

The Accountable Entities Guidelines for Contracted Financial Audits

Department of Administration and Finance, Policy Owner

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ACRONYMS

Acronym	Definition
AC	Access Controls
AEAP	Accountable Entity Audit Program
AICPA	American Institute of Certified Public Accountants
CAP	Corrective Action Plan
CDF	Contractor's Determined Format
CEO	Chief Executive Officer
CFR	Code of Federal Regulations
CIF	Compact Implementation Funding
CPE	Continuing Professional Education
DC	District of Columbia
FAP	Fiscal Accountability Plan
FAM	Financial Audit Manual
FAS	Financial Accounting Standard
FASAB	Federal Accounting Standards Advisory Board
FASB	Financial Accounting Standards Board
FISCAM	Federal Information System Controls Audit Manual
FISMA	Federal Information Security Management Act
FY	Fiscal Year
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAGAS	Generally Accepted Government Auditing Standards
GAO	Government Accountability Office
GAS	Government Auditing Standards
GASB	Government Accounting Standards Board
HCM	Human Capital Management
HR	Human Resources
IAASB	The International Auditing and Assurance Standards Board
IAS	International Accounting Standards
ICOFR	Internal Controls Over Financial Reporting
IFAC	International Federation of Accountants
IFRS	International Financial Reporting Standards
IPA	Independent Public Accounting
IS	Information System
ISA	International Standards on Auditing
IT	Information Technology
MCC	Millennium Challenge Corporation
NIST	National Institute of Standards and Technology
OIG	Office of Inspector General

Acronym	Definition
OMB	Office of Management and Budget
PFS	Program Financial Services
POM	Procurement Operations Manual
PPG	Program Procurement Guidelines
QA	Quality Assurance
QC	Quality Control
QCR	Quality Control Review
SAI	Supreme Audit Institution
SAS	Statement on Auditing Systems
SOW	Statement of Work
SP	Special Publication
SSAE	Statements on Standards for Attestation Engagements
SSARS	Statements on Standards for Accounting and Review Services
TO	Task Order
Treasury	United States Department of the Treasury
U.S.C.	United States Code
USAID	U.S. Agency for International Development
VAT	Value-Added Taxes

CHAPTER 1. PURPOSE OF AUDIT GUIDELINES

PURPOSE

1.1 This policy establishes the audit guidelines for independent audit firms in performing contracted financial audits and review engagements for Accountable Entities¹, as required by Millennium Challenge Corporation (MCC) agreements² with Recipient Country Governments³. This policy also provides guidance to the Accountable Entities and Covered Providers (as defined below in section 1.6) in understanding the audit process and in selecting independent audit firms to perform the audits and/or review engagements.

SCOPE

1.2 *The Accountable Entities Guidelines for Contracted Financial Audits (Guidelines)* applies to Accountable Entities, Covered Providers, contracted independent audit firms, MCC's administration and operations, employees, and contractors (including personal services contractors) of MCC, whether performing work in Washington, D.C. or abroad, associated with financial audits and review engagements of the Accountable Entities.

AUTHORITIES

1.3 The authorities for this policy include, but are not limited to:

- a) Millennium Challenge Act of 2003, as amended (22 United States Code [U.S.C.] §7701 et seq.) (“the Act”).
- b) Code of Federal Regulations (CFR) Title 2, *Grants and Agreements*, Chapter II, Part 200, “Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Subpart F-Audit Requirements.”

BACKGROUND

1.4 MCC was established by the Act to administer the Millennium Challenge Account. MCC grants funds appropriated to the Millennium Challenge Account to nations that govern justly, invest in their people, and encourage economic freedom in order to support agreed economic growth projects in those countries. MCC is a United States Government corporation that supports innovative strategies and ensures accountability for measurable results. MCC makes use of its flexible authorities to optimize efficiency in contracting, program implementation, and personnel. MCC's management unit is supervised by a Board of Directors composed of the Secretaries of the United States Department of State (State) and the United States Department of the Treasury (Treasury), the United States Trade Representative, the Administrator of the United States Agency for International Development (USAID), the Chief Executive

¹ “Accountable Entities” are those entities designated by the Recipient Country Government and approved by MCC to carry out the Recipient Country Government responsibilities and obligations to the MCC Grant. For purposes of a grant made under authority Section 609(g) or 616(a) of the Act, the Accountable Entity may be a team of individuals designated by the Recipient Country Government. The Accountable Entity also manages and oversees all aspects of compact and threshold program implementation.

² “MCC agreements” are defined as MCC-funded grants and implementing agreements.

³ “Recipient Country Governments” are governments of those countries with which MCC has entered into MCC agreements.

Officer (CEO) of the MCC, and four private sector members appointed by the President with the advice and consent of the Senate. By law, the Secretary of State is the Chair of the Board.

1.5 MCC consists of a central headquarters staff in Washington, D.C. and limited staff in countries where its programs are operational and/or in development. Pursuant to Section 605 of the Act, MCC may provide assistance to eligible entities⁴ for each country that enters into a Millennium Challenge Compact.

1.6 A Covered Provider is an entity to which the Accountable Entity has disbursed \$750,000 or more of MCC funding⁵ within a single fiscal year⁶ as part of one or more binding agreements that meet both of the following criteria:

- The agreement is other than a fixed price contract for which the value has been determined through a procurement or other competitive selection process
- The agreement requires the entity to manage funding directly⁷ on behalf of the Accountable Entity.

In addition, Implementing Entities⁸ that directly manage more than \$750,000 of MCC funding, disbursed to them within a single FY, are considered to be Covered Providers.

1.7 The Accountable Entity will perform all the needed contracting actions necessary to engage an independent audit firm to perform the required audits of both the Accountable Entity's program and those of any Covered Providers. Funding for audits of the Accountable Entity's program are funded from Compact or Threshold Program funds.

1.8 The cost of an audit of a Covered Provider may be incurred by the Covered Provider and reported as any normal expense incurred during the project. If a Covered Provider is subject to audit, this requirement should be included in bidding documents and any contracts or agreements.

1.9 In the event that more than one country provides funds to a Covered Provider, the country that provides the greatest amount of funds will act as the designated lead among the countries in assuring appropriate audits are conducted of the Covered Provider, unless otherwise directed by MCC.

1.10 MCC Compacts or Threshold Program agreements with the recipient country require the Accountable Entity to contract with independent auditors that are acceptable to MCC to perform financial audits of the funds provided under the agreements at least annually, unless otherwise specified by MCC. Any Implementing Entity agreements between an Accountable Entity and other agencies of the Recipient Country Government may require application of these Guidelines, and may result in the requirement for the Implementing Entity to contract independent auditors that are acceptable to MCC to perform financial audits of the funds provided under the agreements.

⁴ "Eligible entities" are defined in Section 605(c) of the Act as: the national Government of the eligible country; regional or local Governmental units of the country; or a nongovernmental organization or a private entity.

⁵ "MCC funding" is funding provided to Recipient Country Governments under MCC agreements.

⁶ The relevant fiscal year is the fiscal year adopted by the Accountable Entity and/or the Recipient Country Government.

⁷ This includes the determination and documentation of costs incurred as would be required under a cost reimbursement contract.

⁸ "Implementing Entities" are defined as one or more entities of the Recipient Country Government engaged by that government to implement and carry out any Project or Activity (or a component thereof) under an MCC agreement.

CRITERIA

1.11 MCC is required to follow the Code of Federal Regulations (CFR) Title 2, Grants and Agreements, Chapter II, Part 200 - Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards, Subpart F- Audit Requirements⁹. CFR Title 2 Part 200 (2 CFR 200) Subpart F sets forth standards for obtaining consistency and uniformity among Federal agencies for the audit of non-Federal entities expending Federal awards. To meet the requirements of the 2 CFR 200 Subpart F, MCC created the Accountable Entity Audit Program to monitor the contracted financial audits. These Guidelines are issued by MCC and supersede the previous Office of Inspector General's (OIG) Guidelines for Financial Audits Contracted by Foreign Recipients. These Guidelines focus primarily on contracted financial audits and other audit engagements, and may be revised as needed.

APPLICABILITY

1.12 In accordance with 2 Code of Federal Regulations (CFR) 200¹⁰, MCC agreements with foreign Governments and foreign organizations require that a financial audit must be performed annually when the recipient expends \$750,000 or more in MCC funding in its FY. In addition to these annual audit requirements, a close-out audit must be performed for each award in excess of \$750,000 expended during the life of the project, in accordance with these Guidelines. At its own discretion, MCC may require audits more frequently than annually to mitigate risk or prevent fraud, waste, and abuse. If the Accountable Entity expends less than \$750,000 during a reporting period, the audit may be delayed until the subsequent period. The cumulative costs will be audited during the subsequent reporting period.

1.13 MCC compacts and threshold program agreements also require that an audit contracted by the Accountable Entity be performed at least annually in accordance with these *Guidelines* when a Covered Provider expends \$750,000 or more in MCC funding in its FY as part of an Implementing Entity agreement or contract. The determination of when an award is expended must be based on when the activity related to the award occurs. Even when an audit is not required under the *Guidelines*, if MCC or the Accountable Entity determines that an audit should be performed, the contract, scope of the audit, and the draft audit report must be submitted to the Accountable Entity for review and issuance.

1.14 In addition, agreements for cash transfers and sector assistance may include contracted financial audit requirements. Such audits must be performed in accordance with these *Guidelines* to the extent that the *Guidelines* do not conflict with agreement provisions. If such a conflict presents itself, MCC and the Accountable Entity must come to a mutual agreement regarding how such audits will be performed. Endowment or trust funds created out of MCC awards, fixed-price contracts, and fixed-obligation grants do not require audits under these *Guidelines*, but may be undertaken at the request of the Accountable Entity or of MCC.

⁹ Single Audit Requirements and Audit Follow-up. Uniform Guidance Subpart F—Audit Requirements is issued pursuant to the Single Audit Act Amendments of 1996, (31 U.S.C. 7501–7507).

¹⁰ MCC awards include grant agreements. 2 CFR 200.101 (b)(1) Applicability to different types of Federal awards.

ROLES AND RESPONSIBILITIES

Roles and Responsibilities of MCC

1.15 In July 2017, the USAID OIG notified MCC that it would no longer perform certain functions related to the financial audits of Accountable Entities that it had performed previously, as a result of a peer review that identified independence issues in the audit program and program management functions that should appropriately be performed by MCC. On May 1, 2018, the OIG decided to no longer provide technical guidance to Independent Public Accountants (IPAs), approve IPA deliverables for payment, review work and audit programs not already in the OIG’s possession as of April 5, 2018, or review any draft reports received on or after May 1, 2018. As a result, MCC assumed the former OIG responsibilities to perform the monitoring functions of the Accountable Entity Audit Program.

1.16 MCC’s Accountable Entity Audit Program responsibilities are to: 1) monitor and ensure that the required contracted financial audits of the Accountable Entity and all Covered Providers expending more than \$750,000 in their FYs are performed in a timely manner; 2) issue and revise guidance to the Accountable Entity regarding the scope of external financial audits performed by local IPA firms; 3) establish and maintain an approved list of IPA firms; 4) perform desk reviews of the planning documents and the draft and final audit reports to ensure the audits are compliant with 2 CFR 200 Subpart F, these *Guidelines*, and Generally Accepted Government Auditing Standards (GAGAS); 5) provide “No Objections” to the Accountable Entity for payment of IPA deliverables; and 6) ensure proper actions are taken by the Accountable Entity to correct deficiencies identified by the IPAs.

1.17 MCC is responsible for ensuring that audit contract agreements between the Accountable Entity and its independent auditors contain a standard Statement of Work (SOW) that includes all the requirements of these *Guidelines*. MCC is also responsible for overseeing the resolution of an Accountable Entity’s or Covered Provider’s organization-wide internal control and compliance deficiencies.

MCC HOTLINE

All MCC and Accountable Entity staff, and all others working with MCC funding, are required to promptly report suspected incidents of fraudulent or corrupt practices through one of the following methods:

Email to hotline@mcc.gov or mcchotline@usaid.gov;

Filling out web form on the website of the Office of the Inspector General responsible for MCC (<https://oig.usaid.gov/content/mcc-hotline-report-fraud-or-corruption>);

Telephoning the OIG at 1-800-230-6539 or 202-712-1023;

Contacting a member of MCC’s AFC Team.

Roles and Responsibilities of the OIG

1.18 The OIG provides oversight services for MCC and monitors reports related to contracted financial audits of Accountable Entities and Covered Providers that meet the \$750,000 audit threshold, in order to ensure compliance with GAGAS. The OIG maintains a Hotline to facilitate the reporting of allegations of fraud, waste, abuse, and mismanagement within MCC funds, programs, and operations.

OIG HOTLINE

An OIG Hotline exists to receive complaints of fraud, waste, or abuse within MCC programs and operations, including mismanagement or violations of law, rules, or regulations by MCC employees or program participants. Complaints may be received directly from MCC employees, participants in MCC programs, or the general public. The Inspector General Act¹ and other pertinent laws provide for the protection of persons making Hotline complaints. There are three options to submit complaint(s) via Internet e-mail, telephone, or U.S. mail. However, if the complainant elects to submit the complaint(s) via Internet e-mail, the complainant must waive confidentiality due to the non-secure nature of Internet e-mail systems.

Contact Information:

- Telephone #: (1-800) 230-6539 (inside the U.S.) or (202) 712-1023
- E-mail Address: ig.hotline@usaid.gov
- Mailing address:
USAID OIG HOTLINE
P.O. Box 657
Washington, D.C. 20044-0657

¹ Inspector General Act of 1978, as amended.

Authorities and Responsibilities of the Recipient Country Government

1.19 A Compact or Threshold Program Recipient Country Government is responsible for assigning or delegating responsibilities to an Accountable Entity. The Recipient Country Government has primary responsibility for oversight and management of the implementation of the program 1) in accordance with terms and conditions specified in the Compact or Threshold Agreement, and relevant Supplemental Agreements, 2) in accordance with all applicable country laws, and 3) in at least a timely and cost-effective manner and in conformity with sound technical, financial, and management practices.

Authorities and Responsibilities of the Accountable Entity

1.20 The Accountable Entity is an entity designated to exercise Government responsibilities under the Compact or Threshold Program. The Recipient Country Government delegates authority to the Accountable Entity to enter into contracts and manage the day-to-day compact or threshold program implementation. The Fiscal and Procurement Agents are agents of the Accountable Entity and fulfill certain fiduciary duties in accordance with the Compact or Threshold Program. The Accountable Entity also procures

an independent auditor to provide a periodic audit of its books and records. The Fiscal Agent may be a Finance Ministry, an accounting firm, financial service provider, or a project manager and has responsibility for funds control, disbursements, cash management, and compliance with relevant provisions of the Compact or Threshold Program.

1.21 The Accountable Entity will maintain an inventory of all of its awarded contracts, grants, and agreements, identifying those that may require a contracted audit. Generally, those awarded for amounts greater than \$750,000 for periods of one year or less for something other than the provision of goods or services on other than a fixed-price basis will require a contracted audit. This inventory will be provided annually to MCC.

1.22 The Accountable Entity ensures that the required audits are performed for its programs and that all audit agreements for audits of the Accountable Entity and the Covered Providers and their independent auditors include the standard SOW that is contained in these *Guidelines*. Accordingly, prior to finalization, the Accountable Entity must send all prospective audit contracts to MCC for approval prior to finalization for itself and each of its Covered Providers subject to audit, expending \$750,000 or more in its FY. One annual audit must cover all Accountable Entity funding to a Covered Provider subject to audit.

