6.20. To the extent not specified in Chapter 5, the scope needs to be clearly laid out at this time.

An Example

- 6.21. Annex A contains an illustration of what the audit objective and scope may look like for the construction of a new road between two cities.

Obtaining an Understanding of the Entity and the Specific Capital Project

- 6.22. Like the previous step, this step may have been performed, to at least some extent, when the particular capital project was selected for audit – see Chapter 5. Now that the

particular capital project has been selected, though, a more detailed understanding will likely be required.

6.23. Obtaining a sound understanding of the entity and specific capital project is essential if the auditor is to achieve the audit objective, identify the significant audit issues, determine the most appropriate criteria, etc.

6.24. The auditor should obtain the required knowledge of:

6.24.1. The entity's mandate/overall objectives, its organisational structure, and the units within the entity responsible for overseeing the specific capital project being audited. If more than one government entity is involved in the process, this knowledge would need to extend to all relevant entities.

6.24.2. The size, timing, costs, etc. of the capital project being audited.

6.24.3. The purpose of the project (its expected outputs and the desired results).

6.24.4. The expected users of the project (those who the project is intended to serve) and the impact that the project could have on them.

6.24.5. Any other key stakeholders involved in the project. These could include any international financial institutions funding the project.

6.24.6. The intended users of the audit report. As noted in 6.6, the primary intended user is Parliament, but could also include the entity responsible for the capital project, the media, the academic community, special interest groups and the general public.

6.24.7. Details of each stage of the procurement cycle – pre-tendering, tendering, and post-contract award.

6.24.8. The relevant authorities (laws, regulations, rules, policies, etc.). These will likely include procurement acts, financial administration acts and the legislation under which the entity was established.

6.24.9. The potential areas of risk. This will help identify the key areas within the capital project on which the auditor may wish to focus his/her efforts. It may also help to identify potential audit findings.

6.24.10. Any loan/grant agreements with international financial institutions and the requirements contained in those agreements, including the authorities to be complied with, the procedures to be followed, and the audits to be conducted.

6.24.11. The type of contracts used by the entity and the general contents of those contracts.

6.24.12. The entity's internal controls. Note: This is discussed below.

6.25. The sources of the information could include:

6.25.1. Enabling legislation.

- 6.25.2. Organisation charts.
- 6.25.3. The entity's strategic and operational plans, and its mission and vision statements.
- 6.25.4. Internal guidelines and operating manuals.
- 6.25.5. Loan/grant agreements.
- 6.25.6. All documentation available for each stage of the procurement cycle for the specific capital project. These could include:
 - (a) The needs assessment;
 - (b) The definition of requirements (including the general and detailed specifications);
 - (c) The timeline and budget;
 - (d) The invitation to tender and the process followed to determine to whom to send the invitations;
 - (e) The tenders received;
 - (f) The tender evaluations;
 - (g) The awarded contract;
 - (h) Progress billings from the contractor and the documentation submitted by the contractor to support those billings;
 - (i) Documentation supporting the approval of any changes to the original contract; and
 - (j) Ongoing monitoring and evaluation reports prepared by entity officials.
- 6.25.7. Documentation relating to all stages of the procurement cycle for the specific capital project. These could include:
 - (a) The accounting records and any financial or other reports; and
 - (b) Minutes of committees, etc. responsible for overseeing the project.
- 6.25.8. Entity reports dealing with similar projects.
- 6.25.9. Press coverage.

Obtaining an Understanding of the Internal Controls

- 6.26. Entities should establish systems of internal control designed to assure the completeness and accuracy of the accounting records, compliance with authorities, and the economy, efficiency and effectiveness of operations.
- 6.27. The auditor needs to have an adequate understanding of internal controls to plan the audit. This knowledge is required even when no reliance on controls is intended.
- 6.28. The auditor needs to have this knowledge to ensure that his/her substantive tests provide sufficient and appropriate audit evidence. If, for example, internal controls over project accounting are poor, the auditor needs to take this into consideration when determining the extent to which he/she can make use of any project documents. Similarly, if internal controls over cash disbursements are poor, the auditor would need to treat the information in the cash disbursements book with a high degree of scepticism. In extreme cases, the internal controls may be so poor that the auditor would not be able to complete the audit no matter how much substantive testing was performed.
- 6.29. The auditor also needs to have a basic understanding of internal controls to be able to assess the risk of fraud. The consideration of fraud is discussed below.
- 6.30. How much knowledge should the auditor have? As a general rule, the auditor should have a good understanding of the control environment (the higher-level management controls) and the basic segregation of duties. This knowledge would likely be needed at two levels:
 - 6.30.1. The capital project level (i.e., the internal controls relating specifically to the capital project being audited).
 - 6.30.2. The entity-level controls that could affect the specific project.
- 6.31. This second level is normally required because many management-level controls operate entity-wide, and not just at the specific project level. This would likely be the case, for example, with respect to internal controls over cash disbursements and the accounting records.
- 6.32. This knowledge can be obtained from:
 - 6.32.1. Inquiries of entity officials;
 - 6.32.2. Observations of the internal controls being performed;
 - 6.32.3. Reviews of internal control procedures manuals; and/or
 - 6.32.4. Walk-through procedures (selecting one or two transactions and following the flow of the documents through the system from start to finish).

Assessing Materiality (and Aggregate Expected Error and Performance Materiality)

Materiality

- 6.33. Materiality is relevant to all audits – it needs to be determined even when the auditor is not explicitly expressing an overall opinion on the results of the audit.
- 6.34. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. As such, it needs to be assessed from the users' perspective and the auditor's interpretation of their needs.
- 6.35. In the case of a performance audit, for example, a finding may be material if it would affect the users' perception of whether economy, efficiency or effectiveness had been achieved, and whether improvements could have a significant impact on the entity's performance.
- 6.36. Materiality is often considered in terms of value (quantitatively), but it also has qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs.
- 6.37. One amount is often used for planning purposes. At the reporting phase, though, the auditor may use lower amounts when deciding whether to report individual monetary errors, compliance deviations or VFM deviations (deviations from economy, efficiency and effectiveness).
- 6.38. For the audit of a capital project, materiality would normally be based on a percentage of the total project expenditures. The "usual" percentage is somewhere between 0.5 and 2.0.
- 6.39. To illustrate, assume that the capital project being audited has total expenditures of \$300 million and the auditor has determined that materiality should be set at 1.0 percent of total expenditures. Materiality for planning purposes would then be \$3,000,000.

Aggregate Expected Error and Performance Materiality

Aggregate Expected Error

- 6.40. If assurance is to be provided from analytical procedures or sampling, another factor needs to be considered – aggregate expected error. Materiality less aggregate expected error (which is often referred to as planned precision) can be used as the starting point for determining how large a deviation needs to be before it must be followed up when conducting analytical procedures, and materiality and aggregate expected error are two of the four factors that affect sample sizes when monetary unit sampling is being conducted.
- 6.41. Aggregate expected error is the auditor's best estimate of the monetary errors that exist in the capital project. Put another way, it is the auditor's best estimate of the most likely error that will be determined at the evaluation phase of the audit.

- 6.42. When determining aggregate expected error, the auditor can consider such factors as:
- 6.42.1. Errors found in previous years on this capital project or on similar capital projects; and
 - 6.42.2. The expected strength of the internal controls designed to prevent or detect monetary errors.

Further Possible Error

- 6.43. When the auditor takes a sample, it is possible that his/her sample will not be totally representative of the population being sampled, and that the actual error in the population is higher than the most likely error that the auditor has calculated. The auditor allows for this possibility by reducing planned precision by an allowance for further possible error.
- 6.44. If data analysis software programmes such as IDEA are used, the auditor does not need to calculate further possible error – the software programme will do it automatically. If the auditor is calculating the sample size manually, though, he/she will need to make an allowance for further possible error.
- 6.45. The allowance for further possible error normally is a combination of the aggregate expected error and the level of assurance that the auditor is planning to obtain from the audit procedure.

Performance Materiality

- 6.46. Performance materiality is materiality less aggregate expected error less an allowance for further possible error.
- 6.47. To illustrate these terms, let's assume that the auditor has assessed materiality at \$3,000,000 and aggregate expected error at \$800,000. The auditor could then use the \$800,000 and the planned level of assurance from his/her audit procedure to assess further possible error at \$500,000. The auditor would then have:

Materiality	\$ 3,000,000
Aggregate expected error	<u>800,000</u>
Planned precision	2,200,000
Allowance for further possible error	<u>500,000</u>
Performance materiality	<u>\$ 1,700,000</u>

- 6.48. The larger the aggregate expected error, the more work the auditor will need to perform when conducting analytical procedures or sampling. On the other hand, using a small aggregate expected error increases the risk that the auditor will have an unacceptable result at the evaluation phase of the audit. That is because, should the most likely error at the end of the audit exceed the aggregate expected error (\$800,000 in our example),

the results will almost certainly be unacceptable – the maximum possible error will almost always exceed materiality.

6.49. This matter is discussed further in Chapter 9.

Setting the Overall Level of Assurance

6.50. The ISSAIs contain two levels of assurance – reasonable and limited.

Reasonable Assurance

6.51. Reasonable assurance (also referred to as “audit assurance”) is high but not absolute assurance. The audit conclusion is expressed positively, conveying that, in the auditor's opinion, the subject matter is or is not compliant, in all material respects, with the applicable criteria.

6.52. Reasonable assurance is generally considered to be at least 95 percent.

6.53. Audit risk is the converse of reasonable (audit) assurance. If reasonable assurance is assessed at 95 percent, audit risk is 5 percent.

Limited Assurance

6.54. When providing limited assurance, the audit conclusion states that, based on the procedures performed, nothing has come to the auditor's attention to cause the auditor to believe that the subject matter is not in compliance with the applicable criteria.

6.55. The amount of work performed in a limited assurance engagement is less than the amount of work required to obtain reasonable assurance. The above wording of the report conveys the limited nature of the assurance provided.

6.56. Unlike reasonable assurance engagements, there is no generally recognised level of overall assurance for limited assurance engagements. ISSAI 100 notes, though, that the level of assurance needs to be high enough that the level of assurance being provided is meaningful to the intended users.

The Level of Audit Assurance to Use

6.57. Given the sensitive and public nature of a performance audit, it is good practice to obtain reasonable assurance for these engagements. This audit manual assumes that this is what is being done.

Determining Criteria

Meaning of Criteria

6.58. Criteria are standards used to determine whether an entity programme meets or exceeds expectations. They provide a context for understanding the results of the audit, and help the auditor to answer questions such as:

- 6.58.1. What should I have expected to see if the capital project had been performed properly?
- 6.58.2. What should entity officials have done at each stage of the procurement cycle to ensure economy, efficiency and effectiveness?
- 6.58.3. What results should there have been?
- 6.59. In financial audits, transactions are assessed against the accounting standards used and such standard audit assertions as completeness, occurrence, existence, and valuation.
- 6.60. In compliance audits, transactions are assessed against the relevant authorities (laws, regulations, rules, policies, etc.).
- 6.61. In performance audits, the criteria flow from the audit objectives. Each audit objective may therefore have its own set of criteria.

Setting Criteria

- 6.62. Given that performance audits deal with economy, efficiency and effectiveness, one way to set criteria is to have one criterion for each of economy, efficiency and effectiveness.
- 6.63. While using economy, efficiency and effectiveness is a useful way of breaking down the audit objective, it does have a significant disadvantage – auditors usually structure their audits of capital projects around the basic stages of the procurement cycle, namely the pre-tendering, tendering and post-contract award stages.
- 6.64. Each one of these stages could have economy and efficiency elements, which could make it difficult to group audit procedures and audit findings by economy and efficiency. This, in turn, could make it difficult to reach a conclusion on each of economy and efficiency as a whole.
- 6.65. By basing the criteria on the three stages of the procurement cycle, each audit procedure and each audit finding would only relate to one criterion. This, in turn, would make it easier to reach a conclusion on each criterion.
- 6.66. When setting criteria, the auditor must ensure that they are reasonable and attainable. It is not appropriate for the auditor to expect entity officials to perform to higher standards than would normally be possible in similar situations.
- 6.67. As noted in Chapter 3, performance audits are required to include an audit of compliance with authorities when those authorities are significant to the audit objectives. Therefore, when setting criteria, the auditor normally needs to consider compliance with the relevant authorities – the laws, regulations, rules, policies, etc. governing the capital project.
- 6.68. The auditor needs to keep in mind, though, that auditing compliance with authorities can only be done to the extent to which the authorities exist.

- 6.69. For example, assume that there is no legislation requiring an entity to obtain competitive bids for large construction projects. In that case, the absence of competitive bids cannot be considered a compliance deviation. If the auditor wished to report this matter, he/she would need to do so by noting that:
- 6.69.1. Best international practice calls for the entity to obtain competitive bids for all large capital projects unless there are clearly documented and approved reasons why this was not possible.
 - 6.69.2. In the auditor's opinion, competitive bids could have been obtained for this particular capital project.
 - 6.69.3. Following a competitive bidding process could have resulted in a lower overall cost or a better quality finished product.
 - 6.69.4. The absence of a law requiring a competitive bidding process does not prevent entities from obtaining competitive bids.
- 6.70. The auditor could then recommend that:
- 6.70.1. The entity should obtain competitive bids for all large capital projects; and
 - 6.70.2. The government should amend the procurement act to require competitive bids for all large capital projects except in very specific circumstances.
- 6.71. Criteria for a capital project could be obtained from the following sources:
- 6.71.1. The laws, regulations, etc. governing the entity in general. These could include, for example, the signing authorities and standards of performance established for individuals within the entity.
 - 6.71.2. The laws, regulations, etc. governing the capital project. These could include, for example, procurement acts and their supporting regulations.
 - 6.71.3. The requirements contained in any loan/grant agreements for the capital project.
 - 6.71.4. The standards, desired results, etc. as stipulated in the documentation requesting approval for the project and/or in the approval document itself.
 - 6.71.5. The standards stipulated in the invitation to tender and the contract between the entity and the contractor.
 - 6.71.6. Key performance indicators set by the government or by the entity in general, or contained in the documentation for the particular project.
 - 6.71.7. Professional standards. For example, there may be generally recognised construction standards established by legislation or by a relevant industry association.
 - 6.71.8. Criteria, standards, performance indicators, etc. used previously on similar audits by the SAI or by other SAIs.

- 6.71.9. Academic papers.
- 6.71.10. The views of independent experts.
- 6.72. Hopefully the criteria can be established, in whole or in large part, by reference to the relevant authorities and the documentation for the specific capital project. If the criteria need to be established primarily through those used on other projects or are the views of a few experts, there is greater room for subsequent disagreement with the criteria.
- 6.73. Once set, the criteria (and the supporting questions if desired) should be discussed with the relevant entity officials.
- 6.74. While setting criteria is ultimately the auditor's responsibility, the auditor should attempt to obtain the entity's agreement with the criteria, and to obtain that agreement in writing. If entity officials do not agree with the criteria, they may not agree with the conclusions reached during the evaluation phase of the audit (see Chapter 9).
- 6.75. As noted in Chapter 10, the criteria should be included in the audit report, along with their sources.

The Wording of Criteria

- 6.76. Criteria are often worded in the form of what the auditor would have expected to see had the capital project been performed well.
- 6.77. Each criterion could then be elaborated in the form of questions. These questions would be factual in character and intended to describe or measure the practical situation to be audited.

The Number of Criteria and Questions to Use

- 6.78. The extent to which criteria are aggregated is a matter of professional judgement. The auditor could have a large number of very specific criteria supported by a small number of questions each, or a small number of high level criteria supported by a larger number of questions each. The latter is often preferable as it helps the reader to focus on the "big picture".
- 6.79. Further to the previous paragraph, there could be an almost endless list of questions for each criterion – the auditor could effectively replicate his/her audit programme in the form of questions. In deciding which questions to include, the auditor should consider such matters as the importance of question relative to the criterion, the related risks, and the perceived interest that the readers of the report could have in the answer to the question.

An Example

- 6.80. Annex A contains an example of criteria and supporting questions based on a project designed to construct a new road between two cities.

Assessing Risks, Including the Risk of Fraud

6.81. There are two key risks that the auditor needs to assess at this phase – inherent risk and control risk. The auditor also needs to consider the risk of fraud.

Inherent Risk

6.82. Inherent risk is the chance of material error, compliance deviations or VFM deviations (deviations from economy, efficiency and effectiveness) occurring in the first place, assuming the absence of internal control.

6.83. This risk would be primarily affected by the basic nature and scope of the project being undertaken. Large and complex projects would likely be more prone to error or deviation than smaller, less complex projects.

6.84. Inherent risk could also be affected by such general matters as:

6.84.1. New or urgent activities, such as a capital project being introduced in a hurry in response to an emergency.

6.84.2. New or changed authorities.

6.84.3. Difficult accounting issues.

6.84.4. Major uncertainties or contingences.

6.84.5. A lack of clear policies or procedures, inadequate resources, inexperienced managers, etc.

6.85. The risk should be set for the capital project as a whole and for each criterion. Different risks may also be applicable for each question supporting the criteria, and for each of monetary errors, compliance deviations and VFM deviations.

6.86. The auditor should normally be conservative when setting inherent risk for three reasons:

6.86.1. Inherent risk needs to be set in a hypothetical environment – the auditor needs to assume that there are no internal controls in place to prevent errors or deviations from occurring.