1.23 Covered Providers that have contracts or agreements with more than one recipient country must send their audit contracts for approval to the designated lead Accountable Entity with which they have an agreement. The Accountable Entity that provides the greatest amount of funds will act as the designated lead, unless otherwise directed by MCC. This Accountable Entity will perform all the needed contracting actions necessary to engage an independent audit firm to perform the required audits of the Covered Providers, subject to audit.

1.24 The designated lead Accountable Entity will coordinate the audit efforts with any other accountable entities that have agreements with the Covered Provider. The Accountable Entity will provide the independent auditors with any information required in the conduct of the audits.

AUDIT COSTS AND SANCTIONS

1.25 Accountable Entities and Covered Providers subjected to audit may use MCC funding for performing the specific audit of their MCC-funded programs. However, no audit costs may be charged under an MCC agreement if audits are not performed in accordance with these *Guidelines*. It is incumbent upon the independent auditor to produce a final product that meets this requirement.

1.26 MCC will consider appropriate sanctions against an Accountable Entity in the event of continued inability or unwillingness to have an audit performed in accordance with these *Guidelines*. Sanctions could include suspension of disbursements to the Accountable Entity until a satisfactory audit is performed. Auditors submitting unacceptable work may be noted and excluded from MCC's list of IPA firms approved for performing audits under the contracted financial audit program. Similar actions may be taken against audit firms that do not provide timely responses to MCC's requests.

COMPLIANCE WITH AUDITING STANDARDS

1.27 All contracted financial audits must be conducted in accordance with U.S. GAGAS ("Yellow Book") (hereafter referred to as *Government Auditing Standards*) issued by the Comptroller General of the Unit-

ed States and Generally Accepted Auditing Standards (GAAS) adopted by the American Institute of Certified Public Accountants (AICPA), which have been incorporated into *Government Auditing Standards* by reference. If the contracted IPAs desire technical assistance related to these audits, they should contact MCC's Accountable Entity Audit Program (AEAP) and the Program Financial Services (PFS) practice group.

1.28 MCC is aware that some IPAs contracted by the Accountable Entity may not initially fully comply with these *Guidelines* because of a lack of technical knowledge and experience in using *Government Auditing Standards*. MCC will assess and consider this lack of institutional capability when accepting or rejecting planning documents and drafting and finalizing audit reports. MCC may allow exceptions to compliance with *Government Auditing Standards* and these *Guidelines* provided that: a) audit reports are determined to be reliable, and b) any deviations from *Government Auditing Standards*, including non-compliance with internal and external Quality Control Review (QCR) programs and continuing education requirements, are clearly stated in the report as scope limitations.

1.29 The IPA is responsible for upgrading its audit capabilities. Nevertheless, MCC may consider providing technical assistance to the IPA in certain circumstances. MCC may remove an IPA from the list of approved firms if the IPA does not make adequate progress in upgrading its audit capabilities to comply with *Government Auditing Standards* and these *Guidelines*.

ACCOUNTABLE ENTITY RESPONSIBILITIES OF AUDITS

1.30 Audits of MCC funds provided to an Accountable Entity are to be performed by an IPA firm in accordance with *Government Auditing Standards*. The Accountable Entity must ensure that all records are available to the IPAs, all accounting entries and adjustments are made properly, and all other necessary steps are taken to enable the auditors to complete their work. In accordance with the Compact and Threshold Program agreements, audits must be issued no later than 90 days after the first anniversary of Entry into Force, and no later than 90 days after the end of the audited period thereafter, as well as meet the \$750,000 threshold, or such other periods or amounts less than the \$750,000 threshold, as MCC and the Recipient Country Government may otherwise agree.

1.31 Audits should begin before the close of the period to be audited, since initiating audits after the close of the period could hinder timely audit reporting and may unduly restrict the scope of certain audit procedures. MCC recommends that independent audits be contracted well in advance of the period to be audited so that necessary interim audit work can be performed before the close of the audit period. **Appendix VII** of these *Guidelines* presents an outline of an illustrative SOW to be included in contracted financial audit agreements.

CHAPTER 2. SELECTION OF INDEPENDENT PUBLIC ACCOUNTANTS

2.1 This chapter provides guidance to the Accountable Entities in selecting IPA firms that are acceptable to MCC. MCC agreements with Recipient Country Governments require that the IPA firm audit MCC funding provided under the agreements at least annually, or semi-annually if it is determined by MCC that semi-annual audits are required.

2.2 MCC maintains a list of IPAs that have been vetted by either MCC or OIG. The approved IPA list provides information about each IPA and every IPA listed has been deemed to have the ability to conduct a reliable audit that results in quality audit reports in accordance with applicable auditing standards. The IPA must be included in this list to be contracted by an Accountable Entity. The process to critically examine a potentially acceptable IPA may take months, depending on the country's audit environment. Therefore, the Accountable Entity or PFS needs to contact the AEAP Coordinator to initiate the IPA vetting process as soon as they have a firm idea about the expected timing of the IPA procurement process. MCC encourages local firms to express interest in being included on the approved IPA list, and may base the decision to accept an audit firm on prior experience in conjunction with the pre-qualification review. MCC also encourages rotating IPAs every five years among eligible audit firms to ensure independence.

2.3 MCC must approve the Accountable Entity's selection of the IPA firm. The Accountable Entity must use the standard SOW (**Appendix VII**) when issuing the solicitation. The preferred procedure is for the Accountable Entity to obtain proposals from IPA firms that are included in the approved IPA list, and select an audit firm that the Accountable Entity has determined to be acceptable. The Accountable Entity's selection of an IPA firm may be based on factors including the firm's past performance in terms of quality and timeliness (including preparing audit reports in English), independence from the organization to be audited, membership in the country's public accounting organization, the experience and credentials of firm staff proposed to participate in the audit, the availability of firm staff to accomplish audits within required timeframes, and cost. However, audit cost cannot be a controlling factor in the selection. After the Accountable Entity selects the audit firm, it must submit the draft contract to PFS and program procurement for approval. The Accountable Entity will verify that the firm selected is on the list of approved IPA firms, and that the SOW contained in the contract complies with the *Guidelines*.

AUDIT FIRMS

2.4 Audits should be conducted by an audit firm that is on the MCC list of approved IPAs or, in special circumstances, be approved separately by MCC's Accountable Entity Audit Program.

2.5 All selected IPAs should meet, or make satisfactory efforts within two years of signing the contract with the Accountable Entity toward meeting, Continuing Professional Education (CPE) requirements and internal and external peer review requirements in accordance with *Government Auditing Standards*. MCC may remove from the approved list of IPAs eligible to perform audits of MCC agreements any IPA firm that fails to meet this objective. MCC may remove a firm from the approved list that has not performed any audits under these *Guidelines* for a period of four years, or has not performed audits in accordance with applicable standards.

2.6 It is the responsibility of the contracted IPA firms to perform audits pursuant to these *Guidelines* and to present audit reports and other contractual deliverables in a timely manner. If the Accountable Entity Audit Program rejects the work of an audit firm due to noncompliance with these *Guidelines*, the

audit costs may not be charged to the Accountable Entity until such time as the Accountable Entity Audit Program finds the deliverable to be acceptable. Should the IPA firm fail to make its deliverable acceptable, the IPA firm will not be considered acceptable to perform future audits until the Accountable Entity Audit Program determines that it has undergone an external QCR, implemented the resultant recommendations, and is capable of substantially improved performance.

CHAPTER 3. AUTHORITATIVE AUDITING GUIDANCE

3.1 *Government Auditing Standards* include by reference the AICPA Statements on Auditing Standards (SAS). Consequently, auditors performing financial statement audits in accordance with *Government Auditing Standards* should comply with the requirements found in chapters 1-3 of the *Government Auditing Standards* and the additional requirements for financial audits found in chapter 6 “Standards for Financial Audits” of the *Government Auditing Standards*.

General Standards

3.2 Chapter 3 of the *Government Auditing Standards* contains standards that establish a foundation for the credibility of an auditor’s work. The general standards are as follows:

- **Independence:** In all matters of the audit, work performed by the audit organization and the individual auditor, either Government or public, must be independent. If independence is impaired, auditors should decline to perform a prospective audit or terminate an audit in progress.
- **Professional judgement:** The auditor must use the accumulated knowledge and experience he or she has gained through accounting or auditing training and comprehending ethical standards, in order to make informed decisions about the courses of action that are appropriate in each specific circumstance. Professional judgement also includes exercising reasonable care in accordance with applicable professional standards and ethical principles and professional skepticism.
- **Competence:** The engagement team assigned to conduct the audit must collectively possess adequate professional competence needed to address the audit objectives and perform the work in accordance with *Government Auditing Standards*.
- **Quality Control (QC) and Quality Assurance (QA):** In accordance with *Government Auditing Standards*, each audit organization performing audits must: a) establish and maintain a system of QC that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements, and b) have an external peer review performed by reviewers independent of the audit organization being reviewed at least once every three years.

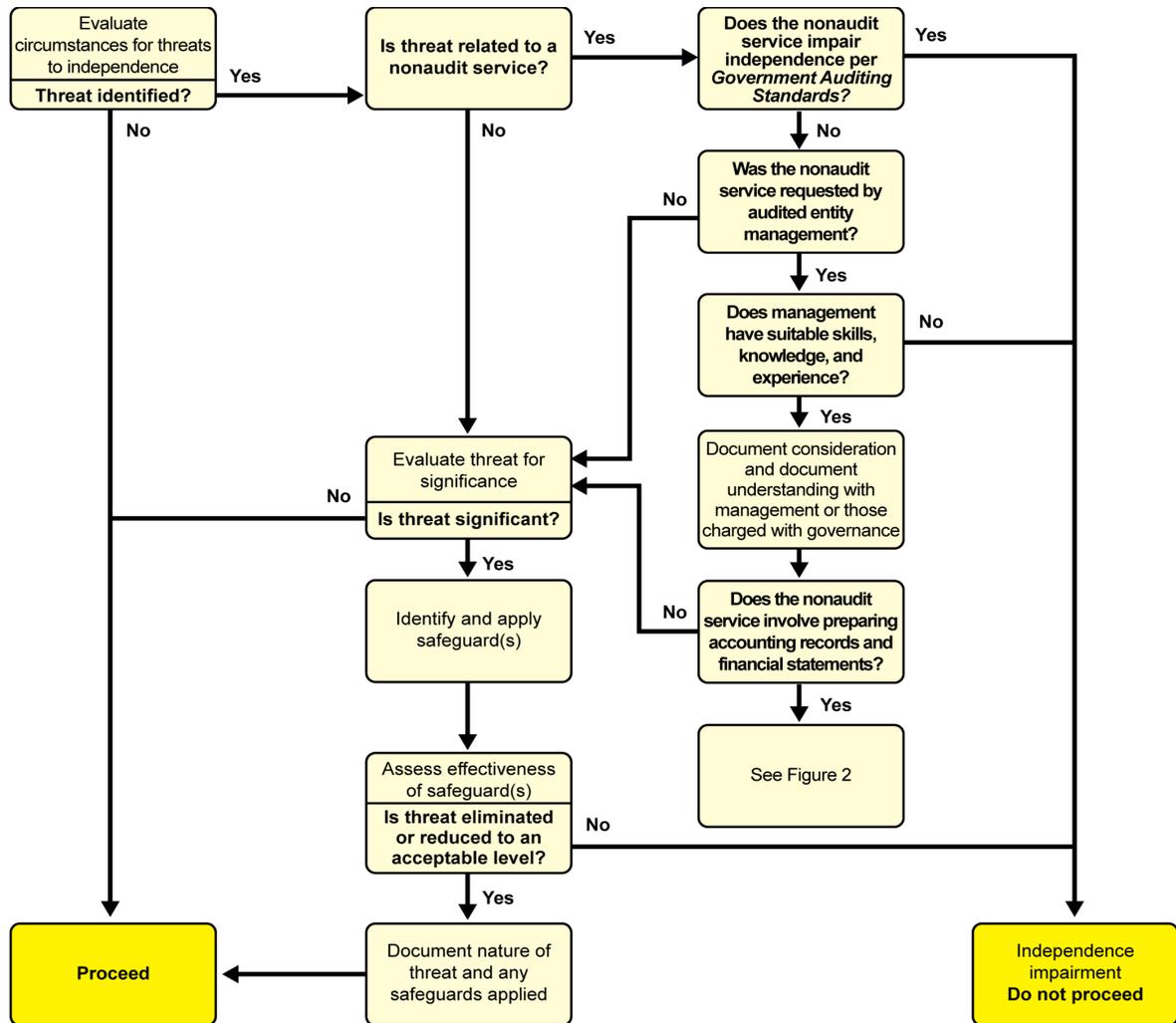
CONCEPTUAL FRAMEWORK FOR INDEPENDENCE

3.3 The *Government Auditing Standards* establish a conceptual framework that auditors use to identify, evaluate, and apply safeguards to address threats to independence. This framework assists auditors in maintaining independence of mind and independence of appearance. The framework can be utilized to address various circumstances that create threats to independence. Auditors should apply the conceptual framework to the audit organization, audit, and individual auditor in order to:

- Identify threats to independence.
- Evaluate the significance of the threats identified, both individually and in the aggregate.
- Apply safeguards, as necessary, to eliminate the threats or reduce them to an acceptable level.

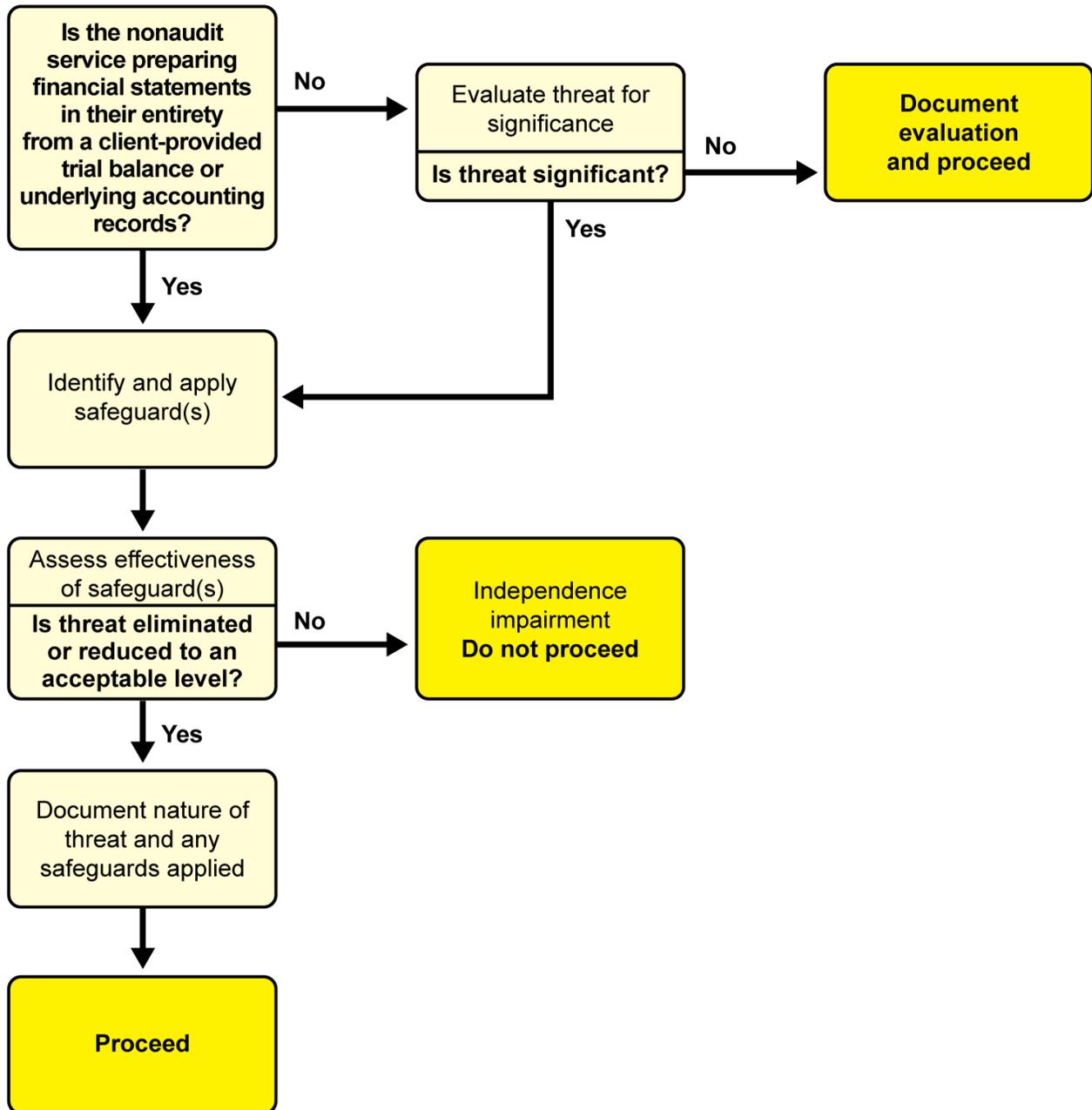
Each audit team member must complete an individual independence self-assessment checklist as evidence. See Appendix IX.