6.86.2. Capital projects are non-recurring. Unless it is audited annually to meet the requirements of a loan or grant agreement, it is likely that the auditor will have little prior experience with the capital project being audited.

6.86.3. The more conservative (higher) the risk, the better chance the auditor will have of obtaining the required level of assurance. This is discussed further in Chapter 9.

Control Risk

- 6.87. Control risk relates is the chance that the internal controls in place fail to prevent or detect material error, compliance deviations or VFM deviations.
- 6.88. Entities should establish systems of internal control designed to assure the completeness and accuracy of the accounting records, compliance with applicable authorities, and that help ensure the economy, efficiency and effectiveness of operations. Control risk would be affected by the strength of the relevant internal controls.
- 6.89. As with inherent risk, control risk should be set for the capital project as a whole and for each criterion. Different risks may also be applicable for each question supporting the criteria, and for each of monetary errors, compliance deviations and VFM deviations.
- 6.90. Also as for inherent risk, given the non-recurring nature of most capital projects, the auditor may not have much prior knowledge of the internal controls over the specific project being audited. If that is the case, the auditor should be conservative when setting control risk.

Consideration of Fraud

- 6.91. As noted in Chapter 3, fraud is defined as an intentional act by one or more individuals among management, those charged with governance, employees, or third parties, involving the use of deception to obtain an unjust or illegal advantage.
- 6.92. As also noted in Chapter 3, the ISSAIs for performance audits require auditors to assess the risk of fraud. If the risk of fraud is significant within the context of the audit objectives, the auditor should obtain an understanding of the internal control systems and examine whether there are signs of irregularities that hamper performance.
- 6.93. Given the above, when assessing inherent risk and control risk, the auditor needs to consider the risk of fraud.
- 6.94. Fraud detection is more a matter of mindset than of routine methodology. It involves being aware of how fraud can occur.
- 6.95. Audits need to be performed with professional scepticism. Professional scepticism means maintaining a professional distance and an alert and questioning attitude when assessing the sufficiency and appropriateness of evidence obtained throughout the audit. It also entails remaining open-minded and receptive to all views and arguments.
- 6.96. Professional scepticism does *not* mean that auditors should conduct audits assuming that management or employees are dishonest. Rather, the auditor should be aware of the risk factors that increase the possibility of fraud.

Role of Red Flags

- 6.97. Red flags are symptoms (indicators) that fraud may have occurred. Knowledge of these indicators provides auditors with a head start in fraud detection and enables them to

build on past experience. Auditors should be aware of them, know how to use them, and understand their strengths and limitations.

6.98. Red flags could include:

- Too many or too few transactions (e.g., two payments to a supplier in a given month when only one is normal);
- Values higher or lower than expected (e.g., a payment to a supplier that is much larger than normal);
- Individuals performing functions that are not within their job descriptions (e.g., management performing clerical functions);
- Transactions being processed differently than normal (e.g., manual cheques being issued or transactions being processed outside the normal transaction cycles); and
- Explanations provided for variances that are not consistent with the available evidence.

6.99. An individual red flag might not be significant in itself, but the existence of several red flags might be an indication of a material fraud.

6.100. Most red flags will likely turn out to be nothing more than valid differences from the usual pattern – there are often simple and straightforward explanations that do not involve fraud.

6.101. For capital projects, the auditor could use a data analysis tool such as IDEA search for potential frauds at various stages of the procurement cycle.

Possible Risks for Capital Projects

6.102. Annex B contains, for each stage of the procurement cycle, examples of the risks that could exist at that stage, including the risk of fraud. It also contains some red flags that could indicate the existence of a potential fraud.

Determining Sources of Audit Assurance for Each Criterion

6.103. Performance audits can draw on a large variety of data-gathering techniques such as inquiries, observations, analysis of data and a review of documents.

6.104. As with other types of audits, the auditor can obtain inherent assurance, assurance from tests of controls, assurance from analytical procedures and data analysis, and assurance from substantive tests of details.

6.105. Regardless of the sources of assurance, the auditor must plan to obtain the required level of overall audit assurance (95 percent, say).

6.106. This section looks at each source of assurance, and then briefly discusses reliance on the work performed by other auditors.

Inherent Assurance

- 6.107. Because inherent risk needs to be assessed in a hypothetical environment (assuming no internal controls in place), the auditor cannot perform any specific procedures. Rather, the auditor assumes that the assurance provided is the converse of the risk.
- 6.108. While performing the audit, though, the auditor must consider events and errors or deviations that call into question his/her assessment of inherent risk. This is discussed in Chapter 9.
- 6.109. As noted above, the auditor should normally set a relatively high inherent risk. That means the auditor will not be able to obtain much inherent assurance.

Assurance from Tests of Controls

- 6.110. Tests of controls involve:
- The identification of the key controls on which reliance is intended; and
 - The testing of the operation of those key controls to establish whether they have operated effectively throughout the period under examination.
- 6.111. At the evaluation phase (Chapter 9), the auditor evaluates the results of the tests of control to determine whether the desired level of reliance can be taken from the examination of the controls.
- 6.112. Tests of controls can include:
- 6.112.1. Inquiries of entity officials;
 - 6.112.2. Observations of the internal controls being performed;
 - 6.112.3. Reviews of internal control procedures manuals;
 - 6.112.4. Walk-through procedures (taking one or two transactions and following them through from initiation to the final recording); and
 - 6.112.5. Taking a sample of transactions and performing detailed tests of controls to see if all the relevant key controls were applied.
- 6.113. The first four are the same procedures that were used to obtain an understanding of the internal controls – see 6.32.
- 6.114. The assurance from internal controls is not the converse of control risk; rather, it is the assurance that the auditor has “earned” from his tests of controls.
- 6.115. What control risk does is place an upper limit on the amount of control assurance that the auditor can obtain. If, for example, control risk is high (controls are poor), it would not be possible to obtain much assurance from internal controls no matter how much testing the auditor performed.

6.116. For the audit of capital projects, it often would not be cost-effective to place a lot of reliance on internal controls – a substantive approach would often be more cost-effective.

Analytical Procedures and Data Analysis

Analytical Procedures

6.117. Analytical procedures are techniques used by the auditor to:

- Study relationships among elements of financial and non-financial information to form expectations as to what the recorded amounts should be; and
- Compare such expectations with recorded amounts.

6.118. The auditor then follows up all unacceptable differences and reaches a conclusion as to the completeness and accuracy of the recorded amounts.

6.119. Different levels of assurance can be derived from analytical procedures depending on how sophisticated they are. Doing simple comparisons on aggregated data will not provide a lot of assurance; doing detailed comparisons on very disaggregated data can provide more assurance.

6.120. For the audit of capital projects, the main analytical procedures would likely involve:

6.120.1. A comparison of actual completion dates to the completion dates called for in the contract.

6.120.2. A comparison of actual costs to the amounts contained in the contract.

Data Analysis

6.121. Data analysis (also referred to as computer-assisted audit techniques as the analysis is usually most cost-effectively performed using data analysis software such as IDEA) involves a detailed review of data looking for unusual patterns or trends.

6.122. The “unusual patterns or trends” could include some of those noted in 6.98 – too many or too few transactions or values higher or lower than expected.

Substantive Tests of Details

6.123. This usually involves:

- The testing of all individually significant transactions (large dollar items and other key items); and
- Taking a sample of the remaining transactions.

6.124. For the audit of capital projects, sampling may not be used as a source of assurance for several steps in the procurement cycle. While every project is different, with different populations of bidders, evaluation criteria, transactions to audit, etc., it may be possible

to cost-effectively audit 100 percent of the documents, transactions, etc. in some steps in the procurement cycle. Also, if these procurement steps are considered to have high inherent and control risks, including the risk of fraud, the auditor may want to do so regardless.

6.125. To illustrate:

6.125.1. At the pre-tendering stage, the auditor may want to look at the needs assessment, the general (high level) definition of requirements and the choice of procedures in their entirety, and may be able to do so cost-effectively. The auditor may, though, need to select a sample when examining the detailed specifications and the line items in the budgets.

6.125.2. At the tendering stage, the auditor may want to audit the selection of the bidders and the terms contained in the invitation to tender in their entirety. Similarly, unless there are a large number of tenders received, the auditor may wish to check the evaluation of all tenders received instead of just a sample of them.

6.125.3. As for the post-contract award stage, it may be possible to audit a considerable percentage of the total expenditures incurred by auditing a few transactions. This would be particularly the case where there was one general contractor who invoiced monthly.

Reliance on the Work Performed by Other Auditors

6.126. The auditor may rely on the work performed by internal auditors or other external auditors throughout the audit planning process. This could include, for example:

6.126.1. Using audit reports prepared by the other auditors to:

- (a) Obtain information about the entity and potential strengths and weaknesses in internal control;
- (b) Help identify the key areas of risk; and/or
- (c) Help identify the criteria.

6.126.2. Taking the work of the other auditors into account when determining the scope of his/her work. For example:

- (a) Obtaining assurance from internal controls based on tests of controls conducted by the other auditors; and/or
- (b) Using the detailed substantive testing conducted by the other auditors to reduce his/her own sample sizes.

6.127. At the end of the audit, the reports of other auditors could be used corroborate or cast doubt on the findings obtained from the audit.

- 6.128. The ISSAIs for performance audits provide some limited guidance with respect to relying on the work performed by internal audit. ISSAI 1610 provides more detailed guidance. While ISSAI 1610 is directed at financial audits, it would be applicable to performance audits as well.

Developing an Audit Design Matrix

- 6.129. Before preparing the audit planning memorandum, it is usually good to stop at this time and make sure that:
- 6.129.1. The decisions made in the previous steps all fit together into a cohesive whole. For each audit objective, there should be a logical flow from the audit objective to the criteria and the supporting questions, and to the sources of assurance for each criterion and question.
 - 6.129.2. The criteria and supporting questions that have been identified will allow the auditor to report against expected findings. It is possible, for example, that the auditor will be aware, from the work performed to date, that there are significant problems in one particular area. The auditor could, at this time, identify potential findings, conclusions and recommendations. The auditor needs to ensure that the audit objective, criteria and supporting questions, as worded, will allow the auditor to report the findings, conclusions and recommendations.
 - 6.129.3. It will likely be possible to obtain sufficient and appropriate audit evidence to conclude against each criterion and the audit objective.
- 6.130. An audit design matrix can be used for the above purpose. For example, it could include, for each audit objective, columns for each of:
- 6.130.1. The criteria.
 - 6.130.2. The supporting questions for each criterion.
 - 6.130.3. The sources used to answer each question.
 - 6.130.4. The key audit evidence needed for each question.
 - 6.130.5. The main sources of assurance for each question (e.g., tests of control, analytical procedures and sampling of invoices and payments).
 - 6.130.6. The findings that could be possible from the above.
 - 6.130.7. The conclusions and recommendations that could be possible from the above.
 - 6.130.8. Any key risks that will need to be managed. These could include, for example, limited documentation (the entity did not document all of its decisions and processes) and missing documentation.

An Example of an Audit Design Matrix

- 6.131. Annex A contains an example of an audit design matrix based on a project designed to construct a new road between two cities.

Documenting the Planning Process

- 6.132. At the end of the planning phase the auditor should prepare a main study proposal (planning memorandum) that contains the key planning decisions determined by following the process described above. It also should contain, or be supported by, an audit programme, budget, time schedule and resourcing schedule. These other documents are discussed in Chapter 7.
- 6.133. The main study proposal should also be supported by working papers containing evidence that supports the work performed during the general planning phase. Several files may be used. For example, the SAI could have:
- 6.133.1. A planning file that contains the working papers supporting the assessments made with respect to materiality, risk, criteria, sources of assurance, etc. It also usually contains the audit programme, budget, staffing and audit timetable developed in the detailed planning phase (see Chapter 7).
 - 6.133.2. A permanent file that contains information on the entity and its internal controls.
 - 6.133.3. A capital project file that contains all of the information obtained during the planning phase relative to the specific capital project being considered.

Using Outside Experts as Advisers

- 6.134. Chapter 7 discusses using outside experts as members of the audit team to perform some of the required audit work.
- 6.135. Outside experts can also be employed to provide overall advice to the audit team.
- 6.136. As noted in Chapter 5, to assist in ensuring quality some SAIs employ a panel of experts at various phases of the audit. These individuals are experts in the areas subject to audit and can help to ensure the quality of the work conducted during those phases.
- 6.137. For example, a panel of experts could:
- 6.137.1. During the planning phase, assist in the determination of the criteria and review the audit plan.
 - 6.137.2. During the evaluation phase, assist in the assessment of the audit findings (e.g., the determination of which findings are material and should be reported to Parliament, and the conclusions that can be drawn from those findings).

- 6.137.3. During the reporting phase, review and comment on the wording of the report and the appropriateness of the entity's responses to the recommendations.
- 6.138. With respect to the planning phase, while the experts can be engaged to review and comment on all key planning decisions, the one for which their advice is most often sought is the selection of the criteria. They could, for example, comment on the completeness of the criteria, the appropriateness of those selected, and on the feasibility of being able to obtain the required audit evidence for each criterion.
- 6.139. Having a panel of outside experts could assist in giving the audit report more credibility. Entity officials could try, for example, to argue that the audit report's findings, conclusions and recommendations are suspect as the auditors are not experts in the area under examination. Using outside experts as advisers (or as members of the audit team – see Chapter 7) could help refute that argument.

Liaison with Entity Officials

- 6.140. As noted in Chapter 5, the SAI may send a formal letter to the entity informing entity officials that it has selected a particular capital project for audit. At that phase, though, the auditor will likely not have fully determined the audit objective(s) and scope of the audit, the criteria to be used, the timing of the audit and the other key planning decisions. Once these are determined, the SAI may wish to send a formal engagement letter to the entity.
- 6.141. Regardless of whether a formal letter is sent, entity officials need to be kept informed of decisions being made throughout the general planning phase. In particular, they should be informed of, and their views sought with respect to, the audit objective(s) and scope of the audit and the criteria being used. Their views could also be sought with respect to other key planning decisions such as the assessment of materiality and risk.
- 6.142. As noted in 6.74, entity officials should be asked to sign off on the criteria in writing.
- 6.143. Entity officials should also be kept informed of the potential timing of the fieldwork and the key SAI staff to contact.

Quality Assurance

- 6.144. The involvement of entity officials in the setting of the audit objective(s), scope of the audit, criteria and other key planning parameters, and the use of a panel of outside experts assist in the determination of the criteria and to review the audit plan are two ways to assure quality. In addition:
- 6.144.1. The work done at this phase should be properly supervised.
- 6.144.2. All key planning decisions should be documented.
- 6.144.3. The audit files and working papers should be reviewed by SAI management.
- 6.144.4. The main study proposal (planning memorandum) should be approved by senior SAI management.

Chapter 7: Detailed Audit Planning

Introduction

- 7.1. Once the sources of audit assurance have been determined (see Chapter 6), the auditor needs to develop an audit programme (or tailor an existing one). The auditor also needs to prepare a budget and timetable for the audit and staff the audit.
- 7.2. For the audit of capital projects, a generic audit programme has been developed; however, for the reasons noted in the next section, it is very likely that some tailoring of the audit programme will be required.

Developing/Tailoring the Audit Programme

Introduction

- 7.3. The auditor needs to perform procedures that provide sufficient and appropriate audit evidence to support the audit report (i.e., to establish findings, reach conclusions and issue recommendations).
- 7.4. A generic audit programme has been developed for this purpose. It is designed to be used on performance audits of capital projects.
- 7.5. The “heart” of the audit programme are the planning procedures dealing with obtaining an understanding of the entity and the specific capital project being audited, and the fieldwork procedures dealing with each stage in the procurement cycle. The other audit procedures in the programme are general (high level) procedures to be performed at the planning, evaluation and reporting phases. These general audit procedures can be used as “memory-joggers” to remind auditors of the basic procedures to be performed at those phases.
- 7.6. An SAI may wish to augment the audit programme with:
 - 7.6.1. Detailed audit programmes and supporting templates, forms, etc. dealing with the planning, evaluation and reporting phases of the audit.
 - 7.6.2. Additional procedures dealing with:
 - (a) Informing, meeting with and obtaining feedback from entity officials; and/or
 - (b) Supervising the audit work, monitoring progress, reviewing working papers, and approving the results of the work done at each phase.
 - 7.6.3. Audit completion checklists and quality assurance checklists.
- 7.7. The fieldwork procedures dealing with each stage of the procurement cycle will likely need to be tailored. The primary reasons for this are as follows:

- 7.7.1. The audit programme includes a *lot* of procedures. This has been done in an effort to cover all potential scenarios. In this respect:
- (a) The audit programme likely contains procedures that will not be applicable to the specific capital project being audited.
 - (b) The audit programme likely contains procedures dealing with matters that, for the specific capital project being audited, are considered to be of such low risk that the procedure is not required to be performed.
- 7.7.2. Contrary to the previous point, each capital project is different, and one audit programme cannot contain all the specific procedures that might be required for each type. As such, there is always a chance that additional (or different) procedures will be required.
- 7.7.3. The programme assumes that an audit level of assurance (reasonable assurance) is to be obtained. If a lower level of assurance (i.e., limited assurance) is all that is required, some of the procedures contained in the programme will be unnecessary.
- 7.7.4. The audit programme is structured around the various stages in the procurement cycle and deals with economy, efficiency and effectiveness and with compliance with the related authorities. As noted in Chapters 5 and 6, though, the auditor may not wish to deal with all stages or with all three of economy, efficiency and effectiveness. If that is the case, some of the procedures contained in the programme will be unnecessary. This is discussed further below.
- 7.7.5. Each country has its own procurement act or other relevant laws, rules, policies, etc. This means that the audit work to test compliance with authorities may differ from country to country, from entity to entity and from capital project to capital project. Therefore, while the audit programme contains some procedures relating to authorities, it is not possible to deal with all possible authorities. This is discussed further below.
- 7.7.6. While the audit programme contains procedures that are designed, at least in part, to identify possible frauds, the audit programme does not contain procedures to deal with all the possible risks of fraud identified in Annex B. If specific risks are assessed as high, procedures may need to be added to the audit programme. This is discussed further below.
- 7.7.7. The audit programme assumes that limited assurance will be placed on internal controls and, with only one exception (controls over payments made) does not contain detailed tests of controls. If more assurance is to be placed on internal control, additional procedures will be needed. This is discussed further below.
- 7.7.8. The audit programme assumes that only a few analytical procedures are to be performed. It also assumes that these will be simple comparisons. If additional and/or more sophisticated analytical procedures are desired, they will need to be added. This is discussed further below.