Exhibit 1: Conceptual Framework for Independence



Source: GAO. | GAO-18-568G

Exhibit 2: Independence Considerations for Preparing Accounting Records and Financial Statements



Source: GAO. | GAO-18-568G

3.4 Categories of Threat

Comprehensive Category of Threat	Brief Explanation of Threat	Examples of Circumstances
Self-Interest Threat	Occurs as a result of the financial or other interests of a professional accountant or of an immediate or close family member.	<ul style="list-style-type: none"> • A financial interest in a client or jointly holding a financial interest with a client • Undue dependence on total fees from a client • Having a close business relationship with a client • Concern about the possibility of losing a client • Potential employment with a client • Contingent fees relating to an engagement • A loan to or from a client or any of its directors or officers.
Self-Review Threat	Occurs when a previous judgment needs to be re- evaluated by the professional accountant responsible for that judgment.	<ul style="list-style-type: none"> • Reporting on the operation of financial systems after being involved in their design or implementation • Having prepared the original data used to generate records that are the subject matter of the engagement • A member of the team being, or having recently been, a director or officer of that client • A member of the team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement • Performing a service for a client that directly affects the subject matter of the engagement.

Comprehensive Category of Threat	Brief Explanation of Threat	Examples of Circumstances
Bias Threat	Occurs when the auditor has a preconceived notion regardless of results.	<ul style="list-style-type: none"> • An auditor's having preconceptions about the objectives of a program under audit that are sufficiently strong to impact the auditor's objectivity • An auditor's having biases associated with political, ideological, or social convictions that result from membership or employment in, or loyalty to, a particular type of policy, group, organization, or level of Government that could impact the auditor's objectivity.
Familiarity Threat	Occurs when, by virtue of a close relationship with a client, its directors, officers, or employees, an auditor becomes too sympathetic to the client's interests.	<ul style="list-style-type: none"> • A member of the team having a close family member who, as an employee of the client, is in a position to exert direct and significant influence over the subject matter of the engagement • A former partner of the firm being a director, officer of the client, or an employee in a position of significant influence • Long association of a senior member of the team with the client • Acceptance of gifts or hospitality, unless the value is clearly insignificant, from the client, its directors, officers, or employees.
Undue Influence Threat	Occurs when the client management attempts to coerce or provide excessive influence over the auditor.	<ul style="list-style-type: none"> • Threat of replacement over a disagreement with the application of an accounting principle • Pressure to reduce inappropriately the extent of work performed in order to reduce fees • Dominant personality in a senior position at the audit client, controlling dealings with the auditor.

Comprehensive Category of Threat	Brief Explanation of Threat	Examples of Circumstances
Management Participation Threat	Occurs when an auditor takes the role of management or otherwise performing management functions on behalf of the audit entity, which will lead an auditor to take a position that is not objective.	<ul style="list-style-type: none"> • A member of the audit team being, or having recently been, a principal or senior manager of the audited entity • An audit organization principal or employee serving as a voting member of an entity’s management committee or board of directors, making policy decisions that affect future direction and operation of an entity’s programs, supervising entity employees, developing or approving programmatic policy, authorizing an entity’s transactions, or maintaining custody of an entity’s assets • An audit organization principal or employee recommending a single individual for a specific position that is key to the entity or program under audit, or otherwise ranking or influencing management’s selection of the candidate • An auditor preparing management’s corrective action plan to deal with deficiencies detected in the audit.
Structural Threat	Occurs as a result of a governmental structure that will affect the audit organization’s ability to perform work and report results objectively.	<ul style="list-style-type: none"> • For both external and internal audit organizations, structural placement of the audit function within the reporting line of the areas under audit • For internal audit organizations, administrative direction from the audited entity’s management.

INDEPENDENCE IMPAIRMENTS

3.5 An independence impairment occurs in situations in which an engagement partner or professional employee of the firm either: 1) committed an impairment or, 2) knows of an impairment and fails to ensure that the impairment is promptly communicated to an appropriate individual within the firm. An independence impairment can compromise the engagement team’s integrity, objectivity, and professional

skepticism, and the threats to the appearance of independence would be considered so significant that no actions could be taken to satisfactorily address the consequences of the impairment.

Identifying and Communicating an Impairment

3.6 When an impairment is identified, the engagement partner or QC Reviewer should, in accordance with the IPA's firm's policies and procedures, promptly communicate the impairment to an appropriate individual within the firm. The responsible individual should report the impairment to those who need to take appropriate action and, when appropriate, should report the impairment to relevant network firms. The responsible engagement partner or QC Reviewer should be satisfied that the interest or relationship that caused the impairment has been terminated, suspended, or eliminated and should address the consequences of the impairment. A consequence of an impairment may be that termination of the engagement is necessary.

Addressing the Consequences of an Impairment

3.7 Depending upon the significance of the impairment, it may be necessary to terminate the engagement or it may be possible to take action that satisfactorily addresses the consequences of the impairment. The engagement partner or QC Reviewer should determine whether satisfactory action can be taken and is appropriate in the circumstances. In making this determination, the responsible individual should exercise professional judgment and take into account whether a reasonable and informed third party, weighing the significance of the impairment, the action to be taken, and all the specific facts and circumstances available to the member at that time, would likely conclude that the attest engagement team's integrity, objectivity, and professional skepticism would be compromised, and therefore whether independence is impaired.

Documentation

3.8 The responsible individual should document the impairment, the action taken, key decisions made, and all the matters discussed with the Accountable Entity and any discussions with MCC. When the firm continues with the audit, the matters to be documented should also include the conclusion that, in the responsible individual's professional judgment, the integrity, objectivity, and professional skepticism of the audit team have not been compromised, and the rationale for why the action taken satisfactorily addressed the consequences of the impairment such that the firm could issue a report.

NON-AUDIT SERVICES

3.9 Auditors have traditionally provided a range of non-audit services that are consistent with their skills and expertise. Before auditors agree to provide a non-audit service to an audited entity, they should determine whether providing such a service would create a threat to independence, either by itself or in aggregate with other non-audit services provided, with respect to any *Government Auditing Standards* engagement they conduct.¹¹

3.10 The IPA may be able to provide non-audit services without impairing independence if:

- a) The non-audit services are not expressly prohibited

¹¹ See paragraph 3.64 of *Government Auditing Standards*

- b) The auditor has determined that the general requirements for performing non-audit services have been met
- c) Any significant threats to independence have been eliminated or reduced to an acceptable level through the application of safeguards. Auditors should use the conceptual framework to evaluate independence given the facts and circumstances of individual services not specifically prohibited.¹²

If the auditor performs such services, then these services need to be outlined within the contract, audit plan, and audit scope within the audit report. The IPA should also disclose in supporting documentation or within the report that non-audit services were performed.

Documentation Requirements

3.11 In connection with non-audit services, the auditor should establish and document their understanding with the audited entity's management or those charged with governance, as appropriate, regarding the following:

- a) Objectives of the non-audit services
- b) Services to be performed
- c) The audited entity's acceptance of its responsibilities
- d) The auditor's responsibilities
- e) Any limitations of the non-audit service.¹³

Threats and Safeguards Applied

In cases where threats to independence are not at an acceptable level, thereby requiring the application of safeguards, the auditor should document the threats identified and the safeguards applied to eliminate the threats or reduce them to an acceptable level.¹⁴

Management's Skills, Knowledge, or Experience

The auditor should document consideration of management's ability to effectively oversee non-audit services to be performed.¹⁵

Failure to Document

While insufficient documentation of an auditor's compliance with the independence standard does not impair independence, appropriate documentation is required under the *Government Auditing Standards* QC and assurance requirements.¹⁶

¹² See paragraph 3.86 of *Government Auditing Standards*

¹³ See paragraph 3.77 of *Government Auditing Standards*

¹⁴ See paragraph 3.107 of *Government Auditing Standards*

¹⁵ See paragraph 3.78 - 3.81 of *Government Auditing Standards*

¹⁶ See paragraph 3.107 of *Government Auditing Standards*

Routine Activities

Routine activities performed by auditors that relate directly to the performance of an audit are not considered non-audit services under *Government Auditing Standards*.

Examples of routine activities include:

- Providing advice to the audited entity on an accounting matter as an ancillary part of the overall financial audit
- Researching and responding to the audited entity's technical questions on relevant tax laws as an ancillary part of providing tax services
- Providing advice to the audited entity on routine business matters
- Educating the audited entity on matters within the technical expertise of the auditors
- Providing information to the audited entity that is readily available to the auditors, including best practices and benchmarking studies.¹⁷

COMPETENCE AND CPE

3.12 Competence includes being knowledgeable about specific GAGAS requirements and having the skills and abilities to proficiently apply that knowledge on GAGAS engagements. CPE contributes to auditors' competence.¹⁸

Competence

3.13 Competence is derived from a combination of education and experience. Education is a structured and systematic process aimed at developing knowledge, skills, and other abilities; it is a process that is typically but not exclusively conducted in academic or learning environments. Experience refers to workplace activities that are relevant to developing professional proficiency.

Competence is not necessarily measured by years of auditing experience because such a quantitative measurement may not accurately reflect the kinds of experiences gained by auditors in any given time period. Maintaining competence through a commitment to learning and development throughout auditors' professional lives is an important element for auditors.¹⁹

CPE

3.14 Auditors who plan, direct, perform engagement procedures for, or report on an engagement conducted in accordance with GAGAS should develop and maintain their professional competence by completing at least 80 hours of CPE in every two-year period. 24 of the 80 hours of CPE are required to be directly related to the Government environment, Government auditing, or the specific or unique envi-

¹⁷ See paragraph 3.70 and 3.72 of *Government Auditing Standards*

¹⁸ See paragraph 4.01 of *Government Auditing Standards*

¹⁹ See paragraph 4.06 of *Government Auditing Standards*

ronment in which the audited entity operates. 56 of the 80 hours of CPE are required to directly enhance auditors' professional expertise to conduct engagements.²⁰

3.15 The audit organization should monitor the auditor compliance with the CPE requirements to ensure that auditors complete sufficient CPE in qualifying programs and subjects, as well as maintain documentation. MCC will request a copy of the engagement team members' CPEs to review. Examples of CPE subjects that may qualify for the 24-Hour Requirement are listed below:

- a) GAGAS and related topics, including internal control, as addressed in GAGAS
- b) The applicable AICPASAS
- c) The applicable AICPA Statements on Standards for Attestation Engagements (SSAE) and Statements on Standards for Accounting and Review Services (SSARS)
- d) The applicable auditing standards issued by the Institute of Internal Auditors, the Public Company Accounting and Oversight Board, the International Auditing and Assurance Standards Board, or other auditing standard-setting body
- e) Generally Accepted Accounting Principles (GAAP) or the applicable financial reporting framework being used, including those issued by the Federal Accounting Standards Advisory Board (FASAB), the Governmental Accounting Standards Board (GASB), or the Financial Accounting Standards Board (FASB)
- f) *Standards for Internal Control in the Federal Government* (Green Book)
- g) Internal Control—Integrated Framework, as applicable
- h) Requirements for recipients of Federal contracts or grants, including Single Audits under the Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards
- i) Requirements for Federal, state, or local program audits
- j) Relevant or applicable audit standards or guides, including those for Information Technology (IT) auditing and forensic auditing
- k) IT auditing topics applicable to the Government environment
- l) Fraud topics applicable to a Government environment
- m) Statutory requirements, regulations, criteria, guidance, trends, risks, or topics relevant to the specific and unique environment in which the audited entity operates
- n) Statutory requirements, regulations, criteria, guidance, trends, risks, or topics relevant to the subject matter of the engagement, including scientific, medical, environmental, educational, or any other specialized subject matter
- o) Topics directly related to the Government environment, including the nature of Government (e.g., structures, financing, operations), economic or other conditions and pressures facing Governments, common Government financial management issues, appropriations, measurement or evalu-

²⁰ See paragraph 4.16 of Government Auditing Standards

ation of Government financial or program performance, and application of general audit methodologies or techniques to a Government environment or program

- p) Specialized audit methodologies or analytical techniques, including the use of complex survey instruments, actuarial estimates, statistical analysis tests, or statistical or nonstatistical sampling
- q) Performance auditing topics, including obtaining evidence, professional skepticism, and other applicable audit skills
- r) Government ethics and independence
- s) Partnerships between Governments, businesses, and citizens
- t) Legislative policies and procedures
- u) Topics related to fraud, waste, abuse, or improper payments affecting Government entities
- v) Compliance with laws and regulations.

Examples of CPE subjects that may qualify for the 56-Hour Requirement are listed below:

- a) Subject matter categories for the 24-Hour Requirement listed above
- b) General ethics and independence
- c) Topics related to accounting, acquisitions management, asset management, budgeting, cash management, contracting, data analysis, program performance, or procurement
- d) Communicating clearly and effectively, both orally and in writing
- e) Managing time and resources
- f) Leadership
- g) Software applications used in conducting engagements
- h) IT
- i) Economics, Human Capital Management (HCM), social and political sciences, and other academic disciplines that may be applied in engagements, as applicable.

QC AND QA

3.16 An audit organization conducting engagements in accordance with GAGAS must establish and maintain a system of QC that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional standards and applicable legal and regulatory requirements.²¹ The firm's system of QC should include policies and procedures that address each of the following elements of QC: a) Leadership responsibilities for quality within the firm (the "tone at the top"), b) Relevant ethical requirements, c) Acceptance and continuance of client relationships and specific engagements, d) Human Resources (HR), e) Engagement performance, and f) Monitoring.

²¹ See paragraph 5.02 of *Government Auditing Standards*

3.17 A system of QC consists of policies designed to achieve the objectives of the system and the procedures necessary to implement and monitor compliance with those policies. The nature, extent, and formality of a firm's QC policies and procedures will depend on various factors, including the firm's size, the number and operating characteristics of its offices, the degree of authority allowed to, and the knowledge and experience possessed by, firm personnel, and the nature and complexity of the firm's practice.