- 7.7.9. The audit programme does not contain any data analysis procedures (i.e., using data analysis software such as IDEA to perform detailed reviews of data looking for unusual patterns or trends). Should data analysis procedures be desired, they will need to be added. This is discussed further below.
- 7.7.10. For substantive tests of details, most procedures call for the testing of all individually significant transactions and a sample of the remainder. For some capital projects and for some steps in the procurement cycle, though, this may not be the best choice – either more testing (e.g., 100 percent testing) could be performed, or no sampling may be required at all. This is discussed further below.
- 7.8. As discussed in Chapter 6, when setting the criteria it is often easier to use the three stages of the procurement cycle (pre-tendering, tendering and post-contract award) than to use another grouping, such as economy, efficiency and effectiveness. If the three stages of the procurement cycle are used, the audit procedures will naturally be grouped by criterion.
- 7.9. If another set of criteria are used, when tailoring the audit programme the auditor will need to ensure that sufficient and appropriate (but not excessive) audit evidence is being obtained for each criterion. To assist in this process, the generic audit programme contains four columns labelled C1 to C4, where “C” stands for “criterion”. If desired, the auditor can insert his/her criteria into the four columns and then use tick marks to indicate to which criterion each audit procedure relates. After doing so, the auditor may be better able to assess if the programme contains enough (or too many) procedures relating to each criterion.

Considering the Scope of the Audit

- 7.10. Further to 7.7.4, when tailoring the generic audit programme (or developing one from scratch), the auditor needs to ensure that the audit procedures deal with the full scope of the audit (i.e., they deal with all the objectives, criteria and areas that the auditor wishes to audit).
- 7.11. For example, assume that the auditor wishes to conduct a performance audit of the construction of a school. That audit is to deal with the full project from the initial needs assessment through to completion, and is to deal with all three of economy, efficiency and effectiveness. The audit programme that is developed (or the end result of tailoring the generic programme) should contain audit procedures that:
- Deal with every stage of the project;
 - Deal with all three of economy, efficiency and effectiveness; and
 - Will provide an audit level of assurance with respect to all of the above.

Considering Authorities and Fraud

- 7.12. As noted in 7.7.5 the audit programme contains some procedures relating to authorities. However, it is not possible to deal with all possible authorities that could be applicable to every possible capital project in every country.

- 7.13. Similarly, as noted in 7.7.6, while the audit programme contains procedures that are designed, at least in part, to identify possible frauds, the audit programme does not contain procedures to deal with all the possible risks of fraud identified in Annex B.
- 7.14. What the audit programme *does* contain are procedures at the start of each of the pre-tendering, tendering and post-contract award stage requiring auditors to ensure that all required authorities have been complied with, and to consider the possibility that fraud, undue political influence or undue senior management influence may have occurred. These general procedures could be replaced by more specific procedures for the particular capital project being audited.

Considering Sources of Audit Assurance

- 7.15. When tailoring the generic audit programme (or developing one from scratch), the auditor needs to ensure that he/she obtains sufficient, appropriate audit evidence to support his/her conclusion.
- 7.16. The types of evidence to be obtained, and the procedures that will need to be performed, will depend, to some extent, on the sources of audit assurance.
- 7.17. As noted in Chapter 6, assurance can come from inherent assurance, tests of control, analytical procedures and data analysis, and substantive tests of details.
- 7.18. Given that the generic audit programme assumes only limited assurance from tests of control and analytical procedures, and no assurance from data analysis, the generic programme does not contain sub-headings to separate the procedures into these categories. If more assurance is planned from tests of controls, analytical procedures and data analysis, it may be advisable to group the procedures in the audit programme by sources of assurance to help ensure that the nature and extent of the work being performed is consistent with the planned levels of assurance.
- 7.19. The following paragraphs provide further guidance on the work required to support different levels of assurance.

Tests of Controls

- 7.20. Further to 7.7.7, if only limited reliance is being placed on internal controls, the audit procedures will usually contain a mix of:
- Inquiries of entity officials;
 - Observations of the internal controls being performed;
 - Reviews of internal control procedures manuals; and/or
 - Walk-through procedures (taking one or two transactions and following them through from initiation to the final recording).
- 7.21. If, on the other hand, a high level of reliance is contemplated, performing tests of controls on a sample of transactions will almost certainly be required.

Analytical Procedures and Data Analysis

7.22. Further to 7.7.8 and 7.7.9:

7.22.1. If only limited assurance is to be placed on analytical procedures, simple comparisons of highly aggregated data (e.g., the total amount for the capital project as a whole) is normally sufficient. If, on the other hand, a high level of assurance is desired, the auditor will usually need to perform more sophisticated comparisons such as predictive analysis or regression analysis, and may do the analysis on very disaggregated data (e.g., monthly amounts for each component of the capital project).

7.22.2. If a lot of assurance is desired from data analysis, the auditor will need to do a more detailed search for unusual payments, duplicate payments, etc. than is needed if only limited assurance is desired.

Substantive Tests of Details

7.23. Further to 7.7.10, if the auditor wishes to obtain assurance for substantive tests of details (as is almost always the case), there will usually be the testing of all individually significant transactions (high value and other key items) and a sample of the remaining transactions. The audit programme assumes that this is the case. However, there may be exceptions. That is because:

7.23.1. As discussed in Chapter 6, it may be possible to cost-effectively audit 100 percent of the documents, transactions, etc. in some steps in the procurement cycle. Also, if these procurement steps are considered to have high inherent and control risks, including the risk of fraud, the auditor may want to do so regardless.

7.23.2. The amount of assurance that can be obtained from inherent assurance, tests of controls and analytical procedures and data analysis affects the amount of assurance that is required from substantive tests of details. If a lot of assurance can be obtained from these other sources, substantive sampling may not be required at all.

Documentation

7.24. The end result of any tailoring exercise (or developing a programme from scratch) will be the final audit programme.

7.25. In addition to the final programme, though, it may be useful to document, in the audit planning file, the main reasons for tailoring the generic audit programme. This will help ensure that the final programme includes all required changes, and that unnecessary procedures have not been added.

Budgeting the Audit

7.26. All audits should be properly budgeted, both in terms of time and in terms of incidental costs. Incidental costs include such items as travel and per diems for out-of-town work,

the costs associated with testing samples of materials, and the costs associated with engaging outside experts.

Staffing the Audit

- 7.27. SAI management has overall responsibility for delivering the audit on time and within budget. Each audit team member is responsible for executing the tasks allocated to her/him by SAI management. It is only by the professional execution of both these responsibilities that the audit can be successful

Required Level of Expertise

- 7.28. When staffing the audit, SAI management needs to ensure that the audit team, overall, has the required expertise to perform the audit. SAI management then needs to allocate the tasks among the audit team in a way that gets the best possible match between the requirements of the work and the skills, experience and capabilities of team members.

Using Outside Experts as Members of the Audit Team

- 7.29. Chapter 6 discusses relying on the work performed by other auditors and using outside experts as advisors.
- 7.30. Outside experts could be employed to perform some of the audit work when the SAI needs (or wishes) to augment the technical knowledge and skills of the audit team. For example, the SAI could engage an engineer who has the technical ability to estimate the amount of materials used and/or the quality of those materials.
- 7.31. The ISSAIs for performance audits provide some limited guidance with respect to using outside experts as members of the audit team. ISSAI 1620 provides more detailed guidance. While ISSAI 1620 is directed at financial audits, it would be applicable to performance audits as well.
- 7.32. If outside experts are used, the SAI will need to ensure that they are independent of the audit entity and the specific capital project being audited, and are competent to do the work. There also needs to be:
- 7.32.1. A clear understanding from the outset about the scope of the expert's work, and the timetable and deadline dates for the completion of that work.
 - 7.32.2. Adequate arrangements for liaison with the experts, including timing of interim reports and meetings at key points in time to ensure that:
 - (a) Any problems are identified and resolved at an early stage;
 - (b) All evidence is properly considered; and
 - (c) The work has been conducted to the required auditing standards.
- 7.33. The SAI may also want to engage an internal auditor to perform some audit procedures. (This is in contrast to relying on the work performed by internal audit.) If an internal auditor is added to the audit team, the internal auditor should be considered an "outside

expert” and, with one exception, the guidance provided above is applicable. (The one exception is that internal auditors are not independent of the entity or the capital project being audited.)

- 7.34. Additional guidance on using internal auditors as members of the audit team can be found in ISSAI 1610. While ISSAI 1610 is directed at financial audits, it would be applicable to performance audits as well

Size of the Team

- 7.35. With small audit teams it is usually easier to assign and schedule the work, supervise the work and monitor progress. Larger teams, though, may be needed to ensure that the team has the required expertise and to complete the work in a short period of time.
- 7.36. It is very important that the audit report be issued within a reasonable period of time relative to the period covered by the audit. If it is not, the report’s findings, conclusions and recommendations may be considered “old news” and not given the attention they deserve by entity officials and parliamentarians.
- 7.37. Given the above, it is often desirable for performance audits to be completed in a relatively short period of time. That, in turn, could require the use of relatively large audit teams.
- 7.38. Paragraphs 7.47 to 7.50 below discuss a further method of issuing the report within a reasonable period of time.

Scheduling the Work

- 7.39. This involves assigning start dates and end dates to each activity to be performed and for the audit as a whole.
- 7.40. The schedule should be detailed enough that SAI management can easily determine if an audit is running ahead of schedule or behind schedule.
- 7.41. One SAI management technique that can be used to monitor whether the audit is on track is the use of T-minus dates, where:
- The “T” stands for “tabling” – the planned date on which the report is to be tabled in Parliament.
 - The “minus” refers to the number of weeks before tabling.
- 7.42. A detailed schedule is drawn up indicating the dates by which specific activities are to be completed.
- 7.43. To illustrate:
- If entity management’s comments are to be received on the final report three weeks before tabling, this will be given a “T minus 3” date.

- If the first draft of the report is to be prepared 10 weeks before tabling, it will be given a “T minus 10” date.
 - If the fieldwork is to be completed 12 weeks before tabling, it will be given a “T minus 12” date.
- 7.44. Extending this further backwards into the fieldwork phase, and assigning T-minus dates to the completion of different procedures in the audit programme, will help to ensure that the fieldwork progresses at a sufficient pace.

When to Start the Audit

- 7.45. One key consideration for a capital project is whether to start the audit before the capital project has been completed, or to wait until after it has been completed.
- 7.46. As discussed above, it is very important that the audit report be issued within a reasonable period of time relative to the period covered by the audit, and that one way of doing so would be to use relatively large audit teams.
- 7.47. Another technique that could be used to get the report issued in a reasonable time period is to start the audit before the capital project has been completed. The audit would then lag the project by a short period of time, with the report issued shortly after the project has been completed.
- 7.48. Starting the audit before the project is completed has the further advantages of:
- 7.48.1. Allowing the team to observe entity officials performing the procedures that they claim to be performing.
 - 7.48.2. Being better able to assess the quality of the work done during the earlier stages of the project. In the case of the construction of a new school, for example, it may be difficult to assess the quality of the foundation or the support beams after the school has been completed.
- 7.49. There are, of course, several disadvantages of this approach:
- 7.49.1. The final project documentation may not be in place. Entity officials could claim that everything is in draft.
 - 7.49.2. The accounting may not be finalised. Entity officials could claim that all amounts are preliminary and therefore any monetary errors the auditor comes up with are not valid errors.
 - 7.49.3. There would likely be breaks in the audit as the audit team waits for the entity to complete the next stage. This could make scheduling and staffing more difficult.
- 7.50. With some advance planning (including discussions with entity officials concerning the timing), these disadvantages can usually be overcome.

Liaison with Entity Officials

7.51. Chapter 6 has discussed liaison with entity officials at the planning phase. Those matters that specifically relate to the matters discussed in Chapter 7 are:

Audit Programme

7.52. Auditors normally do not share their complete audit programme with entity officials. However, there may wish to share specific procedures in order to get the officials' input on the best way to go about performing the procedure (or the feasibility of performing it), and/or to clarify precisely what documents and other information are needed from entity officials.

Staffing the Audit

7.53. Auditors should provide entity officials with the names and contact details of the key individuals with whom entity officials should liaise.

Scheduling the Work

7.54. Auditors should share the timing of their audit with entity officials. This will help ensure that the officials are available to meet with the auditors, and to have the required documents and other information available for them.

Quality Assurance

7.55. To ensure quality throughout the detailed planning phase:

7.55.1. The work should be properly supervised.

7.55.2. The audit programme, budget, staffing and staff scheduling should all be documented.

7.55.3. The above documents should be reviewed and approved by senior SAI management.

Chapter 8: Fieldwork

Introduction

- 8.1. At the end of the general and detailed planning phases of the audit, the audit team will have produced a main study proposal (planning memorandum) and working papers containing evidence that supports the work performed. As noted in Chapter 6, several files may be used – a planning file, a permanent file and a capital project file.
- 8.2. The main study proposal and the supporting files and working papers should contain all the information that the audit team and SAI management require to carry out a successful audit of the capital project.
- 8.3. Once the planning has been completed and the audit plan approved, the fieldwork commences.
- 8.4. The fieldwork phase primarily involves performing the work called for in the audit plan and reflected in the audit programme. However, no matter how well the audit is planned, it would be highly unusual for there not to be changes required during the fieldwork phase. For example, changes could be required to the risk assessments, to the planned procedures, and/or to the length of time required to perform the work. Auditors not only need to be mindful of required changes, but also changes that would improve the efficiency and effectiveness of the audit.

Purpose

- 8.5. The fieldwork phase involves obtaining relevant and reliable audit evidence that is sufficient to enable the auditor to draw reasonable conclusions on the main issues selected for audit. The audit should provide the necessary information for the SAI to produce a fair, unbiased and informative report that adds to public accountability and leads to improvement in value for money.

General Approach

- 8.6. The fieldwork phase should be based on the audit objectives, scope, criteria and timetable set out in the audit plan and the audit programme.
- 8.7. During the fieldwork phase, the auditor will complete the steps in the audit programme and will document all the individual monetary errors, compliance deviations and VFM deviations (deviations from economy, efficiency and effectiveness) and discuss them with entity officials. The results will then be evaluated during the evaluation phase – see Chapter 9.
- 8.8. It is normally advisable to begin the fieldwork with an entrance conference – an introductory meeting involving the audit team and the relevant entity officials. The audit team and entity officials could introduce themselves to each other, and discuss the audit work to be performed and the timing of that work.

- 8.9. If necessary, the audit team could refresh the entity officials' memory concerning the scope of the audit, the audit objective, and the criteria (and supporting questions) being used.
- 8.10. During the meeting, the audit team and entity officials could also discuss how they will interact with each other. This could involve both parties identifying a key contact person that the other could use, and a commitment by both parties to keep the other party informed of all important matters and developments.
- 8.11. The auditors could also use this meeting to provide entity officials with a list of documents, invoices, etc. that they will require to conduct the audit.

Changes to Audit Approach and Audit Programme

- 8.12. No matter how well the audit is planned, it would be highly unusual for there not to be changes required during the fieldwork phase. For example, changes could be required to the risk assessments, to the planned procedures, and/or to the length of time required to perform the work. To illustrate:
 - 8.12.1. Certain matters that were considered low risk and low priority at the planning phase may subsequently be reassessed as being much higher risk and/or a greater priority. Conversely, an area that was expected to be high risk and to generate significant audit findings may turn out to be much better managed than expected.
 - 8.12.2. Auditors may discover that the planned audit procedures will not adequately address a particular issue and additional procedures are required. This could occur, for example, when internal controls turn out to be weaker than expected, making it impossible for the auditors to place the planned reliance on the controls.
- 8.13. Given the above, it is very important that audit programmes not be executed blindly – auditors need to evaluate the results of their work as the audit progresses, and to bring any significant matters to SAI management's attention at the earliest opportunity. Similarly, it is essential for SAI management to monitor progress during the audit, and not to wait to the end of the fieldwork to review the working papers.
- 8.14. While, as described above, it would be unusual for there not to be changes required during the fieldwork phase, if the audit has been well planned there should normally be no need for significant changes to be required to the key planning parameters such as the audit objective(s) and criteria. Changes to these parameters could be an indication of poor planning. In addition, seeing as these key planning parameters had been discussed with entity officials during the planning phase, changes to them could negatively affect entity relations and the entity's impression of the knowledge and skills of the audit team.
- 8.15. If changes suggested by the audit team and/or SAI management require amendments to the audit plan, budget, timetable and resources, these should all be documented and approved, following the same approach as for the initial plan. Entity officials should be advised of any changes that affect them.