3.18 An audit organization should document its QC policies and procedures and communicate those policies and procedures to its personnel. The audit organization should document compliance with its QC policies and procedures and maintain such documentation for a period of time sufficient to enable those performing monitoring procedures and peer reviews to evaluate the extent to which the audit organization complies with its QC policies and procedures.²²

RELATED PARTIES

3.19 The auditor has a responsibility to perform audit procedures to identify, assess, and respond to the risks of material misstatement arising from the Accountable Entity's failure to appropriately account for or disclose related party relationships, transactions, or balances. The auditor should obtain an understanding of the Accountable Entity's relationships, the terms and business purposes, and transactions involving related parties to be able to:

- a) Recognize fraud risk factors, if any, arising from related party relationships and transactions that are relevant to the identification and assessment of the risks of material misstatement due to fraud.
- b) Conclude, based on the audit evidence obtained, whether the financial statements, insofar as they are affected by those relationships and transactions, achieve fair presentation.

The auditor must obtain and document sufficient appropriate audit evidence to determine whether related parties, relationships, and transactions with related parties have been properly identified, accounted for, and disclosed in the financial statements.

FRAUD

3.20 An auditor conducting an audit in accordance with GAAS is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Due to the inherent limitations of an audit, an unavoidable risk exists that some material misstatements of the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAAS.

3.21 The risk of not detecting a material misstatement resulting from fraud is higher than the risk of not detecting one resulting from error. This is because fraud may involve sophisticated and carefully organized schemes designed to conceal it, including forgery, deliberate failure to record transactions, or intentional misrepresentations being made to the auditor. Such attempts at concealment may be even more difficult to detect when accompanied by collusion. Collusion may cause the auditor to believe that audit evidence is persuasive when it is, in fact, false. The auditor's ability to detect fraud depends on factors including the skillfulness of the perpetrator, the frequency and extent of manipulation, the degree of collusion involved, the relative size of individual amounts manipulated, and the seniority of those individuals involved. Al-

²² See paragraph 5.04 of *Government Auditing Standards*

though the auditor may be able to identify potential opportunities for fraud to be perpetrated, it is difficult for the auditor to determine whether misstatements in judgment areas, including accounting estimates, are caused by fraud or error.²³

3.22 Auditors have several explicit requirements to address the risk of material misstatement of the financial statements due to fraud. One of the requirements for planning an audit is a discussion (i.e., brainstorming session) among the engagement team members. The discussion must comprise of how and where the entity's financial statements might be susceptible to fraud, an evaluation of fraud risk factors identified from the brainstorming session and through other risk assessment procedures (e.g., from discussions with management and others within the entity), an overall assessment of the risks of material misstatement due to fraud, and documenting the fraud risk assessment process, including the audit procedures designed to respond to the fraud risk assessments.

FRAUD BRAINSTORMING SESSION

3.23 Prior to conducting the fraud brainstorming session, auditors should collect information regarding the risk of material misstatement due to fraud. This information may include reviewing prior-year working papers, discussing with management and those charged with governance regarding the entity's processes for preventing and detecting fraud, and reviewing the entity's internal controls established to mitigate the risk of fraud. This information is then incorporated in a formal brainstorming session attended by key engagement team members. The purpose of the brainstorming session is to identify fraud risk factors, guided by the fraud triangle model²⁴, and to instill the importance of remaining professionally skeptical, notwithstanding an auditor's past experience of management honesty and integrity.

A fraud brainstorming session can be broken down into the following five steps: 1) select the team; 2) choose an approach; 3) prepare for the meeting; 4) conduct the meeting; and 5) follow-up and documentation.

Based on the engagement team's evaluation of the identified fraud risk factors, an assessment of the risks of material misstatement due to fraud is made at the financial statement-level and at the assertion-level. Auditors respond to the risk assessment by designing audit procedures to mitigate these risks.

INQUIRIES WITH MANAGEMENT AND OTHERS ABOUT FRAUD RISKS

3.24 Auditors must inquire whether management has knowledge of any fraud or suspect fraud within the entity. Auditing standards also require auditors to inquire of the audit committee about its views of the risks of fraud and whether the audit committee has knowledge of any fraud or suspected fraud. If the entity has an internal audit function, the auditor should inquire about internal audit's views of fraud risks and whether they have performed any procedures to identify or detect fraud during the year. Auditing standards further require the auditor to make inquiries of others within the entity whose duties lie outside the normal financial reporting lines of responsibility about the existence or suspicion of fraud. These management inquiries must be properly documented within the IPA's work papers.

²³ AICPA SAS 122, *Considerations of Fraud*, AU-C 240

²⁴ The fraud triangle is a model for explaining the factors that cause someone to commit occupational fraud. Donald R. Cressey, *Other People's Money* (Montclair: Patterson Smith, 1973) p. 30.

PLANNING

3.25 While planning continues throughout the audit, the objectives of planning are to gain an understanding of the entity to be audited; to understand its environment, including internal control; to identify significant areas for audit; and to design effective and efficient audit procedures. To accomplish this, the auditor's planning methodology should include the following²⁵:

- a) Performing preliminary engagement activities relating to: 1) acceptance and continuance of client relationships and audit engagements (e.g., an assessment of previous audits); 2) compliance with relevant ethical requirements; and 3) establishing an understanding of the terms of the engagement with management and, when appropriate, those charged with governance, including establishing that certain preconditions for an audit are present (see **Appendix I**).
- b) Understanding the entity's operations and its environment, including its organization, management style, internal control, and internal and external factors influencing its operating environment.
- c) Performing analytical procedures to assist in planning the audit.
- d) Identifying significant accounts, accounting applications, and financial management systems; relevant budget restrictions; significant provisions of applicable laws, regulations, contracts, and grant agreements; and relevant internal controls.
- e) Determining the likelihood of effective Information System (IS) controls.
- f) Identifying significant items, accounts, and assertions and using them in planning the audit.
- g) Determining materiality for the financial statements taken as a whole, including performance materiality, which is the portion of materiality that the auditor allocates to line items, accounts, or classes of transactions.
- h) Performing a preliminary risk assessment to determine the risk of material misstatement due to error or fraud.
- i) Establishing the overall audit strategy, which sets the scope, timing, and direction of the audit and guides the development of an audit plan.²⁶
- j) Developing an audit plan, which will outline the nature, timing, and extent of direction and supervision of audit team members and review of their work. The nature, timing, and extent of the direction and supervision of the audit team members and review of their work vary, depending on many factors, including: the size and complexity of the entity, the area of the audit (e.g., fraud and accounting estimates), the assessed risks of material misstatement, and the capabilities and competence of the individual team members performing the work.²⁷

ACCEPTANCE AND CONTINUANCE OF CLIENT RELATIONSHIPS

3.26 The engagement partner should be satisfied that appropriate procedures regarding the acceptance and continuance of client relationships and audit engagements have been followed. These procedures are

²⁵ GAO-18-601G, Financial Audit Manual, Volume 1, Section 210, *Overview of the Planning Phase*, June 2018

²⁶ AICPA SAS 122, *Planning an Audit*, AU-C 300.07

²⁷ AICPA SAS 122, *Planning an Audit*, AU-C 300.11 and AU-C 300.A16

established by the auditing organization as part of its system of quality control and documented. The engagement partner should also determine that the conclusions reached in performing the procedures are appropriate. The following information assists the engagement partner in making this determination:

- The integrity of the principal owners, key management, and those charged with governance of the entity.
- Whether the engagement team is competent to perform the audit engagement and has the necessary capabilities, including time and resources.
- Whether the audit organization and the engagement team can comply with relevant ethical requirements.
- Significant findings or issues that have arisen during the current or previous audit engagement and their implications for continuing the relationship.

IDENTIFYING RISK FACTORS AND RISK ASSESSMENTS

3.27 The auditor should perform risk assessment procedures to provide a basis for the identification and assessment of risks of material misstatement at the financial statement and relevant assertion levels. The risk assessment procedures should include the following: (a) inquiries of management and others within the entity who, in the auditor's professional judgment, may have information that is likely to assist in identifying risks of material misstatement due to fraud or error; (b) analytical procedures; and (c) observation and inspection.²⁸ Risk assessment procedures by themselves, however, do not provide sufficient appropriate audit evidence on which to base the audit opinion.²⁹ The auditor's assessments of inherent risk and control risk affect the auditor's assessment of the risks of material misstatement. The risks of material misstatement affect the nature, extent, and timing of other audit procedures, including substantive procedures and control tests.

Based on evidence obtained throughout the audit, the auditor should monitor and revise, if needed, preliminary assessments made during the Planning Phase for risk of material misstatement and the likelihood of control effectiveness. The auditor should revise audit procedures, as needed.

ENGAGEMENT PARTNER RESPONSIBILITIES

3.28 In accordance with GAGAS³⁰, the engagement partner is the individual within the IPA firm who is responsible for the audit engagement, its performance, and the review of the auditor's report that is issued on behalf of the firm and who, when required, has the appropriate authority from a professional, legal, or regulatory body. The engagement partner should take responsibility for the following:

- a) The direction, supervision, and performance of the audit engagement in compliance with professional standards, applicable legal and regulatory requirements, and the firm's policies and procedures.

²⁸ AICPA SAS 122, *Planning an Audit*, AU-C315.06

²⁹ AICPA SAS 122, *Planning an Audit*, AU-C315.05

³⁰ AICPA SAS 122, *Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards*, AU-C 220

- b) The auditor's report being appropriate in the circumstances.
- c) The reviews being performed in accordance with the firm's review policies and procedures.
- d) On or before the date of the auditor's report, the engagement partner should, through a review of the audit documentation and discussion with the engagement team, be satisfied that sufficient appropriate audit evidence has been obtained to support the conclusions reached and for the auditor's report to be issued.
- e) The engagement team undertaking appropriate consultation on difficult or contentious matters.
- f) Be satisfied that members of the engagement team have undertaken appropriate consultation during the course of the engagement, both within the engagement team and between the engagement team and others at the appropriate level within or outside the firm.
- g) Be satisfied that the nature and scope of such consultations are agreed with, and conclusions resulting from such consultations are understood by, the party consulted.
- h) Determine that conclusions resulting from such consultations have been implemented.

CHAPTER 4. ASSESSING INFORMATION SYSTEM CONTROLS

(This section will be effective for all audits after the end of the audit period ending March 31, 2020)

4.1 The Federal Information System Controls Audit Manual³¹ (FISCAM) presents a methodology for performing IS control audits of Federal and other governmental entities in accordance with professional standards. It is designed to be used as guidance for financial and performance audits and attestation engagements performed in accordance with *General Auditing Standards*. The FISCAM control activities are consistent with National Institute of Standards and Technology (NIST) Special Publication (SP) 800-53 and all SP 800-53 controls.³²

4.2 IS controls consist of those internal controls that depend on IS processing, including general controls (e.g., entity-wide-, system-, business process application-levels); business process application controls (e.g., input, processing, output, master file, interface, data management system controls); and user controls (e.g., controls performed by people interacting with IS). General and business process application controls are always IS controls. A user control is an IS control if its effectiveness depends on IS processing or the reliability (e.g., accuracy, completeness, validity) of information processed by IS. Conversely, a user control is not an IS control if its effectiveness does not depend on IS processing or the reliability of information processed by IS.³³

4.3 In the Planning Phase, the auditor, with the assistance of an IS controls specialist or an IS auditor, should use an appropriate methodology to understand the design of IS controls and whether they have been implemented and to determine whether IS controls are likely to be effective and should therefore be considered further in the audit.

4.4 The procedures performed to determine the likelihood of effective IS controls build on those procedures performed to gain an understanding of the entity's operations, including the design of its internal controls, and assess the effects of IS on inherent risk and the control environment, risk assessment, information and communication, and monitoring. The auditor should obtain an understanding of each of the five components of internal control—control environment, risk assessment, information and communication, monitoring, and control activities—sufficient for assessing the risks of material misstatement of the financial statements whether due to error or fraud, as well as for determining the nature, extent, and timing of further audit procedures.

4.5 IS do not affect the audit objectives for an account or a cycle. However, IS (or lack thereof) can introduce inherent risk factors not present in a manual accounting system. The auditor should consider each of the following IS factors and 2) assess the overall impact of IS processing on inherent risk.

- a) **Uniform processing of transactions:** Because IS process groups of identical transactions consistently, any misstatements arising from erroneous computer programming will occur consistently in similar transactions. However, the possibility of random processing errors is reduced substantially in computer-based IS.

³¹ FISCAM, GAO-09-232G, February 2009

³² NIST SP 800-53, Security and Privacy Controls for Federal Information Systems and Organization. The NIST is a non-regulatory agency of the U.S. Commerce Department and was established to encourage and assist innovation and science through the promotion and maintenance of a set of industry standards. NIST SP 800-53 is a set of standards and guidelines to help Federal agencies and contractors meet the requirements set by FISMA.

³³ Financial Audit Manual (FAM), Volume 1, GAO-18-601G, June 2018

- b) **Automatic processing:** The IS may automatically initiate transactions or perform processing functions. Evidence of these processing steps (and any related controls) may or may not be visible.
- c) **Increased potential for undetected misstatements:** Computers use and store information in electronic form and require less human involvement in processing. This increases the potential for individuals to gain unauthorized access to sensitive information and to alter data without visible evidence. Due to the electronic form, changes to computer programs and data may not be readily detectable. Also, users may be less likely to challenge the reliability of computer output than manual reports. As such, management should evaluate security threats, which can be from internal or external sources. External threats are particularly important for entities that depend on telecommunications networks and the Internet. Internal threats may come from former or disgruntled employees.

The impact of these factors typically will be pervasive in nature. An IS controls specialist or an IS auditor may assist the auditor in considering these factors and making this assessment. More detail on assessing information system risks and controls in a financial statement audit is available in the FISCAM.

4.6 FISCAM describes the audit methodology for assessing the effectiveness of IS controls along with the IS controls that auditors evaluate when assessing confidentiality, integrity, and availability of information and IS. The manual is designed to be primarily used for both financial and performance-based audits and attestation engagements in accordance with GAGAS. In addition, this manual is intended for auditors performing financial, performance, and attestation engagements to assist in the understanding the work performed by IS specialists.³⁴

1) ACCESS CONTROLS (AC)

ACs limit or detect inappropriate access to computer resources, protecting from unauthorized modification, loss, and disclosure. Such controls include both logical and physical ACs. Logical ACs require user authentication. Physical ACs involve restricting access to computer resources and protecting these controls from intentional or unintentional loss. Without sufficient AC, unauthorized individuals, including outside intruders and former employees, can duplicate sensitive data and make changes undetected for malicious purposes or personal gains. The objective of limiting access is to ensure the following: outsiders are unable to gain authorization to an entity's system data; authorized users are the only users with access to carry out their specific functions; accessibility to sensitive data is limited to few individuals; and employees, as well as contractors, are restricted from performing functions that are beyond their individual responsibilities. Meeting these objectives reduces the risk of inappropriate modification or disclosure of data without interfering with user's needs.³⁵

The six critical elements for AC are as follows: boundary protection, identification and authentication, authorization, sensitive system resources, audit and monitoring, and physical security.