Dealing with Conflicting Audit Evidence and Different Points of View

- 8.16. There may be cases where different sources of audit evidence lead to different conclusions. For example:
- 8.16.1. The auditor's tests of controls show that there are no weaknesses in or deviations from the controls, but the auditor's substantive tests have revealed material errors, compliance deviations and/or VFM deviations (deviations from economy, efficiency and effectiveness).
 - 8.16.2. There may be a discrepancy between the findings or conclusions arising from the audit and those contained in a report dealing with the same capital project issued by internal audit or by an outside expert engaged by entity officials.
- 8.17. These differences may be due solely to differences in the objectives and scope of the work being conducted. However, they may be due to problems with the audit work carried out by the SAI. For example, the auditors may have failed to properly perform all of the required procedures, or may have failed to take into account all the available evidence.
- 8.18. Different points of view involving hard facts can normally be resolved relatively easily. For example, it is normally relatively easy to determine whether or not:
- A particular document was properly approved;
 - The entity had paid for more materials than were used or for work that had not been performed; and
 - The project had been completed on time and within the original budget.
- 8.19. Other different points of view may be more difficult to resolve. For example, while it may be relatively easy to determine if the correct quantity of materials had been paid for, it may be more difficult to assess whether the materials used were of the required quality. Similarly, while it may be relatively easy to determine if the capital project had been completed on time, it may be more difficult to determine if the project achieved the desired objectives.
- 8.20. If the needs assessment, definition of requirements and the signed contract with the contractor were sufficiently detailed, matters of judgement will be less difficult to resolve than if these documents were less detailed. However, there will almost always be room for disagreement.
- 8.21. Before the auditor can complete the audit, conflicting audit evidence and different points of view need to be investigated and resolved. This is particularly the case where the SAI is criticising the performance of entity officials but another report has concluded that performance was satisfactory. In this case, the possibility arises that entity officials will use the other report to challenge the SAI's findings and conclusions.

Supervising the Audit; Monitoring Progress

- 8.22. The audit should be properly supervised to ensure that it meets the standards called for in the ISSAIs. As part of this ongoing supervision, SAI management should monitor progress to assess whether:
- All required changes to the audit plan and the audit programme are made.
 - Actual progress conforms to planned progress, and whether the audit will be completed on time;
 - The audit will be completed within budget; and
 - The audit work is of the required quality.

Monitoring Progress Relative to Time Schedule

- 8.23. It is normally not possible for SAI management to monitor the progress of every aspect of a performance audit – performance audits are often too large to do so. However, it should be possible to monitor the key aspects of a relatively focussed performance audit, such as one dealing with the audit of a capital project.
- 8.24. One method to monitor progress is to use T-minus dates. These are discussed in Chapter 7.
- 8.25. Another method of monitoring progress is to have frequent meetings with the audit team. Each team member can report progress made since the last meeting and can estimate the extent to which he/she has completed the assigned work. That percent, and the percent for the entire audit, can be compared to the percentage of budgeted time that has been spent.

Monitoring Audit Cost

- 8.26. If the audit is progressing on schedule without an increase in resources, it is likely progressing within budget. On the other hand, if the work is dragging despite all staff working full-time on the audit, then there will likely be cost overruns.

Monitoring Audit Quality

- 8.27. SAI management needs to ensure that the audit work is not only progressing on time and within budget, but that it is meeting the required quality. It is particularly important for SAI management to ensure that audit quality is not being jeopardised in an effort to meet deadlines and/or to be within budget.
- 8.28. Monitoring audit quality can often be accomplished by meeting with the auditors during the fieldwork and by reviewing working paper files completed to date. Waiting until the end of the fieldwork phase to review the working papers is almost always too late to ensure an efficient and effective audit.

Making Adjustments

- 8.29. If the monitoring exercise indicates that the work is progressing slower than expected, SAI management may be able to assign a later completion date. If this is not possible because, say, the tabling date is fixed, more or better qualified auditors could be assigned to do the work and/or the scope of the audit could be reduced.
- 8.30. If the monitoring exercise indicates that the audit is over budget, either an increased budget could be provided or the scope of the audit could be reduced.
- 8.31. If the monitoring exercise indicates that the work is not of the required quality, the work performed to date may need to be redone and/or additional procedures added to the audit programme. Consideration could also be given to assigning better qualified staff, or increasing the supervision and review that is being performed.

Liaison with Entity Officials

- 8.32. It is important that auditors liaise on a regular basis with entity officials throughout the fieldwork phase. In particular:
 - 8.32.1. As noted above, the fieldwork phase should commence with an entrance conference.
 - 8.32.2. Entity officials need to be advised of all individual monetary errors, compliance deviations and VFM deviations, and should be asked to review and comment on those errors and deviations. This should be done at the earliest possible date – certainly no later than the exit conference noted below.
 - 8.32.3. The process in the previous paragraph should continue as the errors and deviations are summarised, findings are drafted, conclusions are reached, and recommendations are made. (Note: The process of developing findings and reaching conclusions is discussed in Chapter 9; recommendations are briefly discussed in Chapter 9 and then discussed in detail in Chapter 10.)
 - 8.32.4. Entity officials should be advised of any changes in the audit plan that could affect them.
 - 8.32.5. The fieldwork phase should end with an exit conference during which the results of the audit to date are summarised.
- 8.33. In addition, it is usually advisable to obtain a management representation letter from entity officials.
- 8.34. All formal meetings and interviews with entity officials should be documented.

Documentation

- 8.35. It is important to document the fieldwork well to ensure that:
 - 8.35.1. The audit work complied with all relevant ISSAIs.

- 8.35.2. All evidence obtained to support the required level of overall assurance and the findings, conclusions and recommendations is properly recorded.
 - 8.35.3. All evidence is given due weight within the audit and the audit report. If certain evidence is not adequately documented, it may be forgotten at the evaluation phase.
 - 8.35.4. Evidence can be easily and quickly located to support the audit report.
 - 8.35.5. SAI management is able to review work with ease.
- 8.36. The working papers should be sufficiently complete and detailed to provide an overall understanding of the audit. Working papers would include the auditor's reasoning on all significant matters that require the exercise of judgment, together with the auditor's conclusions thereon. In areas involving difficult questions of principle or judgment, the working papers should contain the relevant facts that were known to the auditor at the time the conclusions were reached.
- 8.37. In assessing the extent of working papers to be prepared and retained, it may be useful for the auditor to consider what would be necessary to provide another auditor, who has no previous experience with the audit, with an understanding of the work performed, and the basis of the key decisions taken.
- 8.38. Both during and at the end of the fieldwork phase, SAI management should review the working papers to ensure that the objectives outlined in 8.35 to 8.37 are achieved. At the same time, SAI management should ensure that the working papers do not contain unnecessary documentation.

Completion of Audit and Subsequent Events

Completion of the Audit

- 8.39. Once the auditor has completed the fieldwork and has obtained all the evidence that he/she believes is necessary, the fieldwork ends and process of evaluating the results and drafting the report begins.
- 8.40. The ISSAIs do not explicitly state when the audit is deemed to be completed. However, ISSAI 1700 (which applies to financial audits but could be applied to performance audits) states that the auditor's report shall be dated no earlier than the date on which the auditor has obtained sufficient and appropriate audit evidence on which to base the auditor's opinion on the financial statements. This implies that the audit ends when all the required evidence is obtained.
- 8.41. When evaluating results and drafting the report, the auditor normally does not continue to gather further audit evidence – the evaluation and report are based on the evidence already obtained. Therefore, the audit is normally considered to be complete on the date the fieldwork ends.
- 8.42. The one exception to this would be when the evaluation phase indicates that further work is required, and the auditor then conducts this further work. See Chapter 9.

Subsequent Events

- 8.43. ISSAI 1560 (which applies to financial audits but could be applied to performance audits) describes two periods of subsequent events. Altering the description somewhat to reflect the scope of a performance audit of a capital project produces the following two periods:
- 8.43.1. The time period between the end of the capital project (or the period of the project covered by the audit if the entire project was not audited) and the date the audit was completed.
 - 8.43.2. The time period between the completion of the audit and the issuance of the report.
- 8.44. To illustrate, assume that a new school was constructed during the period 1 July 2012 to 31 December 2014. Assume further that the audit fieldwork was completed by 30 June 2015 and that the audit report was issued on 30 September 2015. In this case:
- 8.44.1. The first period would be 1 January to 30 June 2015 – the period between the completion of the project and the completion of the audit fieldwork.
 - 8.44.2. The second period would be 1 July to 30 September 2015 – the period between the completion of the audit fieldwork and the issuance of the report.
- 8.45. ISSAI 1560 would require the auditor to audit any events or transactions that occurred during the first period that would affect the accounting for the school. If, therefore, there were further payments made or amounts recovered between 1 January 2015 and 30 June 2015, these would need to fall under the scope of the audit.
- 8.46. As this is a performance audit, the auditor should also consider any events and transactions that had taken place that might assist in evaluating the economy and efficiency with which the school had been constructed, or the effectiveness of the new school (i.e., the extent to which it achieved the objectives for which it had been built).
- 8.47. ISSAI 1560 does not require any specific procedures during the second period unless the auditor becomes aware of events or transactions that have taken place. However, if there is an extensive period of time between the completion of the fieldwork and the issuance of the report (as there may be when audit reports are only tabled once or twice a year), it would be prudent for the audit team to perform a subsequent events review up to a date shortly before the date on which the report is tabled. This would help avoid issuing a report that is significantly out of date as soon as it is tabled.

Quality Assurance

- 8.48. The following matters, all of which were noted above, will help ensure that the fieldwork phase is completed to the required ISSAIs:
- 8.48.1. The fieldwork needs to be properly supervised, with progress monitored.
 - 8.48.2. The work should be properly documented.

- 8.48.3. The working papers reviewed by SAI management.
- 8.48.4. At the earliest possible date, entity officials should be advised of all individual errors and deviations, and should be asked to review and comment on those errors and deviations. This process should continue as the errors and deviations are summarised, findings are drafted, conclusions are reached, and recommendations are made.

Chapter 9: Evaluating Results – Findings, Conclusions and Recommendations

Introduction

- 9.1. The evaluation phase involves:
 - 9.1.1. Summarising the errors and deviations found. These could be monetary errors, compliance deviations or VFM deviations (deviations from economy, efficiency and effectiveness).
 - 9.1.2. Performing an overall evaluation. This is the process of aggregating the individual errors and deviations. These aggregated amounts are usually the “findings” contained in audit reports.
 - 9.1.3. Based on the overall evaluation process, reaching audit conclusions.
 - 9.1.4. Making recommendations based on the conclusions.
 - 9.1.5. Assessing the level of assurance that has been obtained.
- 9.2. This chapter deals with the process by which the auditor evaluates errors and deviations and reaches his/her conclusions. It also briefly discusses recommendations – a topic dealt with in detail in Chapter 10.
- 9.3. Chapter 10 then discusses the way in which the auditor’s findings, conclusions and recommendations should be worded, and should be reflected in the audit report.

“Findings” Contained in Audit Reports

- 9.4. Before getting into the discussion of the evaluation phase, it is important to clarify how this manual uses the term “finding”.
- 9.5. A finding (also referred to as an “observation”) is the result of the auditor’s comparison of the actual situation (the amount recorded, the extent to which authorities were complied with or the level of performance) with the relevant criteria (the amount that should have been recorded, the authorities that should have been complied with or the level of performance considered appropriate). If the auditor finds that the actual result does not meet the criterion used, the auditor has a matter that should potentially be reported to Parliament.
- 9.6. Findings can be monetary errors, compliance with authority deviations or VFM deviations (deviations from economy, efficiency and effectiveness). Findings can also be the absence of those – the auditor can report that the entity has performed well.
- 9.7. As discussed in Chapter 10, the audit report usually should not contain a separate finding for each and every error or deviation. It is usually better to group errors and deviations and report the related aggregate amounts. That is why, as noted in 9.1.2, findings should usually be aggregated amounts.

Summarising Individual Errors and Deviations

- 9.8. Each individual error or deviation should be evaluated against the criteria set. This usually involves the following steps:

Determining the Existence of Individual Errors and Deviations

- 9.9. As a first step, the auditor needs to determine whether or not there is:
- 9.9.1. A monetary error. This could be, for example, recording an amount in the cash disbursements book that differs from what was actually paid to the contractor.
 - 9.9.2. A compliance with authority deviation. This could be, for example, not obtaining the required number of tenders or not awarding the contract to the winning bidder.
 - 9.9.3. A deviation with respect to economy, efficiency or effectiveness. This could be, for example:
 - (a) Paying a higher price for materials than had been agreed to in the contract, or paying the contractor for more materials than had been used. These would be economy deviations.
 - (b) The amount by which a project was over budget or the number of weeks it was completed late. These would be efficiency deviations.
 - (c) Differences between the objectives achieved and those desired. These would be effectiveness deviations.
- 9.10. While monetary errors, compliance deviations and VFM deviations that involve monetary amounts (such as some of those in the previous paragraph) are normally relatively straightforward, other VFM deviations may not be clear-cut, and the determination of whether a deviation has occurred may require the exercise of considerable professional judgement. When making this determination, the auditor needs to keep in mind the audit objective, criterion and supporting question to which the potential deviation relates.
- 9.11. Individual errors and deviations should be based on hard evidence (i.e., evidence that is supportable, relevant, objective, fair, unbiased and accurate).
- 9.12. The auditor should ensure that all evidence is considered, and not just the evidence that supports a particular point of view. As noted in Chapter 8, it is important that conflicting audit evidence and different points of view be resolved prior to reaching conclusions.
- 9.13. The auditor should also ensure that his/her findings are based, to the maximum extent possible, on factual evidence. The auditor should avoid personal opinions.
- 9.14. If 9.11 to 9.13 hold, there should be no room for disagreement with the individual error or deviation.

- 9.15. To the extent possible, all errors and deviations should be quantified. This makes the overall error evaluation easier to perform, and provides an amount that can be included in the report.
- 9.16. Quantification should always be possible when measuring monetary errors (e.g., errors in the amounts recorded) and compliance deviations (e.g., the number of times a required approval was not obtained).
- 9.17. Similarly, many economy and efficiency issues can usually be quantified. For example, the auditor should be able to determine:
- An excess amount that an entity paid when it paid for more materials than it should have paid for.
 - The number of months that the project was late or exceeded the initial budget.
- 9.18. Even in the case of quality issues, it should sometimes be possible to determine an amount. For example, if a contractor used lower quality materials than should have been used but still billed for the higher quality materials, the auditor may be able to determine the total amount that the entity should have been paid for the lower quality materials and compare that amount to what was actually paid.
- 9.19. Effectiveness issues are usually harder to quantify; however, even here it may be possible. For example, if one of the reasons for building a new school was to reduce class sizes to no more than 20 students per class, the auditor could determine how many classes, if any, had more than 20 students in them. Similarly, if a new road was supposed to reduce the average travel time between two cities from six hours to four hours, the auditor could determine what the actual average travel time was.

Determining the Cause of the Error or Deviation

- 9.20. As a second step, the auditor needs to identify the cause of the monetary error, compliance deviation or VFM deviation. This is important for aggregating these errors or deviations, and for reaching conclusions and developing recommendations.
- 9.21. Causes must be supported by evidence, as opposed to being the auditor's or entity officials' "best guess".
- 9.22. In addition, the relationship between the deviation and the cause may not be all that direct. For example, for the construction of a new school the auditor noted that the entity had paid for work not performed and that entity officials had rarely conducted site visits. Before concluding that the second finding was the cause of the first, the auditor would need to be able to show that more site visits would have detected the non-performed work.

Determining the Effect of the Error or Deviation

- 9.23. The effect is the impact that the error or deviation has on the entity.
- 9.24. In many cases, the effect is obvious and can be quantified. For example, if a contractor was overpaid, the effect is the amount of the overpayment.

- 9.25. In other cases, the auditor may be able to identify potential effects, but may have difficulty quantifying them. For example, if poorer quality materials were used during the construction of the school, the auditor may be able to say that this could result in increased maintenance costs and increased heating and cooling costs. However, it would likely be very difficult for the auditor to be able to say by how much the costs would increase.