³⁴ FISCAM, GAO-09-232G, Section 1.1

³⁵ FISCAM, GAO-09-232G, Section 3.2

- a) **Boundary Protection:** System protection controls connectivity to and from network connected devices. Implementing multiple layers of security to protect IS internally and externally is a best practice for protecting systems against cyber-attacks.³⁶
- b) **Appropriate identification and authentication:** Identification and authentication should be unique to each user. Account policies (e.g., password policies, account lockout policies) should be established and enforced based primarily on risk. Identification is the process of distinguishing users from all others through IDs. Authentication is primarily implemented through the use of passwords. To ensure that passwords are not guessed, attempts to log on to the system should be limited; typically, after three to seven attempts. Encryption is also a best practice to reduce the risk of password disclosure. Other methods of authorization can include smart cards or biometric recognition (e.g., fingerprint). Management should implement effective procedures when determining compliance with authentication policies, considering risk and potential loss of the entity's operations due to potential breach of security. These assessments measure the severity of potential harm and the likelihood of an occurrence of a wide variety of impacts.³⁷
- c) **Implement effective authorization controls:** Authorization is used to allow or prevent actions based on predefined rules. Authorization includes principles of legitimate use, least privilege, and segregation of duties. Access rights and privileges are used to implement security policies that determine what users can do once allowed into the system. Access rights, also referred to as "permissions," allow users to look at, read, or write certain files or directories. Maintaining access rights, permissions, and privileges is the most important aspect of administering system security.³⁸
- d) **Adequately protect sensitive system resources:** Three main areas related to sensitive system resources are: restricting and monitoring access, implementing adequate media controls over sensitive data, and implementing effective cryptographic controls. Restricting access to sensitive system resources and related documentation is critical to controlling the integrity of IS.³⁹
- e) **Implement an effective auditing and monitoring capability:** Audit and monitoring involves collection, review, and analysis of auditable events for inappropriate or unusual activity and appropriate investigation and reporting of such activity. Audit and monitoring controls can help security professionals routinely assess computer security.⁴⁰
- f) **Establish adequate physical security controls:** Adequate physical security controls should be established that are appropriate to the risks of physical damage or access. In evaluating the effectiveness of physical security controls, the auditor should consider the effectiveness of the entity's policies and practices pertaining to the facility and areas housing sensitive information technology components. Physical security controls should be established in the following areas: security management; perimeter security; entry security; interior security; and emerging threats. Controls should also be in place to protect computer resources from intentional or unintentional loss or impairment, as well as restrict access to them.⁴¹

³⁶ FISCAM, GAO-09-232G, Section AC-1

³⁷ FISCAM, GAO-09-232G, Section AC-2.1

³⁸ FISCAM, GAO-09-232G, Section AC-3

³⁹ FISCAM, GAO-09-232G, Section AC-4

⁴⁰ FISCAM, GAO-09-232G, Section AC-5

⁴¹ FISCAM, GAO-09-232G, Section AC-6

2) SEGREGATION OF DUTIES

Effective segregation of duties begins with entity wide policies and procedures that are implemented at the system and application levels. Work responsibilities should be segregated so that one individual does not control all critical stages of a process. Often, segregation of duties is accomplished by dividing roles/responsibilities between groups; as this diminishes the likelihood that errors and wrongful acts will go undetected because the activities of one individual or group will serve as a check on the activities of others. Inadequate segregation of duties increases the risk that erroneous or fraudulent transactions are processed and computer resources could be damaged or destroyed.⁴²

- a) **Segregate incompatible duties and establish related policies:** In determining if duties are appropriately segregated, the entity's operations should be analyzed. Once assessed, identify the incompatible duties and assign duties to different organizational units or individuals. Federal internal control standards specify that key duties and responsibilities for authorizing, processing, recording, and reviewing transactions should be segregated. Functions and related tasks performed by each unit should be documented for the unit and written in job descriptions and, additionally, should be clearly communicated to personnel assigned. Management should further analyze operations and identify incompatible duties that are then segregated through policies and organizational divisions. The following include examples of restrictions that are generally addressed in policies about segregating of duties and are achieved through organizational divisions and AC. Application users should not have access to operating systems or application software; computer operators should not have access to program libraries or data files; and only users (not computer staff) should be responsible for transaction origination or correction and initiating changes to application files.⁴³
- b) **Formal Operating Procedures, Supervision, and Review for Personnel Activities:** Personnel activities require formal operating procedures and active supervision and review, especially for computer operators and system administrators. Formal operating procedures require detailed, written instructions for personnel to follow while performing their duties. Activity logs should exist for supervisors to perform reviews over and then investigate any abnormalities. Management should also perform periodic reviews over activities that cannot be controlled by physical or logical AC.⁴⁴

3) CONTINGENCY PLANNING

It is critical that an entity have in place procedures for protecting information resources and minimizing the risk of unplanned interruptions and planning in place to recover critical operations, should interruptions occur. Such plans should consider activities performed at general support facilities, as well as those performed by users of specific applications. Per FISMA, entities that perform work on behalf of Federal agencies are to implement security programs that detail plans ensuring the continuing of operations of IS in the event of potential damage or interruption.⁴⁵

- a) **Assess the criticality and sensitivity of computerized operations and identify supporting resources:** Management should analyze data and operations to determine which are most critical, and

⁴² FISCAM, GAO-09-232G, Section 3.4

⁴³ FISCAM, GAO-09-232G, Section SD-1

⁴⁴ FISCAM, GAO-09-232G, Section SD-2

⁴⁵ FISCAM, GAO-09-232G, Section 3.5

which resources are needed to recover and support them. In addition, a business impact analysis should be conducted to identify critical IT resources, identify outage impact and allowable outage times, and develop recovery priorities.⁴⁶

- b) **Prevent and minimize potential damage and interruption:** There are steps that an entity should take to prevent or minimize damage that can occur from unexpected events, including:
- Routinely duplicating or backing up data files
 - Arranging for remote back up facilities
 - Establishing an IS recovery and reconstitution capability
 - Installing environmental controls
 - Ensuring that staff and other system users understand their responsibilities in the event of an emergency

These steps are inexpensive ways to prevent minor problems from becoming costly disasters.⁴⁷

- c) **Develop and document a comprehensive contingency plan:** A contingency plan should be developed for restoring critical applications. In addition, the contingency plan should identify critical systems, applications, or any subordinate plans. These plans should be documented, communicated to staff that are affected, and updated to reflect current operations.⁴⁸
- d) **Periodically test the contingency plan and adjust, as is appropriate:** Testing the contingency plans is essential to determine they will function in an emergency situation. According to Office of Management and Budget (OMB), Federal managers have reported that testing revealed essential weaknesses. Tests will assess how well employees have been trained in carrying out their roles and responsibilities in a disaster situation.⁴⁹

4) SECURITY MANAGEMENT

The foundation of a security control structure and a reflection of senior management's commitment to addressing security risks is an entity-wide Information Security Management Program. The program should establish a framework and continuous cycle of activity for assessing the risk, developing and implementing effective security procedures, and monitoring the effectiveness of these procedures. Without a well-designed program, system controls may be inadequate.⁵⁰

- a) **Establish a Security Management Program:** Policies and procedures should exist that clearly describe the security management program. All major systems and facilities and an outline of the duties of those responsible for overseeing security and those who own, use, or rely on computer resources should be covered in this security management plan. The policies, plans, and procedures

⁴⁶ FISCAM, GAO-09-232G, Section CP-1

⁴⁷ FISCAM, GAO-09-232G, Reference CP-2

⁴⁸ FISCAM, GAO-09-232G, Section CP-3

⁴⁹ FISCAM, GAO-09-232G, Section CP-4

⁵⁰ FISCAM, GAO-09-232G, Section 3.1

should be updated and revised to reflect system and organizational changes, as well as any problems identified during implementation or audits.⁵¹

- b) **Periodically assess and evaluate risks:** A comprehensive risk assessment should be the starting point for developing or modifying an entity's security policies and security plans. These assessments help ensure that threats and vulnerabilities are identified. Appropriate risk assessments policies and procedures should be documented and based on the security categorizations.⁵²
- c) **Document and implement security control policies and procedures:** Security control policies should be documented and approved by management. These policies should consider risks, address general and application controls, and ensure that users are held accountable for their actions. Also, a formal sanctions process should be established for personnel who don't comply with IS control policies and procedures.⁵³
- d) **Implement effective security awareness and other security related policies:** An ongoing security awareness program should be implemented that includes first time training for all employees, contractors, and users, and distribution of security policies detailing rules and expected behaviors to all personnel.⁵⁴

⁵¹ FISCAM, GAO-09-232G, Section SM-1

⁵² FISCAM, GAO-09-232G, Section SM-2

⁵³ FISCAM, GAO-09-232G, Section SM-3

⁵⁴ FISCAM, GAO-09-232G, Section SM-4

CHAPTER 5. AUDIT OBJECTIVES

5.1 The financial audit must include a specific audit of all of the Accountable Entity's MCC-funded programs. The Fund Accountability Statement is the basic financial statement to be audited that presents the Accountable Entity's revenues, costs incurred, cash balance of funds provided to the Accountable Entity by MCC, and assets and technical assistance directly procured by MCC for the Accountable Entity's use. The Fund Accountability Statement should be reconciled to the MCC funds included in the financial statements by a note to the financial statements or the Fund Accountability Statement. All currency amounts in the Fund Accountability Statement, cost-sharing schedule, and the report findings, if any, must be stated in U.S. dollars. The auditors should indicate the exchange rate(s) used in the notes to the Fund Accountability Statement. (See Illustrative Examples of the Fund Accountability Statement in **Appendix V** of these *Guidelines*)

AUDIT OF MCC FUNDS AND GOVERNMENT FUNDS ELIGIBLE FOR MCC REIMBURSEMENT

5.2 A financial audit of the funds provided by MCC must be performed in accordance with *Government Auditing Standards* or other approved standards, where applicable, and accordingly includes such tests of the accounting records, as deemed necessary under the circumstances. The specific objectives of the audit of the MCC funding are to:

- a) Express an opinion on whether the Fund Accountability Statement for the MCC-funded programs presents fairly, in all material respects, revenues received, costs incurred, and assets and technical assistance directly procured by MCC for the period audited, in conformity with the terms of the agreements and generally accepted accounting principles or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis).
- b) Evaluate and obtain a sufficient understanding of the Accountable Entity's internal control related to the MCC-funded programs, assess control risk, and identify significant deficiencies or material weaknesses in the design and effectiveness of these internal controls. This evaluation should include the internal control related to required cost-sharing contributions.
- c) Perform tests to determine whether the Accountable Entity complied, in all material respects, with agreement terms (including cost sharing, if applicable) and applicable laws and regulations related to MCC-funded programs. All material instances of noncompliance and all illegal acts that have occurred or are likely to have occurred should be identified. Such tests should include the compliance requirements related to required cost-sharing contributions, if applicable.
- d) Determine if the Accountable Entity has taken adequate corrective action on prior audit report recommendations.
- e) If applicable, conduct a review engagement of the cost-sharing schedule to determine if the schedule is fairly presented in accordance with the basis of accounting used by the Accountable Entity to prepare the schedule.

The specific objectives of the audit of the Recipient Country Government's funding that may be eligible for MCC reimbursement are determined by the specific requirements of the relevant Audit Planning Doc-

ument submitted by the audit firm, as well as the requirements of any applicable supplemental agreements between MCC and the Recipient Country Government.

5.3 Auditors must design audit steps and procedures in accordance with *Government Auditing Standards* to provide reasonable assurance of detecting instances or transactions in which fraud or illegal acts have occurred or are likely to have occurred. If such evidence exists, the auditors must contact the Accountable Entity Audit Program Director and report the issue to the OIG hotline. In addition, the auditor should exercise due professional care in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations or legal proceedings.

REVIEW OF THE COST-SHARING SCHEDULE

5.4 The audit should determine whether cost-sharing contributions were provided and accounted for by the Accountable Entity in accordance with the terms of the agreements, if applicable. The audit firm should clearly state whether or not cost-sharing/counterpart contributions were required by the agreement within the summary or background of the audit report. Once the auditor determined that cost-sharing contributions were provided. The auditors must perform a review engagement of the cost-sharing schedule to determine if the schedule is fairly presented in accordance with the basis of accounting used by the Accountable Entity to prepare the schedule. The review engagement must be properly documented (See **Section 5.6**).

5.5 The auditors should question all cost-sharing contributions that are either ineligible or unsupported costs. For audits of agreements that present a cost-sharing budget on an annual basis and for close-out audits of awards that present cost-sharing budgets on a life-of-project basis, the auditors will review the cost-sharing schedule to determine if cost-sharing contributions were provided by the Accountable Entity in accordance with the terms of the agreement. The type of cost-sharing budget must be disclosed within the audit report.

SSARS

5.6 *AICPA SSARS, Review of Financial Statements*,⁵⁵ states that the performance of a review engagement requires that the auditor perform procedures designed to accumulate review evidence that will provide a reasonable basis for obtaining limited assurance that there are no material modifications that should be made to the financial statements in order for the statements to be in conformity with the applicable financial reporting framework. The accountant/auditor should apply professional judgment in determining the specific nature, timing, and extent of review procedures. Such procedures should be tailored based on the accountant/auditor's understanding of the industry in which the client operates and the accountant's knowledge of the entity.

5.7 Review evidence obtained through the performance of analytical procedures and inquiry will ordinarily provide the accountant with a reasonable basis for obtaining limited assurance. However, the accountant/auditor should perform additional procedures if the he or she determines such procedures to be necessary to obtain limited assurance that the financial statements are not materially misstated.

⁵⁵ AR Section 90

CHAPTER 6. AUDIT SCOPE

6.1 The auditors should use the following steps as the basis for preparing their audit programs and their review. These steps are not considered all-inclusive or restrictive in nature, and do not relieve the auditor from exercising due professional care and judgment. The steps should be modified to fit local conditions and specific program design, implementation procedures, and agreement provisions, which may vary from program to program. Any limitations in the scope of work must be communicated as soon as possible to the Director of the Accountable Entity Audit Program.

PRE-AUDIT STEPS

6.2 Below is a listing of documents related to MCC programs. The auditors should review the applicable documents considered necessary to perform the audit:

- The agreements between MCC and the Recipient Country Government
- The sub-agreements or Implementing Entity agreements between the Accountable Entities and other Implementing Entities, as applicable
- Contracts and subcontracts with third parties, if any
- The budgets, implementation letters, and written procedures approved by MCC
- MCC Cost Principles for Accountable Entities
- MCC Program Procurement Guidelines (PPG)
- Fiscal Accountability Plan (FAP)
- Procurement Operations Manual (POM)
- Applicable Procurement Laws and Regulations (these laws and regulations will be identified in the Compact or Threshold Program agreement and supplemental agreements)
- All program financial and progress reports; charts of accounts; organizational charts; accounting systems descriptions; procurement policies and procedures, including but not limited to POM; and receipt, warehousing, and distribution procedures for materials, as necessary, to successfully complete the required work
- Any previous audits and financial reviews that directly relate to the objectives of the audit.

FUND ACCOUNTABILITY STATEMENT

6.3 The auditors must examine the Fund Accountability Statement⁵⁶ for MCC-funded programs, including the budgeted amounts by category and major items; the revenues received from MCC for the period covered by the audit; the costs reported by the Accountable Entity, as incurred during that period; and the assets and technical assistance directly procured by MCC for the Accountable Entity's use. The Consolidated Fund Accountability Statement must include all MCC funding identified by each specific

⁵⁶ A "Fund Accountability Statement" is a financial statement that presents an MCC recipient's revenues, costs incurred, cash balance of funds (after considering reconciling items), and assets and technical assistance directly procured by MCC that were provided by MCC agreements.

program or agreement. A separate Fund Accountability Statement is required for individual Compact funds, Compact Implementation Funding (CIF), Compact Development Funding, 609 (g) funds, and Threshold Program Funding. The revenues received from MCC less the costs incurred, after considering any reconciling items, must reconcile with the balance of cash-on-hand or in bank accounts. The Fund Accountability Statement should not include cost-sharing contributions provided from the Recipient Country Government's own funds or in-kind contributions. However, a separate cost-sharing schedule must be included and prepared by the Accountable Entity and reviewed by the auditor, as stated in **Appendix IV** of these *Guidelines*.

6.4 The auditor must not prepare or assist the Accountable Entity in preparing the Fund Accountability Statement and the Accountable Entity must accept responsibility for the Statement's accuracy before the audit commences.

6.5 The opinion on the Fund Accountability Statement must comply with SAS.⁵⁷ The Fund Accountability Statement must separately identify those revenues and costs applicable to each specific MCC agreement. The audit must evaluate program implementation actions and accomplishments to determine whether specific costs incurred are allowable, allocable, and reasonable under the agreement terms, as well as to identify areas where fraud and illegal acts have occurred or are likely to have occurred as a result of inadequate internal control. At a minimum, the auditors must:

- Review costs billed to and reimbursed with MCC funds, as well as costs incurred but pending reimbursement by MCC, identifying and quantifying any questioned costs. All costs that are not supported with adequate documentation or are not in accordance with the agreement terms or the *Cost Principles for Accountable Entities Involved in MCC Compact Implementation* or in the Accountable Entity's *Fiscal Accountability Plan* must be reported as questioned.

Questioned costs must be identified in the notes to the Fund Accountability Statement. Questioned costs must be presented in the Fund Accountability Statement in two separate categories:

- Ineligible costs that are explicitly questioned because they are unreasonable, prohibited by the agreements or applicable laws and regulations, or are not program related.
- Unsupported costs that are not supported with adequate documentation or did not have required prior approvals or authorizations. All material questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. The notes to the Fund Accountability Statement must briefly describe both material instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. Also, the notes to the Fund Accountability Statement must briefly describe both material and immaterial questioned costs and must be cross-referenced to any corresponding findings in the report on compliance
- Review general and program ledgers to determine whether costs incurred were properly recorded. Reconcile direct costs billed to, and reimbursed by, MCC to the program and general ledgers.

⁵⁷ SAS No. 62 (AU-C sec. 623)

- Review the procedures used to control the funds, including transfer of funds to contracted financial institutions or other implementing entities. Review the bank statements and the controls on those bank accounts. Perform positive confirmation of balances, as necessary.
- Determine whether advances of funds were justified with documentation, including reconciliations of funds advanced, disbursed, and available. The auditors must ensure that all funding received by the Accountable Entity from MCC was appropriately recorded in the recipient's accounting records and that those records were periodically reconciled with information provided by MCC.
- Determine whether program income was added to funds used to further eligible projects, program objectives to finance the non-Federal share of the project or program, or deducted from program costs, in accordance with MCC regulations, other implementing guidance, or the terms and conditions of the award.
- Review procurement procedures to determine whether they were conducted in a manner consistent with the MCC Program Procurement Guidelines to ensure the use of sound commercial practices, including competition and price reasonableness, as well as ensuring that adequate controls were in place over the qualities and quantities received.
- Review direct salary charges to determine whether salary rates were reasonable for that position, in accordance with those approved by MCC when MCC approval is required, and supported by appropriate payroll records. Determine if overtime was charged to the program and whether it was allowable under the terms of the agreements. Determine whether allowances and fringe benefits received by employees were in accordance with the agreements and applicable laws and regulations. The auditors should question unallowable salary charges in the Fund Accountability Statement.
- Review travel and transportation charges to determine whether they were adequately supported and approved. Travel charges that are not supported with adequate documentation or not in accordance with agreements and regulations, must be questioned in the Fund Accountability Statement.
- Review assets (e.g., supplies, materials, vehicles, equipment, food products, tools), whether procured by the Accountable Entity or directly procured by MCC for the Accountable Entity's use. The auditors should determine whether assets exist or were used for their intended purposes in accordance with the terms of the agreements and whether control procedures exist and have been placed in operation to adequately safeguard the assets. As part of the procedures to determine if assets were used for intended purposes, the auditors should perform end-use reviews for an appropriate sample of all assets based on the control risk assessment. End-use reviews may include site visits to verify that assets exist or were used for their intended purposes in accordance with the terms of the agreements. The cost of all assets whose existence or proper use in accordance with the agreements cannot be verified must be questioned in the Fund Accountability Statement.
- Review technical assistance and services, consultant services, and grant activity procured by the Accountable Entity. The auditors should determine whether technical assistance, services, and grants were used for their intended purposes in accordance with the terms of the agreements. The cost of technical assistance, services, and grants not properly used in accordance with terms of the agreements must be questioned in the Fund Accountability Statement.

- In addition to the above audit procedures, if technical assistance and services were contracted by the Accountable Entity from a non-U.S. contractor, the auditors should perform additional audit steps on the technical assistance and services, unless the Accountable Entity has separately contracted for an audit of these costs. When testing for compliance with agreement terms and applicable laws and regulations, the auditors should not only consider agreements between the Accountable Entity and MCC, but also agreements between the Accountable Entity and the non-U.S. contractors providing technical assistance and services. The agreements between the Accountable Entity and non-U.S. contractors should be audited using the same audit steps described in the other paragraphs of this section, including all tests necessary to specifically determine that costs incurred are allowable, allocable, reasonable, and supported under agreement terms.
- If the technical assistance and services were not contracted by the Accountable Entity from a non-U.S. contractor, the auditors are still responsible for determining whether technical assistance and services were used for their intended purposes in accordance with the terms of the agreements. However, the auditors are not responsible for performing additional audit steps for the costs incurred under the technical assistance and services agreements.
- Review advances made to the Accountable Entity by MCC as well as advances made by the Accountable Entity to contractors and ensure proper liquidation per the terms of the applicable agreement. Review pending reimbursements by MCC or the applicable Accountable Entity when performing final closeout audits. Verify that the Accountable Entity complied with its Closure Plan. Ensure that the Accountable Entity returned any excess cash to MCC. Also, ensure that all assets (e.g., inventories, fixed assets, assets) procured with program funds were disposed of in accordance with the terms of the agreements. The auditors should present, as an annex to the Fund Accountability Statement, the balances and details of final inventories of nonexpendable property acquired under the agreements. These close-out audit procedures must be performed for any award that expires during the period audited.
- Determine the likelihood of effective IS controls.

6.6 There may be situations where an Accountable Entity has more than one Accountable Entity-funded agreement, either for multiple projects in one country or for projects in multiple countries. The Fund Accountability Statement included as **Appendix III** illustrates how to report the results of a single audit that covers more than one Accountable Entity agreement. In such cases, the Fund Accountability Statement must separately disclose the financial information (e.g., revenues, costs) for each agreement and must identify the country program to which each agreement applies. Questioned costs and internal control and compliance findings of any audits of sub-recipient must be reported in the Accountable Entity's financial audit using the same treatment and procedures as the recipient's own questioned costs and findings. The same reporting principles apply when only one Accountable Entity agreement is covered by the audit.

6.7 The auditors must generally express a single opinion on the Consolidated Fund Accountability Statement that includes more than one agreement with MCC. Auditors must *not* express separate opinions on Fund Accountability Statements of each agreement or program unless specifically requested to do so by the MCC or the Accountable Entity.

COST-SHARING SCHEDULE

6.8 MCC agreements may require cost-sharing contributions by the Recipient Country Government. Most agreements establish a life-of-project budget for such contributions. However, some agreements may establish annual budgets for those contributions. The type of cost-sharing contribution selected must be properly disclosed through the audit report. The review of the cost sharing schedule must be approached differently depending on whether the cost-sharing budget is a life-of project budget or an annual budget. In either case, the review consists principally of inquiries of Accountable Entity personnel and analytical procedures applied to financial data supporting the cost-sharing schedule.

6.9 The Accountable Entity must prepare the cost-sharing schedule from the Accountable Entity's books and records. In addition, the Accountable Entity must accept responsibility for the schedule's accuracy before the review commences.

AGREEMENT WITH LIFE-OF-PROJECT COST-SHARING BUDGET

6.10 For an agreement with a life-of-project budget for cost-sharing contributions, it is not possible to determine whether the contributions have been made as required until the agreement ends. Nonetheless, MCC and the Accountable Entity need reliable information to monitor actual cost-sharing contributions throughout the life of the agreement.

6.11 Thus, for agreements with a life-of-project budget for cost-sharing contributions, for each year that an audit is performed in accordance with these *Guidelines*, the auditors will review the cost-sharing schedule to determine if the schedule is fairly presented in accordance with the basis of accounting used by the Accountable Entity to prepare the schedule. The auditors must question all cost-sharing contributions that are either ineligible or unsupported costs. An ineligible cost is a cost that is unreasonable, prohibited by the agreements or applicable laws and regulations, or is not program-related. An unsupported cost lacks adequate documentation or does not have required prior approvals or authorizations. All questioned costs must be briefly described in the notes to the cost-sharing schedule. In addition, material questioned costs must be included as findings in the report on compliance. Notes to the cost-sharing schedule must be cross-referenced to the corresponding findings in the report on compliance. Also, reportable internal control weaknesses related to cost-sharing contributions must be set forth as findings in the report on internal control. (See an Illustration of a cost-sharing schedule at **Appendix IV** of these *Guidelines*.)

6.12 In addition, for closeout audits of agreements with a life-of-project budget for cost-sharing contributions, the auditors will review the cost-sharing schedule to determine if the recipients provided such contributions in accordance with the terms of the agreement. If actual contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost-sharing schedule. (See an Illustration of a cost-sharing schedule at **Appendix IV** of these *Guidelines*.)

AGREEMENT WITH ANNUAL COST-SHARING BUDGET

6.13 For agreements with an annual budget for cost-sharing contributions, for each year that an audit is performed in accordance with these *Guidelines*, the auditors will review the cost-sharing schedule to determine whether: a) the schedule is fairly presented in accordance with the basis of accounting used by the Accountable Entity to prepare the cost-sharing schedule, and b) contributions were provided by

the Accountable Entity in accordance with the terms of the agreement. The auditors must question all cost-sharing contributions that are either ineligible or unsupported costs. An ineligible cost is unreasonable, prohibited by the agreements (including the MCC Cost Principles) or applicable laws and regulations, or is not program-related. An unsupported cost lacks adequate documentation or does not have required prior approvals or authorizations. All questioned costs must be briefly described in the notes to the cost-sharing schedule. In addition, material questioned costs must be included as findings in the report on compliance. Notes to the cost-sharing schedule must be cross-referenced to the corresponding findings in the report on compliance. Also, reportable internal control weaknesses related to cost-sharing contributions must be set forth as findings in the report on internal control. If actual cost-sharing contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost-sharing schedule.

INTERNAL CONTROL

6.14 The auditors must review and evaluate the Accountable Entity’s internal control related to MCC programs to obtain a sufficient understanding of the design of relevant control policies and procedures and whether those policies and procedures are in operation. The GAO Green Book⁵⁸ may prove helpful in assessing the Accountable Entity’s internal control. The internal control environment must be documented in the working papers.

6.15 Auditors must then prepare the report required by these *Guidelines*, identifying deficiencies in the design or operation of internal control. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A deficiency in design exists when: a) a control necessary to meet the control objective is missing, or b) an existing control is not properly designed so that, even if the control operates as designed, the control objective would not be met. A deficiency in operation exists when a properly designed control does not operate as designed or when the person performing the control does not possess the necessary authority or qualifications to perform the control effectively.

A significant deficiency is a deficiency or a combination of deficiencies in Internal Control over Financial Reporting (ICOFR) that is less severe than a material weakness, yet important enough to merit attention by those responsible for oversight of the Accountable Entity or Covered Provider’s financial reporting. A material weakness is a deficiency or a combination of deficiencies in ICOFR, such that there is a reasonable possibility that a material misstatement of the entity’s annual or interim financial statements will not be prevented or detected on a timely basis. Significant deficiencies and material weaknesses must be set forth in the report as “findings” (see **Appendix V** of these *Guidelines*). Other matters related to internal control (e.g., control deficiencies) should be included in a separate management letter to the Accountable Entity and referred to in the report on internal control. The management letter should be provided to the MCC along with the audit report.

6.16 The major internal control components to be studied and evaluated include, but are not limited to, the controls related to each revenue and expense account on the Fund Accountability Statement. The auditors must:

⁵⁸ GAO, *Standards for Internal Control in the Federal Government*, GAO-14-704G, September 2014

- a) Obtain a sufficient understanding of internal control to plan the audit and to determine the nature, timing, and extent of tests to be performed.
- b) Assess inherent risk and control risk, as well as determine the combined risk. Inherent risk is the susceptibility of an assertion (e.g., an account balance) to a material misstatement, assuming there are no related internal control policies or procedures. Control risk is the risk that a material misstatement that could occur in an assertion will not be prevented or detected in a timely manner by the entity's internal control policies or procedures. Combined risk (sometimes referred to as detection risk) is the risk that the auditor will not detect a material misstatement that exists in an assertion. Combined risk is based upon the effectiveness of an auditing procedure and the auditor's application of that procedure.
- c) Summarize the risk assessments for each assertion in a working paper. The risk assessments should consider the following broad categories under which each assertion should be classified⁵⁹: a) existence or occurrence; b) completeness; c) rights and obligations; d) valuation or allocation; and e) presentation and disclosure. At a minimum, the working papers should identify the name of the account or assertion; the account balance or the amount represented by the assertion; the assessed level of inherent risk (high, moderate, or low); the assessed level of control risk (high, moderate, or low); the combined risk (high, moderate, or low); and a description of the nature, timing, and extent of the tests performed based on the combined risk. These summary working papers should be cross-indexed to the supporting working papers that contain the detailed analysis of the fieldwork. If control risk is evaluated at less than the maximum level (high), then the basis for the auditor's conclusion must be documented in the working papers.
 - c.1 If the auditors assess control risk at the maximum level for assertions related to material account balances, transaction classes, and disclosure components of financial statements when such assertions are significantly dependent upon computerized IS, the auditors must document in the working papers the basis for such conclusions by addressing: a) the ineffectiveness of the design and/or operation of controls, or b) the reasons why it would be inefficient to test the controls.
- d) Evaluate the control environment, the adequacy of the accounting systems, and control procedures. Emphasize the policies and procedures that pertain to the recipient's ability to record, process, summarize, and report financial data consistent with the assertions embodied in each account of the Fund Accountability Statement. This should include, but not be limited to, the control systems for:
 - Ensuring that charges to the program are proper and supported
 - Managing cash on hand and in bank accounts
 - Procuring goods and services
 - Managing inventory and receiving functions
 - Managing personnel functions, including timekeeping, salaries, and benefits

⁵⁹ FAM 395 G and 395 H

- Managing and disposing of assets (e.g., supplies, materials, vehicles, equipment, food products, and tools) purchased either by the Accountable Entity or directly by MCC
 - Ensuring compliance with agreement terms and applicable laws and regulations that collectively have a material impact on the Fund Accountability Statement. Specifically, evaluate compliance with the Procurement Agreement and Procurement Guidelines, as well as the Fiscal Accountability Plan. The results of this evaluation should be properly documented within the auditor's work papers.
- e) Evaluate internal control established to ensure compliance with cost-sharing requirements, if applicable, including both provision and management of the contributions.
- f) Include in the study and evaluation other policies and procedures that may be relevant if they pertain to data the auditors use in applying auditing procedures. This may include, for example, policies and procedures that pertain to non-financial data that the auditors use in analytical procedures.