Performing an Overall Evaluation

- 9.26. Once the individual errors and deviations have been determined, the auditor needs to aggregate those errors and deviations and reach conclusions. This process involves combining results from different audit procedures and from different sources.
- 9.27. In the case of monetary errors, the errors can first be aggregated (grouped) by cause and/or by component (the individual line items in the financial report for the project). The choice will depend on the auditor's terms of reference and/or what the auditor intends to include in his/her report.
- 9.28. The ISSAIs require the auditor to reach a conclusion at the criterion and audit objective level. To do so, monetary errors need to be aggregated further by the related criterion and for the audit objective.
- 9.29. The ISSAIs do not require the auditor to reach a conclusion for the audit as a whole. If, though, there is only one audit objective (as there often is for the audit of a capital project), reaching a conclusion at the audit objective level will be the same as reaching a conclusion for the audit as a whole. If there is more than one audit objective, the auditor could decide to further aggregate his/her errors to produce an overall error evaluation for the audit as a whole.
- 9.30. A similar process can be used for compliance deviations. The deviations can first be aggregated by cause and/or by each authority. The auditor then needs to further aggregate the deviations by criterion and audit objective, and could go further to reach an overall conclusion with respect to compliance with authorities as a whole.
- 9.31. A similar process can also be used for VFM deviations. The deviations can first be aggregated by cause and then by criterion and audit objective. The auditor could then go further to reach an overall conclusion with respect to value for money as a whole.
- 9.32. Auditors should not expect the entity to perform perfectly. It is not reasonable, for example, to expect that there will be no monetary errors, that every transaction will be properly approved, that all laws, regulations, rules and policies will be complied with all the time, and that there are never any deviations from economy, efficiency and effectiveness. The cost to the entity of ensuring that these are the case would likely far outweigh the benefits of doing so.
- 9.33. What the auditor does is compare the actual result to what is considered acceptable. That process is illustrated below.

Monetary Errors

- 9.34. At the planning phase, the auditor will have determined a materiality amount and an aggregate expected error.
- 9.35. At the evaluation phase, the auditor aggregates the monetary errors that have been found to arrive at a most likely error. The auditor then determines the maximum possible error and compares that amount to the materiality amount. As noted above, the aggregation needs to be done by cause and/or by component, and then by criterion and audit objective.
- 9.36. To illustrate, let's assume that the auditor is auditing payments to contractors.
- 9.37. If the auditor has audited every payment, the total of the errors that the auditor has found will be the most likely error. Also, because every transaction has been audited, there is no possibility of there being any further errors, so the most likely error is also the maximum possible error.
- 9.38. If, on the other hand, the auditor has only taken a sample of payments to contractors, the auditor uses the errors found in the sample to estimate the most likely error in all of the payments to contractors. The auditor then has to consider the possibility that, because only a sample was taken, the actual error could be higher than the most likely error. The auditor then considers this further possible error to arrive at a maximum possible error.
- 9.39. Software tools such as IDEA can be used to assist in the calculation of the most likely error and maximum possible error resulting from sampling procedures.
- 9.40. Rather than calculate the maximum possible error, the auditor can use a simple comparison to estimate whether the maximum possible error is less than or greater than materiality. What the auditor does is compare the most likely error to the aggregate expected error determined at the planning phase and used when determining the sample size. If the most likely error is greater than that the aggregate expected error, the maximum possible error will almost always exceed materiality.
- 9.41. To illustrate, let's assume that the most likely error is \$1,000,000 and that the parameters used in Chapter 6 were used to determine the sample size. Those parameters were:

Materiality	\$3,000,000
Aggregate expected error	<u>800,000</u>
Planned precision	<u>\$2,200,000</u>

- 9.42. In this case, the most likely error (\$1,000,000) exceeds the aggregate expected error (\$800,000). The maximum possible error will therefore almost certainly exceed the \$3,000,000 materiality amount.
- 9.43. Once the most likely error and maximum possible error have been determined, there are three possible outcomes:

- 9.43.1. The maximum possible error is less than materiality. If this is the case, the auditor can conclude that the recorded amounts are not materially misstated.
- 9.43.2. The most likely error exceeds materiality. If this is the case, the auditor can conclude that the recorded amounts are materially misstated.
- 9.43.3. The most likely error is less than materiality but the maximum possible error exceeds materiality. (This is what is illustrated above.) If this is the case, the auditor has an unacceptable risk that the recorded amounts are materially misstated (i.e., the auditor does not have the desired overall audit assurance). Either more audit work needs to be performed, or else the auditor cannot reach an unqualified conclusion.

Compliance Deviations

- 9.44. As noted in 9.30, the deviations can be aggregated by cause and/or by each authority, and then need to be aggregated by criterion and audit objective.
- 9.45. Compliance deviations can be aggregated in the same fashion as monetary errors – the auditor can take the monetary amounts of the transactions containing compliance deviations and estimate a most likely amount and a maximum possible amount.
- 9.46. Alternatively, compliance deviations can be evaluated based on deviation rates.
- 9.47. To illustrate the second, let's assume that the auditor is performing procedures to audit the approval process for payments.
- 9.48. It is not reasonable for the auditor to expect that every payment will be properly approved – the cost of implementing controls to do so would far exceed the possible savings that could result from those controls. Instead, the auditor needs to come up with two rates at the planning phase:
 - 9.48.1. The expected deviation rate – the deviation rate he/she believes actually exists in the population.
 - 9.48.2. The tolerable deviation rate – the rate above which the deviation rate would not be considered tolerable. That could be because a higher rate may result in a material misstatement in the accounts, or result in the criterion not being met. The latter could be the case if, for example, the auditor believes that the entity should be able to afford controls that would prevent or detect higher rates.
- 9.49. Let's also assume that the auditor estimated that 1 percent of the payments will not be properly approved and considered that a non-approval rate of 5 percent or more is not tolerable.
- 9.50. The auditor would then audit the sample and determine a most likely deviation rate. (That rate would be the same as the rate found in the sample.) The auditor would then calculate the maximum possible deviation rate. At this point, the same three possible outcomes as described for monetary errors could exist:

- 9.50.1. The maximum possible deviation rate is less than the 5 percent tolerable deviation rate. If this is the case, the auditor can conclude that the deviation rate is acceptable.
 - 9.50.2. The most likely deviation rate exceeds the tolerable deviation rate. If this is the case, the auditor can conclude that the deviation rate is unacceptable.
 - 9.50.3. The most likely deviation rate is less than the tolerable deviation rate but the maximum possible deviation rate exceeds the tolerable deviation rate. If this is the case, the auditor has an unacceptable risk that the actual deviation rate will exceed the tolerable deviation rate (i.e., the auditor does not have the desired level of confidence). Either more audit work needs to be performed, or else the auditor cannot reach an unqualified conclusion.
- 9.51. Rather than calculate the maximum possible deviation rate, an equivalent simple comparison to the one noted for monetary errors can be used. The auditor can compare the most likely deviation rate to the expected deviation rate used when determining the sample size – 1 percent in our example. If the deviation rate found in the sample is greater than 1 percent, then the maximum possible deviation rate will almost certainly exceed the 5 percent tolerable deviation rate.

VFM Deviations

- 9.52. As noted in 9.31, VFM deviations can be aggregated by cause and then need to be further aggregated by criterion and audit objective.
- 9.53. As discussed above, some deviations from economy, efficiency and effectiveness can be quantified. These deviations can be evaluated as illustrated above.
- 9.54. To illustrate using one of the economy examples above (paying the contractor for more materials than had been used), the auditor could take a sample of payments and make estimates of the materials that were actually used. The auditor could then determine a most likely overpayment amount and a maximum possible overpayment amount.
- 9.55. To further illustrate with an effectiveness example, let's assume that the construction of a new school was intended to reduce the average class size in the region to 20 students. The auditor could take a sample of class sizes and determine the most likely average class size and the maximum possible average class size.
- 9.56. Other deviations from economy, efficiency and effectiveness cannot be aggregated at the cause and criterion levels. That is because there is only one individual result relative to the criterion.
- 9.57. To illustrate using an efficiency example, if the auditor is interested in comparing the completion date of a project to its planned completion date, there is only one comparison to be made and no results to aggregate.
- 9.58. Similarly, some effectiveness deviations cannot be aggregated at the cause and criterion levels because there are no quantifiable deviations that can be aggregated to reach an overall conclusion. Rather, the conclusions are subjective (qualitative) and relate the criterion as a whole.

Reaching Audit Conclusions

- 9.59. Conclusions are logical inferences about the capital project based on the results of the auditor's work.
- 9.60. The strength of the auditor's conclusions depends on the persuasiveness of the evidence supporting the findings, and the convincingness of the logic used to formulate the conclusion. If the relationship among criteria, findings (including cause and effect) and conclusions is clear, the conclusions will be hard to refute.
- 9.61. Most conclusions will be a direct result of the overall evaluation process – the auditor will know the most likely and maximum possible monetary errors in the amounts recorded for the project and the most likely and maximum possible deviation rates for each authority and for each criterion for economy, efficiency and effectiveness. The auditor can then compare those amounts and rates to what is considered acceptable to reach a conclusion on each issue.
- 9.62. Other conclusions, though, will require a significant amount of professional judgement, particularly at the audit criterion and audit objective level. To illustrate, the auditor may have five questions for one criterion, and four of those questions may have acceptable results and one may have an unacceptable result. The auditor would need to carefully weigh the results for each question and the relative importance of each question to reach a conclusion at the audit criterion level.
- 9.63. The same process applies at the audit objective level – there may be four criteria relating to the audit objective, and the auditor may have reached different conclusions with respect to each criterion.
- 9.64. For financial audits, the ISSAIs suggest various types of standard opinions:
- 9.64.1. An unqualified opinion.
 - 9.64.2. A qualified opinion (except for) due to a disagreement with one or more particular items.
 - 9.64.3. A qualified opinion (except for) due to a scope limitation.
 - 9.64.4. An adverse opinion.
 - 9.64.5. A disclaimer of opinion.
- 9.65. While not required for performance audits, the concept of having qualified or adverse conclusions or a disclaimer of conclusion may help when drafting the conclusions.
- 9.66. To illustrate, let's assume that the auditor has four criteria relating to the audit objective, three of which have acceptable results and one that has an unacceptable result. The auditor's conclusion on the audit objective could be that:
- 9.66.1. The entity met the objective. This could be the case if the one criterion was relatively minor relative to the audit objective.

- 9.66.2. The entity met the objective except for the one matter. This would be the case if the one criterion was material but not pervasive to the audit objective.
- 9.66.3. The entity did not meet the objective. This would be the case if the one criterion was both material and pervasive to the audit objective.

Making Recommendations

- 9.67. Recommendations follow directly from the auditor's conclusions. They are the auditor's proposals to correct errors and deviations that have occurred, reduce the number and amount of monetary errors that will occur in the future, improve compliance with authorities, or improve economy, efficiency and effectiveness. Recommendations are designed to prompt corrective action in cases where such action can cost-effectively be taken.
- 9.68. It is important that the relationship among the audit objective, criteria, findings, conclusions and recommendations is clear. In particular, the recommendations to correct particular errors or deviations should be directly linked to those errors or deviations. And recommendations designed to prevent the recurrence of errors or deviations should be directly linked to their cause.
- 9.69. Chapter 10 provides suggestions as to ways in which the report can be structured so as to make the relationship among the audit objective, criteria, findings, conclusions and recommendations as clear as possible. Chapter 10 also contains other suggestions with respect to the wording of the report.

Assessing the Level of Overall Assurance Achieved

- 9.70. A final step in the evaluation phase is to assess the level of overall audit assurance that has been achieved.
- 9.71. As noted in Chapter 6, the overall level of audit assurance is normally set at 95 percent or higher. As also noted in that chapter, this assurance can be obtained from inherent assurance, tests of controls, analytical procedures and data analysis, and substantive tests of details.
- 9.72. As noted in 9.43.3, if the auditor is in a situation where the most likely error is less than materiality but the maximum possible error exceeds materiality, the auditor will not have the desired amount of assurance. As noted in 9.50.3, the same situation exists where the most likely deviation rate is less than the tolerable deviation rate but the maximum possible deviation rate exceeds the tolerable deviation rate. In both cases, the auditor will need to perform additional procedures to obtain the desired amount of overall audit assurance.
- 9.73. There may be cases, though, where the audit results are acceptable (the maximum possible amounts or rates are less than materiality or the tolerable rate) but the auditor still does not have the required amount of assurance. This could occur, for example, when:

- 9.73.1. At the planning phase the auditor assessed inherent risk as being low but, during the audit, identified matters that indicated that some of the factors that went into the assessment of the low inherent risk do not hold and inherent risk may be higher than initially assessed. In this situation, the auditor cannot obtain the desired inherent assurance, and more tests of controls or substantive testing is required.
 - 9.73.2. Reliance on internal controls was planned but the tests of controls indicate that the internal controls are not functioning as intended. In this situation, the auditor cannot obtain the desired assurance from his/her tests of controls, and more substantive testing is required.
 - 9.73.3. Assurance from analytical procedures was planned but the auditor was unable to obtain satisfactory explanations for identified variances. In this situation, the auditor cannot obtain the desired assurance from analytical procedures, and more substantive tests of details is required.
- 9.74. It is important that, at the evaluation phase, the auditor considers each intended source of audit assurance to determine if the planned level of assurance was achieved. The auditor should then conclude with respect to the total amount of assurance that has been achieved.

Quality Assurance

- 9.75. To help ensure that the evaluation phase is completed to the required ISSAIs:
- 9.75.1. The evaluation phase needs to be properly supervised.
 - 9.75.2. Staff should feel free to bring the more contentious matters to SAI management's attention before the completion of the work.
 - 9.75.3. The evaluation phase and the findings, conclusions and recommendations should be documented in working papers.
 - 9.75.4. The working papers should be reviewed by SAI management. As part of this review, SAI management needs to ensure that all findings, conclusions and recommendations are fully supported, are not biased, and are drafted using a tone that is consistent with the seriousness of the findings.
 - 9.75.5. As discussed in Chapter 8, at the earliest possible date entity officials should be advised of, and should be asked to review and comment on, individual errors and deviations, their summarisation, and the resulting conclusions and recommendations.
 - 9.75.6. Senior SAI management should sign off on the evaluation, findings, conclusions and recommendations.
- 9.76. In addition, consideration could also be given to using a panel of outside experts to review the findings, conclusions and recommendations. Such a panel could be particularly useful in providing advice as to whether the actual performance should be considered acceptable or not (i.e., whether or not it meets the criterion).

Chapter 10: Reporting

Introduction

- 10.1. Reports are the principal means by which an SAI meets its objective of providing Parliament with independent information, advice and assurance on the use of resources by the audited entity. Reports are also springboards for action.
- 10.2. The main intended reader of an audit report is Parliament and its PAC. Not only is Parliament the body to whom the SAI is mandated to report, but it is also the body that can ensure that action is taken on the SAI's recommendations.
- 10.3. As discussed in previous chapters, though, there are likely other users of the report – the entity responsible for the capital project being audited, the media, the academic community, special interest groups, and the general public.
- 10.4. Not all audit findings, conclusions and recommendations should be included in a report to Parliament – only those matters considered to be the most critical and that are expected to be of interest to the PAC and the other intended users would normally be included in a report. Other matters could be reported in a management letter addressed to entity officials.
- 10.5. Reports should not just expose weaknesses and criticise, but acknowledge achievements and attempt to show the way forward.
- 10.6. In order to be effective, audit reports need to get their essential messages across clearly and simply. When structuring and wording performance audit reports to be submitted to Parliament, the auditor needs to take into account the fact that these reports will be read by individuals who almost certainly do not know, do not wish to know and/or do not have the time to know the details and complexities that may surround the subjects being examined. The reports need to be written in a way that reflects the needs, capabilities and time of those readers.
- 10.7. Much of this chapter deals with performance audit reports submitted to Parliament. It ends with a brief discussion of management letters.

Report Content – General Principles

- 10.8. Auditors need to provide audit reports that are comprehensive, convincing, balanced, timely, and reader friendly. Each is discussed below.

Comprehensive

- 10.9. To be comprehensive, the report needs to include all the information and arguments required to address the audit objective and criteria. There needs to be a sufficient level of detail for the reader to be able to understand the purpose of the audit, the scope of the audit, the nature and extent of the work performed, and the findings, conclusions and recommendations.

Convincing

- 10.10. To be convincing, the report needs to be logically structured. In particular, it needs to present a clear relationship among the audit objective, criteria, findings, conclusions and recommendations.
- 10.11. To be convincing, the report also needs to present the findings persuasively. In doing so, though, the auditor needs to ensure that the report is also accurate. Not including all of the relevant information and/or not including the information accurately in an effort to make the point more persuasively can, if discovered, cast doubt on the validity of the entire report.

Balanced

- 10.12. In addition to being accurate, the report needs to be balanced. This means that the presentation of the report needs to be impartial in content and tone, with evidence presented objectively and in a fair and unbiased manner. Minor deficiencies should not be exaggerated or overemphasised in an effort to stress the importance of implementing the recommendation.
- 10.13. To be balanced, a report also needs to:
 - 10.13.1. Be complete. The auditor needs to include all relevant information and not just information that supports his/her point of view.
 - 10.13.2. Point out areas where the entity has performed well; not just areas where it has done poorly.

Timely

- 10.14. As discussed in previous chapters, audit reports dealing with matters that took place many years ago will often not be of much interest to the PAC, the media or other intended users. They also may not be of much use in helping entity officials to improve their performance. As such, it is normally advisable to select relatively current capital projects, and to ensure that there are not unreasonable delays in completing the audit and issuing the audit report.

Reader Friendly

- 10.15. As noted in 10.6, auditors need to keep in mind that the PAC almost certainly contains members who do not know, do not wish to know and/or do not have the time to know the details and complexities that may surround the subjects being examined. Given this audience, auditors need to ensure that, in general, their reports:
 - 10.15.1. Are as brief as possible;
 - 10.15.2. Use executive summaries and annexes;
 - 10.15.3. Start with the most significant matters;
 - 10.15.4. Highlight the key messages;

- 10.15.5. Use simple, direct and unambiguous language;
 - 10.15.6. Include photos, graphs, charts, etc.;
 - 10.15.7. Use examples;
 - 10.15.8. Are visually appealing; and
 - 10.15.9. Follow a clear and consistent report structure.
- 10.16. Each is discussed below. Further comments on the wording of findings, conclusions and recommendations are presented later in this chapter.

Are as Brief as Possible

- 10.17. While the report needs to be comprehensive and contain sufficient information to be convincing, the SAI needs to keep in mind that readers only have a limited amount of time. Shorter reports have a better chance of getting read than longer reports.
- 10.18. SAIs may place limits on the total length of a report, the number of criteria and findings, and/or or the total number of pages to be allotted to each criterion and finding.
- 10.19. For example, an SAI may specify that, unless prior approval is received from senior SAI management, a report:
- 10.19.1. Deals with no more than five criteria;
 - 10.19.2. Contains no more than two or three findings for each criterion;
 - 10.19.3. Restricts the description of each finding, conclusion and recommendation to no more than two pages; and/or
 - 10.19.4. Is, in total, no more than 20 pages in length.
- 10.20. Further to 10.19.2, an SAI may place more severe restrictions on the number of pages that can be devoted to the less significant matters. That is because readers may assume that the matters given the largest number of pages are the ones that the SAI considers to be the most significant. Ensuring that more pages are devoted to the more significant matters will help the readers to identify the matters that the SAI considers to be the most significant.
- 10.21. The above limitations help to ensure that only the most important findings and recommendations are included in the report, and that the report contains only the information that is essential for the reader to understand the main issues and the more important findings, conclusions and recommendations.

Use Executive Summaries and Annexes

- 10.22. SAIs only have a limited amount of time to grab the readers' attention. Therefore, particularly if the report is lengthy, the auditor could summarise the key findings and recommendations in an executive summary.

- 10.23. Similarly, annexes can be used for information that is required by the ISSAIs but is not essential for the reader to understand the key messages contained in the report.

Start with the Most Significant Matters

- 10.24. Auditors often report matters in the order in which the related transaction or event occurs. For example, when reporting on a capital project, the report may follow the procurement cycle – pre-tendering, tendering, and post-contract award.
- 10.25. The problem with the above approach is that, if a report begins with a relatively insignificant matter, readers may assume that there is very little of interest in the report and stop reading it. Therefore, unless the report is quite short, it is usually beneficial to start with the most significant matters. They have the best chance of grabbing the readers' attention, and encouraging them to read the entire report.

Highlight the Key Messages

- 10.26. Key messages can be highlighted through such means as:
- 10.26.1. Including them near the start of the report. This is discussed above.
 - 10.26.2. Using text in the margins. The key messages could be presented in large font in wide margins.
 - 10.26.3. Including the key messages in the headings and sub-headings, instead of just using the headings and sub-headings to introduce the topic. For example, instead of having a heading that reads "Evaluation of Tenders", the heading could be "Insufficient Explanation Provided for Why Lowest Bidder Not Selected".

Use Simple, Direct and Unambiguous Language

- 10.27. In order to be understood, the report should be written in plain language. Accounting and audit terms should be kept to an absolute minimum, and those used should be defined. (Readers, for example, may not know how much assurance the auditor obtained to provide "reasonable assurance".)
- 10.28. Similarly, it is best to avoid the use of abbreviations and jargon, and use only one term to describe a specific idea or matter.
- 10.29. The report should also be free from vagueness and/or ambiguity. If something has not been done correctly, the auditor should clearly say so, as opposed to use terms such as "it appears that" or "it is possible that".
- 10.30. Also, words such as "large" or "small", "many" or "few" should be avoided if possible – different readers may have different views as to what these words mean.
- 10.31. And finally, the active tense is normally clearer than the passive tense.

- 10.32. Most word processing tools contain readability statistics such as the average length of a sentence, the number of sentences in a paragraph, a “reading ease” score and a “grade level”. An SAI may specify required scores for any of these to improve readability.

Use Photos, Tables, Graphs, Charts, Etc.

- 10.33. It is said that a picture is worth a thousand words. Photos can be an excellent way of clearly showing the reader the issue at hand.
- 10.34. Similarly, tables, graphs, charts, etc. can clearly show trends, and can provide a lot of detailed information in a simple format. The auditor needs to ensure, though, that the table, etc. etc. is simple enough that the message is clearly conveyed.

Use Examples

- 10.35. General statements and overviews may not be easily understood, and may not have a great deal of impact. Providing a specific example will help the reader to better understand the issue at hand, and the significance of that issue.

Are Visually Appealing

- 10.36. Crowded pages containing a lot of words in a small font certainly will not leave a good first impression – the reader may automatically assume that this is a very technical report that will be difficult to understand.
- 10.37. Pages with wide margins (where key messages can be inserted if desired), paragraphs typed in larger fonts and with some line spacing give a “user friendly” appearance and may encourage the reader to read the report.

Follow a Clear and Consistent Report Structure

- 10.38. If all audit reports issued by the SAI have the same “look and feel”, readers will become familiar with the structure and will be better able to locate what they are looking for.
- 10.39. At the same time, though, it is essential that the structure used for a particular audit report fits that audit and the messages that the SAI wishes to deliver. For this reason, the SAI will need some flexibility with the structure for each audit report.
- 10.40. The report structure is discussed further below.

Report Content – Specific Contents

- 10.41. While each SAI employs its own structure, the ISSAIs require reports to contain specific information. The following paragraphs outline the required information and what best international practice would usually contain.

Title

- 10.42. A title will help the reader to distinguish it from statements and information issued by others.

Date of Report

10.43. This is not the date of any cover letter used by the Auditor General/Director of Audit when submitting the report to Parliament. Instead, it is the date on which the audit was completed. As noted in Chapter 8, this is normally the date on which the fieldwork was completed.

Signature

10.44. The report should be signed by the Auditor General/Director of Audit or his/her designate.

Audit Objective

10.45. The audit objective should clearly explain the purpose of the audit (why it was conducted). See Chapter 6 for guidance on wording and Annex A for an example.

Scope of the Audit

10.46. This would include a description of the capital project (or portion thereof) that was the subject of the audit, and the period of time covered by the audit. See Chapter 6 for guidance on wording and Annex A for an example.

Background Material

10.47. This would add to what is included in the scope of the audit. It would include a more detailed description of the entity responsible for the capital project and of the capital project itself. The latter could include the main goals and objectives of the project (why it was being done) and the total expenditures involved.

Criteria Used and Their Sources

10.48. As noted in Chapter 6, these are the standards used to determine whether a programme meets or exceeds expectations. They provide a context for understanding the results of the audit.

10.49. The auditor should include, in the audit report, the sources used to arrive at each criterion. This is most easily accomplished through the use of a table.

10.50. See Chapter 6 for guidance on wording the criteria, and Annex A for an example.

Standards/Methodology Used

10.51. Auditors should clearly indicate the auditing standards used, and should summarise the sources of assurance and/or evidence gathering techniques used to achieve the audit objective. The sources of assurance and evidence gathering techniques would be those noted in Chapter 6 and reflected in the audit programme. They could include, for example, tests of internal control, analytical procedures, discussions with entity officials, and the review of a sample of specified documents and transactions.

10.52. Auditors could also indicate from where they obtained the documents, data and other information used during the audit, and any limitations in that material.

Audit Findings

10.53. The wording of the audit findings is discussed below.

Conclusions Reached

10.54. The wording of conclusions is discussed below.

Recommendations Made

10.55. The wording of recommendations is discussed below.

Management Comments

10.56. Entity officials should be given the opportunity to comment on the report, and their comments on the final report should be contained in the report itself.

10.57. The process that should generally be followed to obtain the comments is discussed below – see “Clearing the Report”.

Possible Audit Report Structures

10.58. Annex C contains possible audit report structures that reflect the above material and the structuring of findings, conclusions and recommendations (discussed in the next section).

The Wording and Structuring of Findings, Conclusions and Recommendations

10.59. Previous sections of this chapter have dealt with the wording and contents of the report. This section provides additional guidance on the wording and structure of findings, conclusions and recommendations to help ensure that the report gets the attention it deserves.

Audit Findings

10.60. As noted in Chapter 9, a finding is the result of the auditor’s comparison of the actual situation to the related criterion. If the auditor finds that the actual result does not meet the criterion used, the auditor has a matter that should potentially be reported to Parliament.

10.61. As also noted in Chapter 9, audit findings should, to the extent possible, be based on hard evidence (i.e., evidence that is supportable, relevant, objective, fair, unbiased and accurate). If this is the case, there should be no room for disagreement with the findings.

10.62. Audit findings should be presented in the report in a fair and balanced manner, using a tone that is consistent with the seriousness of the matter. In addition, if entity officials have already commenced actions to deal with the matter, that fact should be reported.

- 10.63. The audit finding should include:
 - 10.63.1. Sufficient background information for the reader to understand the matter at hand;
 - 10.63.2. The relevant criterion (what the auditor should have seen);
 - 10.63.3. What the auditor actually saw;
 - 10.63.4. The difference between the two (if not obvious). This could be a monetary error, a compliance deviation or a VFM deviation;
 - 10.63.5. The likely cause of the matter; and
 - 10.63.6. The effect of the matter.
- 10.64. If the above is done, it should be relatively easy for the reader to understand how the finding relates to the criterion and, by extension, to the related audit objective.
- 10.65. Normally the audit report would not contain a separate finding for each and every monetary error or deviation. To do so could result in an unnecessarily long report that is so detailed that readers such as the PAC could be lost in the details and could miss the “big picture” – they could incorrectly conclude that the audit report contains only immaterial and inconsequential errors and deviations that are not worthy of the PAC’s attention.
- 10.66. To deal with this, it is best if findings are grouped in some fashion. That way, the audit report will be shorter, the auditor will be able to report larger amounts, and the “big picture” is less likely to get lost in the details.
- 10.67. Consistent with the overall evaluation process described in Chapter 9:
 - 10.67.1. Findings relating to monetary errors could be grouped by cause and/or by component, and then by criterion.
 - 10.67.2. Compliance deviations could be grouped by cause and/or by each authority and then by criterion.
 - 10.67.3. VFM deviations could be grouped by cause and then by criterion.
- 10.68. To illustrate, instead of separately reporting each overpayment to a supplier, all overpayments to suppliers could be grouped into one finding. The auditor could then report the total of the overpayments identified by the audit – a larger amount that should improve the chances of the finding grabbing the attention of the intended readers. Also, if the auditor had not tested payments to all suppliers but had only taken a sample, the auditor could also report the most likely error and the maximum possible error. These amounts would be even larger than the total of the overpayments found.
- 10.69. Similarly, the auditor could report, for each cause or for each authority, the total number of compliance deviations found, and the most likely and maximum possible number of

transactions or the most likely and maximum possible monetary amounts of transactions containing those deviations.

- 10.70. The one possible drawback of grouping findings is that, without a description of the individual errors or deviations, the reader may not be able to fully understand the matter at hand. This drawback can be overcome by providing examples.

Conclusions Reached

- 10.71. As discussed in Chapter 9, conclusions are logical inferences about a matter based on the results of the auditor's work. The strength of the auditor's conclusion depends on the persuasiveness of the evidence supporting the findings and the convincingness of the logic used to formulate the conclusion. If the relationship among criteria, findings (including cause and effect) and conclusions is clear, the conclusions will be hard to refute.
- 10.72. Consistent with the above, the audit report should clearly indicate how the conclusion flows from the audit criterion and from the findings.
- 10.73. The conclusion also needs to be clearly stated – the reader needs to know whether the auditor believes that the value for money achieved was adequate or not.
- 10.74. The conclusions should be clearly highlighted in the report. To help the reader to differentiate the conclusions from the findings, the conclusions could be entitled "conclusion" and phrases such as "in our opinion" or "in conclusion, we believe that" should be used.

Recommendations Made

- 10.75. As noted in Chapter 9, recommendations follow directly from the auditor's conclusions. They are the auditor's proposals to correct errors and deviations that have occurred (by, for example, recovering overpayments from contractors), reduce the number and amount of monetary errors that will occur in the future, improve compliance with authorities, or improve economy, efficiency and effectiveness. Recommendations are designed to prompt corrective action in cases where such action can cost-effectively be taken.
- 10.76. Recommendations should be constructive, action oriented, convincing, well supported and effective. When appropriately implemented, they should get the desired results.
- 10.77. To achieve the desired results, recommendations must be:
- 10.77.1. Constructive.
 - 10.77.2. Positive in tone and content.
 - 10.77.3. Clearly linked to the criteria, findings and conclusions.
 - 10.77.4. Properly directed.
 - 10.77.5. Clearly identified.

10.77.6. Clearly worded.

10.77.7. Specific but not overly prescriptive.

10.77.8. Feasible.

10.78. Each is discussed below.

Constructive

10.79. Constructive recommendations are ones that will assist the entity to make improvements to its operations, as opposed to simply correcting past errors and deviations. To illustrate, rather than simply recommending that past overpayments be recovered, the SAI could also recommend actions that entity officials could take to ensure that overpayments do not occur in the future.

Positive in Tone and Content

10.80. Recommendations that stress the positive improvements that will occur in the future as opposed to dwelling on the problems that occurred in the past are more likely to get action than those that do the reverse.

Clearly Linked to Criteria, Findings and Conclusions

10.81. If a recommendation is clearly linked to the criterion, finding and conclusion, the readers will be better able to understand the need for the recommendation and why the auditor has made the specific recommendation as opposed to another recommendation.

10.82. Some recommendations follow directly from the finding and will not require much discussion or explanation. For example, if the finding is that there were overpayments to contractors and the recommendation is that the entity should recover the overpayments, an explanation for the recommendation is not normally required.

10.83. Recommendations to prevent errors or compliance deviations from occurring in the future, or to improve economy, efficiency and effectiveness, may need some additional wording to show the link among the recommendation and the criterion, finding and conclusion. This additional wording could, for example, help the reader to better understand how the recommendation deals with the cause and effect of the finding.

10.84. Additional wording could also help the readers to understand the benefits that are expected to be achieved as a result of the recommendation. These benefits could be improved operations, the safeguarding of assets, or bringing the situation into compliance with the applicable authorities.

Properly Directed

10.85. Recommendations should be directed to those who have responsibility and authority to act on them, and that person or persons should be clearly identified in the report. Recommendations beginning with "The Government should" are less likely to get action than ones directed at a particular division within a particular ministry.

- 10.86. At times, recommendations may be directed to people who have a number of different roles. If that is the case, the recommendation should state the role that applies.

Clearly Identified

- 10.87. Recommendations should be clearly labeled as such. They should be readily identifiable and stand out in the report; not buried in the middle of other text.

Clearly Worded

- 10.88. Vague language should be avoided. Soft language such as “consideration should be given to”, does not suggest significance or conviction that action is required.

Prescriptive but Not Overly Prescriptive

- 10.89. Recommendations should state what needs to be improved and/or what action needs to be taken. They should be sufficiently detailed that they can be understood and implemented by the entity and followed up by the SAI.
- 10.90. At the same time, though, recommendations should not be too prescriptive. That is because entity officials are the ones who are primarily responsible for improving operations, compliance with authorities, and economy, efficiency and effectiveness. If the recommendation is too prescriptive, the auditor might be perceived as taking on the role of the entity officials.
- 10.91. To obtain the balance called for in the previous paragraphs, auditors should focus more on what should be changed and leave the question of precisely how the change could be made to the entity officials.

Feasible

- 10.92. Recommendations need to take into account legal and practical constraints that would make their implementation impossible or unlikely. Put another way, they need to consider the limitations that entities face. If, for example, a recommendation would require a significant increase in the entity’s appropriation or its approved staffing levels, the auditor should think twice about making the recommendation. The issue, though, could still be discussed in the audit findings.
- 10.93. Recommendations must also be cost-effective – the costs of implementing the recommendation must not outweigh the benefits that could be achieved.

Structuring Findings, Conclusions and Recommendations

- 10.94. To help the readers understand the significance of the findings, conclusions and recommendations, there needs to be a logical flow from the audit objective to the criterion, and then to the findings, conclusions and recommendations.
- 10.95. Each SAI is free to follow its own structure. As long as the presentation of findings, conclusions and recommendations is logical, the conclusions can be tied back to the criterion to which it relates, and the recommendations follow logically from the findings (including the cause), any structure is acceptable.

10.96. If each finding relates to only one criterion and each conclusion and recommendation relate to only one finding, the report can be structured based on each criterion. The structure would then look like this:

- Audit Objective
- Criterion A:
 - Finding A1; Conclusion A1; Recommendation A1;
 - Finding A2; Conclusion A2; Recommendation A2;
 - Etc.;
 - Conclusion with respect to Criterion A.
- Criterion B:
 - Finding B1; Conclusion B1, Recommendation B1;
 - Finding B2; Conclusion B2, Recommendation B2;
 - Etc.;
 - Conclusion with respect to Criterion B.
- Criterion C, etc.:
- Overall Conclusion for Audit Objective.