6.17 In fulfilling the audit requirement relating to an understanding of internal control and assessing the level of control risk, the auditor must follow, at a minimum, the guidance contained in AICPA SAS Nos. 109 and 115 (AU-C sec 314 and AU-C sec 325), respectively entitled *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement, and Communicating Internal Control Related Matters Identified in an Audit*, as well as SAS No. 117 (AU-C sec 801) *Compliance Audits*.

COMPLIANCE WITH AGREEMENT TERMS AND APPLICABLE LAWS AND REGULATIONS

6.18 In fulfilling the audit requirement to determine compliance with agreement terms and applicable laws and regulations related to MCC programs, the auditors must, at a minimum, follow guidance contained in AICPA SAS No. 117 (AU-C sec 801) *Compliance Audits*. The compliance review must also determine—on audits of awards that present cost-sharing budgets on an annual basis and on close-out audits of awards that present cost-sharing budgets on a life-of-project basis— if cost-sharing contributions were provided and accounted for in accordance with the terms of the agreements. The auditor's report on compliance must set forth as finding all material instances of noncompliance, defined as instances that could have a direct and material effect on the Fund Accountability Statement. Nonmaterial instances of noncompliance should be included in a separate management letter to the Accountable Entity and referred to in the report on compliance. The management letter should be provided to MCC along with the audit report.

6.19 The auditor's report should include all conclusions that fraud or an illegal act either has occurred or is likely to have occurred. In reporting material fraud, illegal acts, or other noncompliance, the auditors should place their findings in proper perspective. To give the reader a basis for judging the prevalence and consequences of these conditions, the instances identified should be related to the universe or the number of cases examined and is quantified in terms of U.S. dollars, if appropriate. In presenting material fraud, illegal acts, or other noncompliance, auditors must follow the reporting standards contained in Chapter 6 of *Government Auditing Standards*. Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense. If the auditors conclude that sufficient evidence of fraud or illegal acts exists, they must contact the OIG and exercise due professional care in pursuing indications of possible fraud and illegal acts to avoid interfering with potential future investigations or legal proceedings.

6.20 In planning and conducting the tests of compliance, the auditors must:

- a) Identify the agreement terms and pertinent laws and regulations and determine which of those, if not observed, could have a direct and material effect on the Fund Accountability Statement. Special attention should be given to the Procurement Agreement and Procurement Guidelines, MCC *Policies and Procedures for Common Payment System*, the *Cost Principles for Accountable Entities Involved in MCC Compact Implementation*, and the Fiscal Accountability Plan. The auditors must:
 - List all standard and program-specific provisions contained in the agreements that cumulatively, if not observed, could have a direct and material effect on the Fund Accountability Statement.
 - Assess the inherent and control risk that material noncompliance could occur for each of the compliance requirements listed in the bullet above.
 - Determine the nature, timing, and extent of audit steps and procedures to test for errors, fraud, and illegal acts that provide reasonable assurance of detecting both intentional and unintentional instances of noncompliance with agreement terms and applicable laws and regulations that could have a material effect on the Fund Accountability Statement. This should be based on the risk assessment described in the bullet above.
 - Prepare a summary working paper that identifies each of the specific compliance requirements included in the review, the results of the inherent, control, and combined (detection) risk assessments for each compliance requirement; the audit steps used to test for compliance with each of the requirements based on the risk assessment; and the results of the compliance testing for each requirement. The summary working paper should be cross-indexed to detailed working papers that support the facts and conclusions contained in the summary working paper.
- b) Determine if payments have been made in accordance with agreement terms, the Cost Principles, and applicable laws and regulations.
 - Determine whether the Accountable Entity is accurately tracking advance payments made to contractors and the liquidation of those advance payments consistent with the terms and conditions of contract agreements. Identify any material instances of non-compliance with agreement terms and/or instances in which the recipient's records do not support a complete and accurate status of advance payments owed by contractors.
 - Determine whether the Accountable Entity is accurately tracking amounts retained from their contractors as a percentage of amounts invoiced, consistent with the terms and conditions of contract agreements. Identify any material instances of non-compliance with agreement terms and/or instances in which the recipient's records do not support a complete and accurate status of amounts withheld from contractors.
 - Determine whether the Accountable Entity has an adequate system for ensuring that MCC funding is free of Value-Added Taxes (VAT), as well as other such taxes, tariffs, duties, and levies per the Compact or Threshold Program agreement. The system should identify VAT paid, claims for reimbursement, status of refunds, and outstanding balance. A note and/or

schedule describing the recipient's taxation control system and status of claims should be included in the Audit Report.

- c) Determine if funds have been expended for purposes not authorized or not in accordance with applicable agreement terms and Cost Principles. If so, the auditors must question these costs in the Fund Accountability Statement.
- d) Identify any costs not considered appropriate, classifying and explaining why these costs are questioned in accordance with the Cost Principles, applicable laws, and regulations.
- e) Determine whether assets, whether procured by the Accountable Entity or directly procured by MCC for the Accountable Entity's use, exist or were used for their intended purposes in accordance with the terms of the agreements. If not, the cost of such assets must be questioned.
- f) Determine whether any technical assistance and services, whether procured by the Accountable Entity or directly procured by MCC for the Accountable Entity's use, were used for their intended purposes in accordance with the agreements. If not, the cost of such technical assistance and services should be questioned.
- g) Determine if the amount of cost-sharing funds was calculated and accounted for, as required by the agreements or applicable Cost Principles.
- h) Determine if the cost-sharing funds⁶⁰ were provided according to the terms of the agreements and quantify any shortfalls.
- i) Determine whether those who received services and benefits were eligible to receive them.
- j) Determine whether the Accountable Entity's financial reports (including those on the status of cost-sharing contributions) contain information that is supported by the books and records.
- k) Determine whether the Accountable Entity held advances of MCC funds in interest-bearing accounts and whether the Accountable Entity remitted to MCC any interest earned on those advances.
- l) Determine whether the Accountable Entity complied with MCC's *Common Payment System Policy and Procedures*. This should include a determination as to whether the Accountable Entity had adequate systems in place to monitor the amount of periodic spending authority authorized by MCC, if applicable.

FOLLOW-UP ON PRIOR AUDIT RECOMMENDATIONS

6.21 The auditors must review the status of actions taken on findings and recommendations reported in prior audits of MCC-funded programs. *Government Auditing Standards* states:

“When planning the audit, auditors should ask management of the audited entity to identify previous audits, attestation engagements, and other studies that are directly related to the objectives of the audit, including whether related recommendations have been implemented. Auditors should evaluate whether the audited entity has taken appropriate corrective action to address findings and

⁶⁰ On audits of awards that present cost-sharing budgets on an annual basis and for closeout audits of awards that present cost-sharing budgets on a life-of-project basis, as explained in paragraphs 4.12 and 4.13 of these Guidelines.

recommendations from previous engagements that could have a significant effect on the subject matter. Auditors should use this information in assessing risk and determining the nature, timing, and extent of current audit work and determining the extent to which testing the implementation of the corrective actions is applicable to the current audit objectives.”

6.22 The auditors must review and report on the status of actions taken on prior findings and recommendations in the summary section of the audit report. The auditors should refer to the most recent contracted audit report for the same award (for a follow-up audit) or other MCC awards (for an initial audit). When corrective action has not been taken and the deficiency remains unresolved for the current audit period and is reported again in the current report, the auditors need to briefly describe the prior finding and status and show the page reference to where it is included in the current report. If there were no prior findings and recommendations, the auditors must include a note to that effect in this section of the audit report.

OTHER AUDIT RESPONSIBILITIES

6.23 The auditors must perform and document the following steps:

- a) Hold Entrance and Exit Conferences with the Accountable Entity. MCC should be notified of these conferences in order that MCC representatives may attend, if deemed necessary. The audit firm is required to hold an Entrance Conference before the audit starts and an Exit Conference informing the Accountable Entity of its results and findings.
- b) During the planning stages of an audit, communicate information to the auditee regarding the nature and extent of planned testing and reporting on compliance with laws, regulations, and ICOFR. Such communication should state that the auditors do not plan to provide opinions on compliance with laws, regulations, and ICOFR⁶¹. Written communication is preferred. Auditors should document the communication in the working papers.
- c) Institute QC procedures to ensure that sufficient competent evidence is obtained through inspection, observation, inquiries, and confirmations to afford a reasonable basis for an opinion regarding the Fund Accountability Statement under audit. While auditors may use their standard procedures for ensuring QC, those procedures must, at a minimum, ensure that:
 - c.1 Audit reports and supporting working papers are reviewed by an auditor, preferably at the partner level, who was not involved in the audit. This review must be documented.
 - c.2 All quantities and monetary amounts involving calculations are footed and cross-footed.
 - c.3 All factual statements, numbers, conclusions, and monetary amounts are cross-indexed to supporting working papers.
- d) Ascertain whether the Accountable Entity ensured that audits of its sub-recipients were performed to ensure accountability for MCC funding passed through to sub-recipients. If sub-recipient audit requirements were not met, the auditors should disclose this in the Fund Accountability Statement and consider qualifying their opinion.

⁶¹ The auditors only express an opinion on the Fund Accountability Statement as indicated in Chapter 4 of these *Guidelines*.

- e) Obtain a management representation letter in accordance with AICPA SAS No. 85 (AU-C sec 333) signed by the Accountable Entity's management. See **Appendix II** for an illustrative management representation letter.

CLOSEOUT AUDIT

A closeout audit is an audit for the Compact or Threshold Program agreement that concluded during the period audited. Closeout audits require additional scope of the audit services, including but not limited to the following:

- Review advances made to the Accountable Entity by MCC as well as advances made by the Accountable Entity to contractors and ensure proper liquidation per the terms of the applicable agreement. Review pending reimbursements by MCC to the Accountable Entity or by the applicable Accountable Entity to third-party recipients.
- Ensure that the Accountable Entity has returned any excess cash to MCC
- Review final share of costs in accordance with the terms of the agreement, if applicable
- Ensure that all assets (e.g., inventories, fixed assets, commodities) procured with program funds were disposed of in accordance with the terms of the agreements.

The auditors must determine whether the Fund Accountability Statement showing the balances and details of final inventories of nonexpendable property acquired under the award is presented fairly in all material respects in relation to the financial statements. This inventory must indicate which items were titled to the U.S. Government and which were titled to other entities. These closeout audit procedures must be performed for any award that expires during the period audited.

For closeout audits of awards with a life-of-project budget for cost-sharing or matching contributions, the auditors will review the cost-sharing or matching schedule to determine if the recipients provided such contributions in accordance with terms of the agreement. If actual contributions were less than budgeted contributions, the shortfall will be identified in the appropriate column of the cost-sharing or matching schedule.

CHAPTER 7. AUDIT REPORTS

What is an Auditor's Opinion?

7.1 An auditor's opinion is a certification that accompanies financial statements based on an audit of an auditor's judgment on the procedures and records used to produce the statements, regardless of whether material misstatements exist in the financial statements. For financial audits, the opinion may be an unmodified opinion, a modified opinion, or an adverse opinion. The audit is performed by an auditor who is independent of the entity being audited. An auditor's opinion is also called an accountant's opinion.

7.2 An auditor's opinion is presented in the auditor's report. The audit report begins with an introductory section outlining the responsibility of management and the responsibility of the audit firm. The second section identifies the financial statements on which the auditor's opinion is given. A third section outlines the auditor's opinion. Although it is not found in all audit reports, a fourth section may be presented as further explanation regarding a qualified opinion or an adverse opinion.

OPINION TYPES

7.3 An unmodified opinion is also known as a clean opinion. The auditor reports an unmodified opinion if the financial statements are found to be free from material misstatements.

A modified opinion is given when an entity's financial records have not been presented in accordance with the generally accepted accounting principles (GAAP) or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis). Although the wording of a modified opinion is very similar to an unmodified opinion, the auditor provides an additional paragraph including exclusions from the cleanliness of the financial statements and provides an explanation as to why the auditor report is not unmodified.

An adverse opinion is the most unfavorable opinion an entity may receive. An adverse opinion indicates financial records are not in accordance with GAAP or any other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis) and are grossly misstated. An adverse opinion may be an indicator of fraud and entities that receive an adverse opinion are forced to correct their financial statements and have the financial statements re-audited.

In the event the auditor is unable to complete the audit report due to absence of financial records or insufficient cooperation from management, the auditor issues a disclaimer of opinion. This is an indication that no opinion over the financial statements was able to be determined. A disclaimer of opinion is not an opinion itself.

7.4 To make it easier for audit firms to comply with these *Guidelines*, the format and content of the audit reports should closely follow the following illustrative reports in the appendices of these *Guidelines*.

- a) The audit report package must contain:
 - Title page (close-out audits must be visibly titled)⁶²
 - Table of contents

⁶² "Closeout" audits must specify they are closeout audits on the title page. A closeout audit is an audit for an award that expired during the period audited.

- Transmittal letter
- Independent audit reports (draft and final)(dated)
- Summary that includes:
 - A background section with a general description of the Accountable Entity programs audited, the period covered, the program objectives, a clear identification of all entities mentioned in the report, a section on the follow-up of prior audit recommendations, and whether the Accountable Entity has a MCC-authorized provisional indirect cost rate
 - The objectives and scope of the financial audit and a clear explanation of the procedures performed and the scope limitations, if any
 - A brief summary of the audit results on the:
 - Fund Accountability Statement
 - Questioned costs
 - Internal control
 - Compliance with agreement terms and applicable laws and regulations
 - Status of prior audit recommendations
 - A brief summary of the type of cost-sharing/matching contributions and the results of there view
 - A brief summary of the Accountable Entity's management comments regarding its view on the audit and results and findings.

INDEPENDENT AUDITOR'S REPORT ON THE FUND ACCOUNTABILITY STATEMENT REPORT

- b) The Independent Auditor's Report on the Fund Accountability Statement Report is the auditor's report on the Fund Accountability Statement, identifying any material questioned costs not fully supported with adequate records or not eligible under the terms of the agreements. The report must be in conformance with the standards for reporting in Chapter 6 of *Government Auditing Standards* and must include:
- b.1 The **auditor's opinion** on whether the Fund Accountability Statement presents fairly, in all material respects, program revenues, costs incurred, and assets and technical assistance directly procured by Accountable Entity for the year then ended, in accordance with the terms of the agreements and in conformity with generally accepted accounting principles or other basis of accounting. This opinion must clearly state that the audit was performed in accordance with *Government Auditing Standards*. Any deviations from these standards, including noncompliance with the requirements for CPE and external QCRs, must be disclosed (see **Appendix V** of these *Guidelines*).

- b.2 The **Fund Accountability Statement** identifying the program revenues, costs incurred, and assets and technical assistance directly procured for the period audited. The Fund Accountability Statement must also identify questioned costs not considered eligible for reimbursement and unsupported, if any, including the cost of any assets and technical assistance directly procured by MCC whose existence or proper use in accordance with the agreements could not be verified. All material questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance. Also, the notes to the Fund Accountability Statement must briefly describe both material and immaterial questioned costs and must be cross-referenced to any corresponding findings in the report on compliance (see **Appendix V** of these Guidelines). All questioned costs in the notes to the Fund Accountability Statement must be stated in U.S. dollars
- b.3 **Notes to the Fund Accountability Statement**, including a summary of the significant accounting policies, explanation of the most important items of the statements, the exchange rates during the audit period, value-added taxes, and foreign currency restrictions, if any.