10.97. This format will result in a very clear link among the audit objective, criteria, findings, conclusions and recommendations.

10.98. As noted in Chapter 6, when setting criteria it is often best to use the basic stages of the procurement cycle, namely the pre-tendering, tendering and post-contract award stages. If this approach is used, each finding will usually relate to only one criterion.

10.99. Sometimes, though, even when this approach is used a finding may relate to more than one criterion. If that is the case, the report could group the relevant criteria together, and then have a section at the end in which the auditor clearly expresses a conclusion on each criterion.

10.100. Similarly, a recommendation may relate to more than one finding. If that is the case, the auditor may wish to group the related findings, conclusions and recommendations together.

Clearing the Report

10.101. Each SAI will have its own procedures for clearing a report through its own office and through entity officials. As a general rule, though, the following steps should be taken:

Clearing Findings with Entity Officials

- 10.102. As noted in Chapters 8 and 9, individual errors and deviations should be discussed with entity officials at the earliest possible date – certainly no later than the exit conference. This process should continue as the errors and deviations are summarised, findings are drafted, conclusions are reached, and recommendations are made. If this approach is followed, the draft report will not contain any “surprises”.
- 10.103. Clearing the findings early will help ensure that all material and relevant facts have been included and that the facts are not in dispute. This, in turn, will help ensure that the presentation of the conclusions and recommendations drawn from the findings are fair, and that the report is balanced in coverage, content and tone.
- 10.104. In rare cases, there may be disagreement with the findings that cannot be resolved. This could occur, for example, when entity officials believe that the methodology used by the auditors was not appropriate, and the results are biased as a result. Where such differences of opinion cannot be satisfactorily resolved, and where the SAI continues to believe that its findings are appropriate and fully supported, the report should contain a discussion of the disagreement. As discussed in Chapter 11, though, except in very rare cases the auditor should not ask the PAC to determine the accuracy of the findings with which the entity disagrees.

Prepare an Initial Draft

- 10.105. This draft would include the more significant findings, conclusions and recommendations. It would then go through the SAI’s internal review process.
- 10.106. The internal review process would include an initial assessment of the overall tone of the report and whether the relatively more significant matters are sufficiently identified.

Obtain Entity Officials’ Comments on the Initial Draft

- 10.107. Assuming that there is no disagreement with the findings, comments by entity officials on the initial draft will usually involve a discussion on the tone and balance of the report and the wording of the conclusions and the recommendations. Entity officials may, for example, agree with the finding, but not consider it to be as serious a matter as the wording of the conclusion may imply. Entity officials may also believe that the recommendation is too severe in relation to the finding, and that the costs of implementing the recommendation would far exceed its benefits.
- 10.108. Ideally the comments should come from the officials who have the authority to implement the recommendation. In some cases, that may mean that the comments need to be provided from officials in a different ministry, or from several ministries. This could be the case, for example, where a central agency needs to be involved in implementing the recommendation.
- 10.109. Some recommendations, such as those requiring changes to legislation, may not be implementable by officials in any ministry – they may need to be implemented by Parliament. In these cases, the comments should come from the most senior officials in the ministry that would be taking the lead in proposing the legislation.

Update the Draft for Comments Received

10.110. The report will then be updated for comments received from entity officials. At this point in time, senior SAI management may also get more involved in improving the wording of the report.

Present the Final Version to Entity Officials for Comment

10.111. The updated version is then presented to entity officials who will prepare their final comments on the report. Those comments are usually included in the report itself.

10.112. Again assuming that there is no disagreement with the findings, the comments at this point in time normally deal with whether management agrees or disagrees with the conclusions reached and the recommendations made. If entity officials disagree with the conclusions and recommendations, they will normally state why. If they agree with the recommendations, they will often promise to implement them, and may provide a timeline for doing so.

10.113. When the SAI receives management's final comments, it should ensure that the comments are:

10.113.1. Factually correct and fair. This means that:

- (a) Entity officials have not attempted to distort the facts as a way of expressing disagreement with the findings, conclusions and recommendations.
- (b) Any reservations or disagreements that entity officials may have with the findings, conclusions and recommendations are potentially justifiable from the entity's perspective.

10.113.2. Complete. This means that they address all aspects of each recommendation made in the report.

10.113.3. Relevant. This means that entity officials have responded to the actual issues raised in the report.

10.113.4. Sufficient. This means that the entity's proposed course of action will solve the problems identified in the report in their entirety, and will lead to the speedy and full implementation of the recommendations.

10.114. If the SAI has any doubts about any of the above, and where further discussions with entity officials do not resolve those doubts, the SAI may wish to add its comments on management's comments.

Delays in Receiving Entity's Comments

10.115. Entity officials should always be given adequate time to provide comments, and the T-minus dates assigned to the audit should reflect that time. Auditors should not reduce the time provided to entity officials to make up for missing their own deadline dates.

- 10.116. The reporting schedule should be discussed with entity officials in advance of the reporting process so they will know when they will be asked to provide comments and how long they will be given to provide those comments. Ideally, the auditor should get entity officials to agree to that schedule.
- 10.117. Even when they are provided with what should be adequate time, entity officials may not provide comments by the requested deadline dates. If entity officials can provide the auditors with a reasonable explanation for missing the requested deadline and if the SAI can provide entity officials with more time without significantly delaying the final report, the SAI should do so.
- 10.118. Audit reports, though, do need to be timely, and the SAI should not wait forever for entity officials to provide their comments. If comments have not been received, the “management comments” section of the report could simply indicate that entity officials had been given the opportunity to provide comments but had not done so. If the reasons why management had not provided comments were known, they could be included in the report.

Referring the Draft Report to Third Parties

- 10.119. The above material has discussed clearing the report with entity officials. There may also be a need to clear the report with third parties, such as contractors or suppliers, mentioned in the report. This would be particularly important if the report makes mention of actions taken by or views held by those individuals or organisations.
- 10.120. Unless the third party is referred to throughout the report, it is normally sufficient to send the third party extracts of the report instead of the entire report. When sending extracts, though, the SAI needs to ensure that sufficient material is sent for the third party to understand the context in which its actions or views are being presented.

Issuing the Report

- 10.121. Auditors should seek to make their reports as widely accessible as possible. This can promote the credibility of the SAI and the audit function, and can encourage parliamentarians to take action on the recommendations contained in the report.
- 10.122. Usually when a report is presented to Parliament, it is a public document. If this is the case, the SAI should be free to distribute the report to the media, put the report on its website, or take other actions to ensure that the report is widely assessable.

Presenting the Report to the Media

- 10.123. Parliamentarians often pay a great deal of attention to what is reported in the media – if the media consider something to be a significant matter and give it wide coverage, Parliamentarians often do the same.
- 10.124. To help ensure that Parliament and the PAC give the report the attention it deserves, and to better ensure that public accountability is achieved, it is good practice to ensure that the media give the report a lot of coverage. At the same time, it is also good

practice to ensure that what is presented by the media is factual, accurate, and does not exceed what is included in the report.

10.125. To help achieve the above, the SAI may use press releases to summarise the reports and their main messages.

10.126. The SAI may also make use of media lock-ups where the media are invited to meet with the Auditor General/Director of Audit and the senior staff who were directly involved in the audit. The media could be provided with copies of the report and could ask questions of the Auditor General/Director of Audit and the senior staff to help them better understand the findings, conclusions and recommendations.

10.127. This lock-up could take place shortly before the report is tabled, which would then allow the media to commence reporting on the audit report immediately after it is tabled.

Management Letters

10.128. As noted at the start of this chapter, not all audit findings, conclusions and recommendations should be included in a report to Parliament – only those matters considered to be the most critical and that are expected to be of interest to the PAC and the general public would normally be included in a report. Other matters could be reported in a management letter addressed to entity officials.

10.129. While not a report to Parliament, management letters are still external reports issued by the SAI and therefore should comply with the ISSAIs.

10.130. The management letter can follow the same format as the report to Parliament, and the same clearance process can be followed. At the same time, though:

10.130.1. The findings do not need to be as completely described. This would be particularly the case if entity officials have access to all the documents that the auditors used to reach their conclusions.

10.130.2. More technical language can be used.

10.130.3. The SAI need not be as concerned about the total length of the document or the number of matters raised – all relevant matters can be included in the report.

Documenting the Reporting Process and Final Report

10.131. The audit files should contain all drafts of the report and notes on all discussions with entity officials. Any comments made in writing by entity officials should be retained.

10.132. During and at the end of the evaluation phase, the SAI would have given the audit files a detailed review to ensure, among other things, that all audit findings were fully supported by the audit evidence. During the reporting process, though, it would be good practice to cross-reference each paragraph of the final report back to the supporting audit working papers. This serves as a final check to ensure that the SAI can support everything in the report. Such a review could also help to ensure that the wording of the

findings, conclusions and recommendations is consistent with the seriousness of the issues under consideration.

Quality Assurance

10.133. To help ensure that the reporting phase is completed to the required ISSAIs:

10.133.1. The draft reports and all changes to those reports should be reviewed by SAI management.

10.133.2. Senior SAI management should have significant involvement in the finalisation of the report. This should include ensuring that the report is not biased and is written using a tone that is consistent with the seriousness of the findings.

10.133.3. Each paragraph in the final report to be referenced back to the supporting audit working papers.

10.133.4. SAI management should review the working papers supporting each paragraph in the final report. As part of this process, they should ensure that all findings, conclusions and recommendations contained in the final report continue to be fully supported.

10.133.5. Consideration could be given to using a panel of outside experts to review the draft report and/or the final report, and to assess the appropriateness of the entity's responses to the recommendations.

Chapter 11: Working with Public Accounts Committees (PACs)

Introduction

- 11.1. Under the Westminster structure, SAIs do not have the right to force an entity to implement a recommendation – they only have the right to recommend. Also, SAIs cannot draft new or amended laws, regulations, rules or policies. Only Parliament can force an entity to do something, and only Parliament can amend legislation.
- 11.2. Members of Parliament should be interested in improving economy, efficiency and effectiveness and public accountability. Consistent with this, an SAI can:
 - 11.2.1. Use its reports to provide independent information, advice and assurance to Parliament on the use of resources in audited entities.
 - 11.2.2. Seek Parliament's support for its recommendations, and thereby encourage entities to improve their operations.
- 11.3. Each SAI may have different arrangements with its Parliament and Public Accounts Committee (PAC), and an SAI may not have a great deal of control over how Parliament and the PAC decide to operate. What follows assumes that an SAI's report is tabled in Parliament, and Parliament then refers the report to the PAC for further consideration.
- 11.4. PAC hearings on performance audit reports normally involve the PAC, the Auditor General/Director of Audit and his/her senior staff, and senior entity officials. The hearing will normally involve a discussion on the report, with the objective of obtaining commitments from entity officials to implement the recommendations contained in the report by a specific deadline date.

Preparing for the Hearing

- 11.5. Hearings are most effective if they are well planned in advance. These advance preparations could involve discussions between the SAI and the PAC and between the SAI and entity officials. They could also involve discussions between the PAC and entity officials.

Advance Preparations – SAI and PAC

- 11.6. Even if the reports are very well written (see Chapter 10), it may still be difficult for PAC members to fully understand the key issues contained in the report, what line of questioning they should take, and what recommendations they should make at the end of the process.
- 11.7. In addition, if reports are only tabled once or twice a year, several performance audit reports may be tabled at the same time, and it may be difficult for PAC members to be able to determine which reports most deserve their attention.

- 11.8. To help deal with the above matters, and for the other reasons noted below, it is normally good practice for the SAI to guide the PAC in advance of the hearing. This process could include the following steps.

Prepare an Initial PAC Brief

- 11.9. Shortly after tabling the report, the SAI could prepare a PAC brief. This document could:
- 11.9.1. Identify the performance audit reports that the Auditor General/Director of Audit considers to be the most important, and describe why each of these reports is considered to be the most important.
 - 11.9.2. Provide a brief summary of each report to help clarify the issues raised in the report.
 - 11.9.3. Suggest lines of questioning that the PAC could follow to be able to issue sound recommendations.
- 11.10. It would be ideal if the Auditor General/Director of Audit could, upon tabling the report and issuing the PAC brief, have an initial meeting with the PAC to help clarify matters further.

Discussions with the PAC in Advance of Hearing on Particular Performance Audit Report

- 11.11. Discussions between the PAC and the SAI in advance of the hearing could be a useful way to help guide the hearing and for the SAI to obtain the desired outcome. Among other things, the SAI could:
- 11.11.1. Answer any questions that the PAC may have about the content of the report.
 - 11.11.2. Suggest questions that the PAC members could ask to solicit the desired responses from entity officials.
 - 11.11.3. Update the PAC on developments that have taken place since the effective date of the report.
 - 11.11.4. Provide its point of view on matters where there is ongoing disagreement between the SAI and entity officials.
- 11.12. Each is discussed below.

Answer Questions PAC May Have

- 11.13. As noted above, even if the report is well written it may still be difficult for the PAC members to fully understand the key issues contained in the report. This would be particularly the case if the report contained matters of such a technical nature that even the simplest of prose could not fully explain the matter or its significance. Face-to-face meetings may be necessary in order to fully explain the matter and its significance to the PAC.

Suggest Questions PAC Could Ask

- 11.14. Even if the report is well written and relatively easy for the PAC members to follow, they may still have difficulty determining the line of questioning they should take and how to phrase questions to entity officials in a way that will elicit a positive response. SAI officials could help the PAC by suggesting suitable questions and wording.

Update PAC on Developments Since Date of Report

- 11.15. Events may have taken place that affect the findings, conclusions and recommendations. Entity officials may, for example, have already taken steps to deal with some or all of the recommendations contained in the report. The SAI could update the PAC on these developments.
- 11.16. Before updating the PAC on new developments, though, it may be advisable to first clear the information with entity officials. Doing so will help ensure that what is being presented is factually accurate and will not be disputed by entity officials. It might also help to ensure that the SAI is not revealing confidential information.

Provide Views on Disagreements

- 11.17. The SAI may be aware of the entity's ongoing disagreement with some of the findings, conclusions and recommendations contained in its report. SAI officials could use this meeting to explain in some detail its views on any findings, conclusions and recommendations with which entity officials disagree.
- 11.18. What SAI officials should *not* do is ask the PAC to conclude on the accuracy of a finding with which the entity disagrees. The PAC will likely not have the technical expertise to do so and, even if it did, would likely not have the time or the willingness to do so. Only in very rare situations, such as when the related recommendation is considered critical to the achievement of the audit objective, should the SAI consider making this request.

Discussions between the SAI and Entity Officials

- 11.19. It is in neither the SAI's nor the entity's interests to have the hearing turn into a shouting match between themselves. To help avoid this, it would be useful for the two parties to know, in advance, the position that each is intending to take on a particular issue. This would be particularly important if there are still disagreements concerning the findings and/or the significance of those findings.
- 11.20. In addition, as noted above the entity may have taken steps between the finalisation of the report and the date of the PAC hearing to implement some or all of the recommendations contained in the report. SAI officials could use these meetings to obtain information on the actions taken to date and, if relatively easy to do, could follow up those actions to ensure that they have, indeed, already taken place. The SAI could also make a preliminary assessment as to the effectiveness of the entity's actions to date, and inform entity officials of its views.

The Hearing Itself

- 11.21. The hearing normally involves each party making opening remarks, and the PAC members then asking questions of the SAI and entity officials.

- 11.22. Entity officials may, at this time, introduce evidence of progress that they have made since the report was tabled, and the PAC may ask SAI officials to comment on that progress.
- 11.23. Entity officials may also express, during the hearing, their disagreement with some of the findings, conclusions and recommendations contained in the report.
- 11.24. It is also possible that PAC members may also express disagreement with some of the findings, conclusions and recommendations. PAC members are parliamentarians and each will have his/her own political agenda. PAC members from the governing party, for example, may feel inclined challenge any finding, conclusion or recommendation that they believe could be seen as a criticism of their performance. Similarly, members from all parties may feel inclined to criticise any recommendation that they believe could be unpopular among the general public.
- 11.25. If PAC members do express these disagreements, SAI officials need to ensure that they do not get drawn into a political debate – they should simply explain the finding and the reasoning behind the conclusion and the recommendation.

PAC Reports

- 11.26. Following the hearing, the PAC may issue a word-for-word transcript of the proceedings to the SAI and to the entity. This is to ensure that the transcript has accurately captured what was said during the hearing.
- 11.27. The SAI could prepare its own debriefing note on the hearing and send it to the PAC. This document could outline the key themes of the hearing and the possible conclusions and recommendations that could be contained in the PAC report.
- 11.28. The PAC will then prepare a report.
- 11.29. It would be ideal if the SAI could be involved in drafting the PAC report. It would also be ideal if a draft copy of the report could be submitted to the SAI and to entity officials for their comments. This would be particularly important if the PAC was intending to issue its own recommendations. (The PAC could, for example, augment an SAI recommendation by adding deadline dates by which specific actions needed to be taken, or it could issue a totally new recommendation.)
- 11.30. The PAC may also instruct the SAI to follow up any actions taken by the entity and to report its findings to the PAC. Follow up is discussed in Chapter 12.

Quality Assurance

- 11.31. Senior SAI management should take part in discussions with PAC staff and should attend PAC hearings.

Chapter 12: Follow-Up

Introduction

- 12.1. The auditor's recommendations are designed to make improvements but it is the actions taken on those recommendations, and not the recommendations themselves, that lead to improvements. Therefore, the auditor needs to ensure that actions are taken.
- 12.2. Entity officials may promise, in their written response to a recommendation contained in an audit report or in a PAC report, to implement the recommendation. Follow-up audits can help ensure that entity officials are not making these promises solely to get the auditors and the PAC off their backs. If entity officials know that the auditors will be able to determine during the follow-up the extent to which entity officials have, indeed, taken the actions that they have promised to take, entity officials may be inclined to provide more honest responses, and to take the actions that they have promised to take.
- 12.3. Many recommendations, though, cannot be implemented immediately; sometimes they can take a few years. This is particularly the case where changes to laws or regulations are required, or where implementing the recommendation will require changes to be made by more than one ministry. As such, it may take several years before the SAI and the PAC can determine if a particular recommendation was implemented.
- 12.4. Given the above, it is good practice for auditors to follow up recommendations a couple of years after the report has been issued and to assess the extent to which entity officials have, indeed, implemented the recommendations that they had agreed to implement. The objectives of this exercise are to:
 - 12.4.1. Identify the extent to which the audited entity has implemented changes in response to the audit findings and recommendations.
 - 12.4.2. Determine the impacts that can be attributed to the audit.
- 12.5. The follow-up can also be used by the SAI as a way to help evaluate its performance, thereby contributing to better knowledge and improved practices in the SAI.
- 12.6. As should be evident from the above, follow-up is more than simply determining whether or not a recommendation has been implemented. The focus of the follow-up should be on determining whether or not the audited entity has adequately addressed the problems and remedied the underlying conditions.

The Follow-Up Phase

- 12.7. Follow-up should include the following basic elements:
 - 12.7.1. It should be rooted in policy. The SAI could, for example, have a policy of following up all recommendations two years after the report has been issued.

- 12.7.2. The scope of the audit should be restricted to following up the recommendations contained in the original audit report and any related PAC reports, and perhaps assessing the overall effectiveness of the initial audit. Auditors should not expand the scope to look at areas not examined during the original audit or to consider issues that were not considered during the initial audit. Additional areas or issues should be the subject of a new audit.
- 12.7.3. The audit should follow the same basic approach as the initial audit – general planning, detailed planning, fieldwork, evaluation and reporting, and all the related auditing standards should be complied with. Similarly, the guidance provided in Chapters 6 to 11 should be followed. In this regard, as this is a follow-up:
- (a) Unless there are compelling reasons to the contrary, all planning parameters (materiality, criteria, risk, etc.) should remain the same; and
 - (b) The audit programme should only contain the procedures that are necessary to follow up of the recommendations and to assess the extent to which the underlying conditions have been remedied.
- 12.7.4. The auditors should follow up all recommendations to determine if they were fully implemented, partially implemented, or not implemented. The criteria to be used to assess “fully”, “partially” or “not” should be clearly laid out.
- 12.7.5. The follow-up phase should result in the auditor being able to identify:
- (a) The extent to which each recommendation has been implemented and, if known, the reason(s) why a particular recommendation has not been fully implemented.
 - (b) For those recommendations that have been fully implemented, the extent to which this has remedied the underlying conditions (i.e., the impact that this has had on the entity’s performance).
 - (c) For at least the more important/critical recommendations that have not been fully implemented, the potential impact on economy, efficiency and effectiveness, compliance with authorities, etc.
- 12.8. Ideally the follow-up audit should be conducted by the staff who were responsible for the initial audit. This will help ensure that those conducting the follow-up audit are fully familiar with the findings that led to the recommendations.

Determining the Adequacy of Actions Taken

- 12.9. As noted above, the auditors need to determine if each recommendation was fully implemented, partially implemented, or not implemented. This involves identifying what each recommendation was expected to accomplish, including an estimate of potential monetary benefits. The auditor would then assess the extent to which the desired objective/monetary benefit was achieved.

- 12.10. When assessing whether a recommendation was fully, partially or not implemented, it is important for the auditor to remember that the basic responsibility for taking action on audit recommendations rests with entity officials. Entity officials may have used a somewhat different approach to implement the recommendation. If the somewhat different approach resulted in the objective behind the recommendation being met, the auditor should consider the recommendation implemented.
- 12.11. Auditors also need to remember that recommendations may become redundant over time. The entity's organisation may have changed, as may the environment in which it operates. The auditor should consider whether these changes have eliminated the need for the recommendation.
- 12.12. Except for relatively minor recommendations, auditors should not accept, at face value, a statement by entity officials that certain actions had been taken and that those actions have corrected the problems to which the recommendation was directed. Normally auditors would perform additional procedures, such as verifying the receipt of monies owing and/or verifying that changes to policies and procedures had taken place.
- 12.13. In some cases, it will be very easy to assess the extent to which the recommendation was implemented. For example, if the recommendation called for the entity to recover excess amounts paid to a contractor, the follow-up would simply involve determining if the amount had been recovered.
- 12.14. In other cases, more work could be required. For example, if the recommendation involved changes to internal control or oversight procedures to ensure that a particular matter did not recur, the follow-up would require determining if the changes had been implemented. As a minimum, this would involve looking at policy documents, procedures manuals, etc. For the more significant recommendations, it could also involve ensuring that the change was actually taking place in practice.
- 12.15. To illustrate, let's assume that the auditor recommended that entity officials visit construction sites at least once a month to ensure that the work was progressing as per the agreed upon schedule and that what was being invoiced had actually been done. As a minimum, the auditor would check to ensure that the entity had updated its policies and procedures to require these visits. The auditor could, though, also select one or two ongoing projects and see if these visits were taking place in practice.
- 12.16. As noted above, recommendations may take several years to implement. During the follow-up, entity officials may claim that a particular recommendation could not possibly have been implemented in the time period since the report was issued, and that they are still working on implementing the recommendation.
- 12.17. If the entity had provided a timeline and/or implementation date in its response to the recommendation, the auditor could compare the progress to date to what had been outlined in the entity's response to the recommendation. If the entity had not provided a timeline for doing so, the auditor would need to compare the progress to date to what could be considered reasonable. If virtually nothing had been done during the intervening period beyond, say, establishing a committee to investigate the matter, the auditor should seriously question the entity's commitment to implementing the recommendation.

The Follow-Up Report

- 12.18. The follow-up report should normally follow the same clearance process as any other performance audit report, and should ultimately be presented to Parliament and to the PAC.
- 12.19. The follow-up report should follow the same basic structure as any other performance audit report. In doing so it should include all of the material contained in Chapter 10, and should follow the same basic structure.
- 12.20. Each finding in a follow-up report would normally contain:
 - 12.20.1. The finding from the original report and the recommendation that was made as a result.
 - 12.20.2. The actions taken by entity officials to implement the recommendation and a comparison of those actions to the required actions.
- 12.21. In rare cases, the finding could also be that the original recommendation was no longer applicable, and the reasons why.
- 12.22. The conclusion would then normally be:
 - 12.22.1. The extent to which the recommendation had been implemented (i.e., the extent to which the underlying condition had been remedied).
 - 12.22.2. For implemented recommendations, an estimate of the impact that the actions taken by entity officials has had on the entity's performance (i.e., on economy, efficiency and effectiveness, compliance with authorities, etc.). To the extent possible, the impact should be quantified.
 - 12.22.3. For recommendations that have not been fully implemented, an estimate of the impact that the actions taken to date by entity officials have had on the entity's performance, and an estimate of the potential additional benefits that could have been derived from fully implementing the recommendation.
- 12.23. For recommendations that had not been fully implemented, there would normally be a recommendation that entity officials fully implement the original recommendation.
- 12.24. As this is a follow-up, auditors normally do not make new recommendations. In some cases, though, changed circumstances may mean that an outstanding recommendation is no longer precisely what is required. In these cases, the auditor could insert an amended recommendation in place of the original one.
- 12.25. As with the original report, entity officials should be provided with the opportunity to respond to each recommendation and their comments should be included in the report.
- 12.26. As with responses to the initial recommendations, the auditor should ensure that the management responses are factually correct, fair, complete, relevant and sufficient.

Assessing Accomplishments

- 12.27. The SAI may wish to include, in its follow-up report, an assessment with respect to the impact that the audit has had on public accountability (including compliance with authorities) and on the economy, efficiency and effectiveness of government operations.
- 12.28. Accomplishment reporting involves more than a “numbers game” of scoring the number of recommendations that have been fully implemented, etc. It also involves assessing whether the initial objectives behind the recommendation were achieved. It therefore involves answering such questions as:
- 12.28.1. Is the entity now more efficient and effective as a result of the audit and, if so, by how much?
- 12.28.2. How much money has been saved as a result of the audit?
- 12.28.3. Have there been improvements to compliance with authorities, internal controls and/or the prevention or detection of fraud?
- 12.29. In doing so, of course, the SAI must be careful not to attempt to take credit for savings or improvements that may not be directly attributable to the audit.

Following Up the Follow Up

- 12.30. As noted above, some recommendations, such as those involving changes to laws and regulations, may take many years, and may therefore legitimately not be implemented at the time of the follow-up. Should auditors continue to follow up all recommendations until they are fully implemented?
- 12.31. If entity officials know that auditors will only follow up a recommendation once, say, they may be less inclined to implement recommendations with which they do not fully agree. Knowing that the SAI will continue to follow up the matter could provide entity officials with an additional incentive to implement the recommendation.
- 12.32. On the other hand, endlessly following up a recommendation even after it is clear that entity officials have no intention of implementing it may not be the best use of an SAI's limited resources.
- 12.33. While this a matter of SAI policy, as a general rule the following should be considered:
- 12.33.1. The expected motives of entity officials – as above, are they hoping that the SAI will not continue to follow up the recommendation?
- 12.33.2. The significance of the recommendation.
- 12.33.3. The time period that is apparently now required to implement the recommendation compared to what was estimated at the time of the initial audit. As above, sometimes entity officials claim that more time is required as a way of avoiding taking any action at all.

12.33.4. The progress achieved to date. If there has been much less progress than originally envisaged or would appear reasonable under the circumstances, this could be a clear indication that entity officials really are not taking the recommendation seriously or are not intending to implement it at all.

12.33.5. The desires of the PAC. The PAC may request the SAI to continue to follow up some or all of the outstanding recommendations.

Quality Assurance

12.34. The quality assurance procedures noted in each of Chapters 6 through 11 would apply to each phase of the follow-up audit.

Chapter 13: Quality Assurance

Introduction

- 13.1. Each of Chapters 5 to 12 contains procedures designed to ensure quality at that phase. This chapter summarises those procedures and then provides some further ways in which quality can be ensured.

Quality Assurance at Each Phase of the Audit Process

- 13.2. The last section in each of Chapters 5 to 12 contains procedures designed to ensure quality at that phase. These are repeated in the following paragraphs.
- 13.3. Chapter 5 (Strategic Planning – Selecting Capital Projects to Audit) calls for:
- 13.3.1. Liaising with entity officials to obtain their views with respect to the factors taken into consideration when selecting the capital project to audit.
 - 13.3.2. The work to be properly supervised.
 - 13.3.3. All of the capital projects being considered, the factors relating to each project and the basis for the final selection to be documented.
 - 13.3.4. The working papers to be reviewed by SAI management.
 - 13.3.5. The final decision(s) concerning the specific capital project(s) to audit should be approved by senior SAI management.
 - 13.3.6. Consideration to be given to using a panel of outside experts to help assure quality.
- 13.4. Chapter 6 (General Audit Planning) calls for:
- 13.4.1. Liaising with entity officials when setting the audit objective(s), scope of the audit, criteria, and other key planning parameters.
 - 13.4.2. Consideration to be given to using a panel of outside experts to assist in the determination of the criteria and to review the audit plan.
 - 13.4.3. The work to be properly supervised.
 - 13.4.4. All key planning decisions to be documented.
 - 13.4.5. The audit files and working papers to be reviewed by SAI management.
 - 13.4.6. The main study proposal (planning memorandum) to be approved by senior SAI management.

- 13.5. Chapter 7 (Detailed Audit Planning) calls for:
 - 13.5.1. The work to be properly supervised.
 - 13.5.2. The audit programme, budget, staffing and staff scheduling to be documented.
 - 13.5.3. The above documents be reviewed and approved by senior SAI management.
- 13.6. Chapter 8 (Fieldwork) calls for:
 - 13.6.1. The work to be properly supervised and the progress monitored.
 - 13.6.2. All audit work to be documented in working papers.
 - 13.6.3. The working papers to be reviewed by SAI management.
 - 13.6.4. Entity officials should be advised of all individual errors and deviations at the earliest possible date, and should be asked to review and comment on those errors and deviations. This process should continue as the errors and deviations are summarised, findings are drafted, conclusions are reached, and recommendations are made.
- 13.7. Chapter 9 (Evaluating Results – Findings, Conclusions and Recommendations) calls for:
 - 13.7.1. The evaluation phase to be properly supervised.
 - 13.7.2. Staff to feel free to bring the more contentious matters to SAI management's attention before the completion of the work.
 - 13.7.3. The evaluation phase and the findings, conclusions and recommendations to be documented in working papers.
 - 13.7.4. The working papers to be reviewed by SAI management to, among things, ensure that all findings, conclusions and recommendations are fully supported, are not biased, and are drafted using a tone that is consistent with the seriousness of the findings.
 - 13.7.5. As discussed in Chapter 8, at the earliest possible moment entity officials should be advised of, and should be asked to review and comment on, individual errors and deviations, their summarisation, and the resulting conclusions and recommendations.
 - 13.7.6. Senior SAI management to sign off on the evaluation, findings, conclusions and recommendations.
 - 13.7.7. Consideration to be given to using a panel of outside experts to review the findings, conclusions and recommendations.
- 13.8. Chapter 10 (Reporting) calls for:
 - 13.8.1. The draft reports and all changes to those reports to be reviewed by SAI management.

- 13.8.2. Senior SAI management to have significant involvement in the finalisation of the report, including ensuring that the report is not biased and is written using a tone that is consistent with the seriousness of the findings.
 - 13.8.3. Each paragraph in the final report to be referenced back to the supporting working papers.
 - 13.8.4. SAI management to review the working papers supporting each paragraph in the final report. As part of this process, they should ensure that all findings, conclusions and recommendations contained in the final report continue to be fully supported.
 - 13.8.5. Consideration to be given to using a panel of outside experts to review the draft report and/or the final report, and to assess the appropriateness of the entity's responses to the recommendations.
- 13.9. Chapter 11 (Working with Public Accounts Committees (PACs)) calls for senior SAI management to take part in discussions with PAC staff and to attend PAC hearings.
- 13.10. Chapter 12 (Follow-Up) calls for the quality assurance procedures noted in the earlier chapters to be applied to each phase of the follow-up audit.

General Quality Assurance Procedures for All Phases of the Audit Process

- 13.11. In addition to the quality assurance procedures summarised above, the SAI should have general policies and procedures to ensure that the audit work is carried out in accordance with the ISSAIs and established internal standards and procedures.
- 13.12. For example, SAIs normally have procedures in place to ensure that:
- 13.12.1. All personnel adhere to the principles of independence, integrity, objectivity, confidentiality and professional requirements.
 - 13.12.2. Audits are staffed by personnel who have attained and maintain the technical standard and professional competence required to enable them to fulfill their responsibilities. These procedures could include hiring standards and standards for ongoing professional development.
 - 13.12.3. Audit work is assigned to personnel who have the required technical training and proficiency.
 - 13.12.4. Whenever necessary, experts within or outside the SAI are used to ensure that, overall, the audit team has the required expertise to perform the audit.
 - 13.12.5. There is ongoing monitoring to ensure the continued adequacy and operational effectiveness of quality control policies and procedures.

Post-Audit Quality Assurance

- 13.13. This can involve audit team post-audit self-reviews, post-audit quality reviews by other SAI staff, and peer reviews by other SAIs. Each is discussed in turn.

Audit Team Post-Audit Self-Reviews

- 13.14. At the end of the audit (including at the end of a follow-up audit), the audit team should conduct a self-review of the audit. Such a review could look at what went well, what went less well, and how things could be improved in future for each phase of the audit process.
- 13.15. To assist in this process, the audit team could obtain feedback from entity officials. This would not only include the entity officials' assessment as to the extent to which they were kept informed about the audit, but also the usefulness of the audit report with respect to improving their operations.

Post-Audit Quality Reviews

- 13.16. Further to 13.12.5, it is often desirable that suitably qualified SAI staff not involved in a particular audit conduct an in-depth review of that audit.
- 13.17. These reviews are usually performed by quality assurance units who conduct these reviews on numerous audits.
- 13.18. These reviews could be limited to the matters contained in the audit report, or could deal with the entire audit process.
- 13.19. The outcome of these internal quality assurance reviews should be reported to senior SAI management.

Peer Reviews

- 13.20. The internal reviews could be augmented by peer reviews conducted by other SAIs.
- 13.21. To assist in the peer review process, the INTOSAI Development Initiative has developed a Performance Measurement Framework. The framework contains seven "domains" that can be included in the scope of the peer review. The review can cover all or some of them.

Quality Assurance

- 13.22. Like every other phase of an audit, the SAI should ensure that any work performed is properly supervised, documented and reviewed.