COST-SHARING REVIEW REPORT

- c) The Cost-Sharing Review Report is a report on the auditor's review of the schedule of cost-sharing contributions. The report must follow the guidance in the AICPA SSARS, *Review of Financial Statements*, AR-C Section 90. The report must include:
 - c.1 **A review report on the cost-sharing schedule.** This review report must state that the review was conducted in accordance with AICPA standards. It should also explain that a review is more limited in scope than an examination performed in accordance with AICPA standards and state that an opinion on the schedule is not expressed. The report must identify material questioned costs related to the provision of, and accounting for, cost-sharing funds, with a reference to the corresponding finding in the report on compliance if the questioned costs are material. The report must provide negative assurance with regard to the provision of, and accounting for, cost-sharing contributions for items not tested (see **Appendix IV** of these *Guidelines*).
 - c.2 The **cost-sharing schedule** identifying questioned costs (see **Appendix IV** of these *Guidelines*). Cost-sharing contributions that are unreasonable, prohibited by the agreements or applicable laws and regulations, or not program-related are ineligible. Cost-sharing contributions that lack adequate documentation or do not have required prior approvals or authorizations are unsupported.
 - c.3 The cost-sharing schedule identifying the budgeted amounts required by the agreements⁶³, the amounts actually provided, and any cost-sharing shortfalls.
 - c.4 Notes to the cost-sharing schedule that briefly explain the basis for questioned costs and shortfalls, if applicable. The notes must be cross-referenced to the corresponding findings, if the questioned costs are material, in the report on compliance.

⁶³ This step is required for audits of agreements that present cost-sharing budgets on an annual basis and for closeout audits of awards that present cost-sharing budgets on a life-of-project basis.

REPORT ON INTERNAL CONTROL AND COMPLIANCE

- d) The auditor's report must include as a minimum: a) the scope of the auditor's work in obtaining an understanding of internal control and in assessing the control risk; and b) the reportable conditions, including the identification of material weaknesses in the Accountable Entity's internal control. Reportable conditions must be described in a separate section. This report must be made in conformance with SAS No. 115 and the standards for reporting in Chapter 6 of *Government Auditing Standards*. Other matters related to internal control should be communicated to the Accountable Entity in a separate management letter that should be referred to in the report on internal control and sent with the audit report.
- e) The Report on Internal Control and Compliance also includes the auditor's report on the Accountable Entity's compliance with the Procurement Agreement and Procurement Guidelines, the Fiscal Accountability Plan, and other agreement terms and applicable laws and regulations related to MCC-funded programs. The report must follow the guidance in SAS No. 117. Material instances of noncompliance must be described in a separate section (see **Appendix V** of these *Guidelines*). Nonmaterial instances of noncompliance should be communicated to the Accountable Entity in a separate management letter that should be sent with the audit report. All material questioned costs resulting from instances of noncompliance must be included as findings in the report on compliance. Also, the notes to the Fund Accountability Statement that describe both material and immaterial questioned costs must be cross-referenced to any corresponding findings in the report on compliance.
- e.1 The auditor's report must include all conclusions, based on evidence obtained, that fraud or an illegal act either has occurred or is likely to have occurred. This report must include identification of all questioned costs, if any, as a result of fraud or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected and whether the Accountable Entity does or does not agree with the findings and questioned costs.
- e.2 In reporting material fraud, illegal acts, or other noncompliance, the auditors must place their findings in proper perspective. To give the reader a basis for judging the prevalence and consequences of these conditions, the instances identified should be related to the universe or the number of cases examined and is quantified in terms of U.S. dollar value, if appropriate. In presenting material fraud, illegal acts, or other noncompliance, auditors must follow the reporting standards contained in Chapter 6 of *Government Auditing Standards*. Auditors may provide less extensive disclosure of fraud and illegal acts that are not material in either a quantitative or qualitative sense. Chapter 4 of *Government Auditing Standards* provides guidance concerning factors that may influence auditors' materiality judgments. If the auditors conclude that sufficient evidence of fraud or illegal acts exist, they must contact the OIG and exercise due professional care in pursuing indications of possible fraud and illegal acts so as not to interfere with potential future investigations or legal proceedings.

FINDINGS

7.5 The findings contained in the reports on internal control and compliance related to MCC-funded programs must include a description of the condition (what is) and criteria (what should be). The cause

(why it happened) and effect (what harm was caused by not complying with the criteria) must be included in the findings. In addition, the findings must contain a recommendation that corrects the cause and the condition, as applicable. It is recognized that material internal control weaknesses and noncompliance found by the auditors might not always have all of these elements fully developed, given the scope and objectives of the specific audit. The auditors must, however, at least identify the condition, criteria, and possible effect to enable management to determine the effect and cause. This will help management take timely and proper corrective action.

7.6 Findings that involve monetary effect must:

- Be quantified and included as questioned costs in the Fund Accountability Statement, the Auditor's Report on Compliance, and cost-sharing schedule (cross-referenced)
- Be reported without regard to whether the conditions giving rise to them were corrected
- Be reported whether the Accountable Entity does or does not agree with the findings or questioned costs
- Contain enough relevant information to expedite the audit resolution process (e.g., number of items tested, size of the universe, error rate, corresponding U.S. dollar amounts).

7.7 The reports must also contain, after each recommendation, pertinent views of responsible Accountable Entity officials concerning the auditor's findings and actions taken by the Accountable Entity to implement the recommendations. If possible, the auditor should obtain written comments. When the auditors disagree with management comments opposing the findings, conclusions or recommendations, they must explain their reasons following the comments. Conversely, the auditors should modify their report if they find the comments to be valid.

7.8 Any evidence of fraud or illegal acts that have occurred or are likely to have occurred must be included in a separate written report, if deemed necessary by MCC. This report must include an identification of all questioned costs as a result of fraud or illegal acts, without regard to whether the conditions giving rise to the questioned costs have been corrected or whether the Accountable Entity does or does not agree with the findings and questioned costs.

REPEAT FINDINGS

7.9 Repeat audit findings generally occur when corrective actions either were not effectively implemented or failed to address the root cause of the problem. The Accountable Entity must ensure that corrective actions taken to close an audit recommendation directly address the root cause of the finding cited. The auditor must state that the finding has been repeated. (See **Appendix VII**)

MANAGEMENT LETTER

7.10 Other internal control deficiencies identified during the audit that are not considered severe enough to be significant deficiencies or material weaknesses need not be communicated in writing. If auditors determine the deficiencies are important enough to merit management's attention, they may choose to orally communicate them. Unlike material weaknesses and significant deficiencies, once the other inter-

nal control deficiencies are communicated to management, auditors are not required to repeat them, even if the deficiencies have not been remediated.

7.11 Auditors may choose to include the other internal control deficiencies in written communication for various reasons. It can be a way to ensure that all appropriate parties are aware of a deficiency and have the opportunity to address it. Written communication also serves as a reference document for management in its ongoing evaluation of the nonprofit's internal controls.

7.12 Other internal control deficiencies, including failure to consistently maintain proper supporting documentation for expenses, may become significant deficiencies if not corrected by management. This depends, in part, on the pervasiveness of the deficiency. Auditors may include such other internal control deficiencies in their annual written communications to prompt continued monitoring by management or those charged with governance.

7.13 During the course of an audit, the auditors might also identify other matters that are not considered deficiencies in internal control, but are opportunities for strengthening procedures and/or operating deficiencies. There is no requirement for the auditors to communicate other matters in writing, although this is sometimes done as a value-added service to the organization.

7.14 It is important to note that auditors' consideration of internal control over financial statement reporting is not conducted for the purpose of identifying all deficiencies in internal control that might be material weaknesses or significant deficiencies or for the purpose of expressing an opinion on your internal controls. Material weaknesses or significant deficiencies may exist that were not identified during the audit and auditors are required to disclose this in their written communication.

APPENDIX I

ILLUSTRATIVE ENGAGEMENT LETTER

The following is an illustration of an engagement letter that will satisfy the requirements of these Guidelines. For additional guidance, the auditors should refer to the applicable American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SAS).

TO COMPLY WITH THESE GUIDELINES, THE FORMAT AND CONTENT OF THE ENGAGEMENT LETTER SHOULD CLOSELY FOLLOW THE FOLLOWING ILLUSTRATIVE LETTER.

[Auditor letterhead]

[Date]

Board of Directors

Name of Accountable Entity

Complete Mailing Address

Dear _____:

[Name of auditor] will audit the Fund Accountability Statement(s) (FAS) of [name of recipient] and related notes to the FAS for the period ended Month XX, 20XX. We confirm our acceptance and our understanding of this audit engagement by means of this letter. The objectives and scope of our audits are as follows:

- 1) Express an opinion on whether **[name of Accountable Entity]**'s FAS for the Millennium Challenge Corporation (MCC) funded programs presents fairly, in all material respects, revenues received, costs incurred, and assets and technical assistance directly procured by MCC for the period from Month 1, **[20XX]** to Month 31, **[20XX]**, in conformity with the terms of the agreements and Generally Accepted Accounting Principles (GAAP) or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis)
- 2) Report any significant deficiencies and material weaknesses in Internal Control Over Financial Reporting (ICOFR) that come to our attention as a result of the audit
- 3) Report on the results of our tests of **[name of Accountable Entity]**'s compliance with the agreement terms and applicable laws and regulations related to MCC-funded programs
- 4) If applicable, provide a limited assurance to determine whether the cost-sharing contributions were provided and accounted for by the Accountable Entity in accordance with the terms of the agreements
- 5) Determine if the **[name of Accountable Entity]** has taken adequate corrective action on prior audit report recommendations

Upon completion of our audit, we will issue a written report consistent with these objectives. We cannot provide assurance that an unmodified opinion on the financial statements will be expressed. Circumstances may arise in which it is necessary for us to modify our opinions or add emphasis-of-matter or other-matter paragraphs.

The purpose of our report on internal control and compliance with laws, regulations, contracts, and grant agreements solely will be to describe the scope of our testing of internal control and compliance with applicable laws, regulations, contracts, and grant agreements, as well as the results of that testing, and not to provide an opinion on the effectiveness of ICOFR or compliance with applicable laws, regulations, contracts, and grant agreements. Accordingly, our report on internal control and compliance with laws, regulations, contracts, and grant agreements will not be suitable for any other purpose.

Management's Responsibilities

Our audit will be conducted on the basis that **[name of Accountable Entity]**'s management acknowledges and understands that it has responsibility for the following:

- 1) The preparation and fair presentation of the **[name of Accountable Entity]**'s FAS in accordance with GAAP or another comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis)
- 2) Maintaining effective ICOFR. This includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of FAS(s) that are free from material misstatement, whether due to fraud or error
- 3) Complying with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]**
- 4) Preparing, measuring, and presenting the cost sharing contributions, if applicable, in accordance with the terms of the agreements
- 5) Designing, implementing, and maintaining internal controls to prevent and detect fraud. This includes providing management's written representation that it has disclosed to the auditor the results of its assessment of the risk that the financial statements may be materially misstated as a result of fraud
- 6) Maintaining adequate accounting records, selecting and applying appropriate accounting policies, and safeguarding the entity's assets related to **[name of Accountable Entity's]** operations.

In addition, **[name of Accountable Entity]**'s management acknowledges and understands that it has the responsibility to provide us with the following:

- 1) Access to all information of which management is aware that is relevant to the preparation and fair presentation of the FAS, including records, documentation, and other matters
- 2) Additional information that we may request from management for the purpose of the audit
- 3) Unrestricted access to persons within **[name of Accountable Entity]** from whom we determine it necessary to obtain audit evidence.

[Accountable Entity] management agrees to communicate to us the following:

- 1) The discovery of any material misstatement that would affect the fair presentation of its Fiscal Year (FY) **[20XX]** or prior FY's financial statements
- 2) All deficiencies in the design or operation of ICOFR as of **[FY-end date]**, including separately identifying any deficiencies management believes to be significant deficiencies or material weaknesses

- 3) A description of a) any fraud that did, or suspected fraud that could, result in a material misstatement to the financial statements and b) any other fraud that did not, or suspected fraud that would not, result in a material misstatement to the **[name of Accountable Entity]**'s financial statements, but involves senior management, management, or other employees who have a significant role in the **[name of Accountable Entity]**'s internal control
- 4) Any events occurring or facts discovered subsequent to the date of the financial statements, of which management may become aware, that may affect the financial statements
- 5) Whether, subsequent to the date being reported on, there were any changes in internal control or other factors that might significantly affect internal control, including any corrective actions taken by management with regard to material weaknesses and significant deficiencies
- 6) Agree to correct any material misstatements/state that uncorrected misstatements are immaterial, both individually and in the aggregate
- 7) Establish and maintain a tracker for the status of audit findings/recommendations and implemented Corrective Action Plans (CAP).

As part of our audit process, we will require from **[name of Accountable Entity]** management written confirmation concerning representations made to us in connection with the audit of the financial statements, including ICOFR; compliance with applicable laws, regulations, contracts, and grant agreements; and other related matters.

Definition and Limitations of ICOFR

An entity's ICOFR is a process enacted by those charged with governance, management, and other personnel, the objectives of which are to provide reasonable assurance that 1) transactions are properly recorded, processed, and summarized to permit the preparation of financial statements in accordance with GAAP or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis), and assets are safeguarded against loss from unauthorized acquisition, use, or disposition, and 2) transactions are executed in accordance with provisions of applicable laws, including those governing the use of budget authority, regulations, contracts, and grant agreements, noncompliance with which could have a material effect on the financial statements.

Because of its inherent limitations, ICOFR may not prevent, detect, or correct misstatements due to fraud or error.

Auditor's Responsibilities

We are responsible for conducting our audit in accordance with U.S. Generally Accepted Government Auditing Standards (GAGAS), issued by the American Institute of Certified Public Accountants (AICPA), and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain

reasonable, rather than absolute, assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the auditor's assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. An audit also involves evaluating the appropriateness of the accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, an unavoidable risk exists that some material misstatements in the financial statements may not be detected, even though the audit is properly planned and performed in accordance with GAGAS.

In making our risk assessments, we will consider internal control relevant to the preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the **[name of Accountable Entity]**'s ICOFR. As such, we will not express an opinion on internal control. In addition, our internal control work will not necessarily identify all deficiencies in internal control, including those that might be material weaknesses or significant deficiencies.

We will communicate all deficiencies in internal control of which we become aware. We are responsible for communicating in writing to those charged with governance any significant deficiencies and material weaknesses in internal control that come to our attention as a result of the audit. If we identify deficiencies in **[name of Accountable Entity]**'s internal control that we consider not to be material weaknesses or significant deficiencies, we will communicate these matters in writing to management and, where appropriate, will report on them separately. In addition, if we identify misstatements or new deficiencies, we will communicate them to **[name of Accountable Entity]** management on a timely basis.

In accordance with GAGAS, we are responsible for testing compliance with selected provisions of laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]** that have a direct effect on the determination of material amounts in **[name of Accountable Entity]**'s Fund Accountability Statements and performing certain other limited procedures as part of our audit. We will not test compliance with all laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]**. We caution that noncompliance may occur and not be detected by these tests.

Audit Coordination and Other Matters

To use audit resources efficiently and expedite audit completion, we will work with **[name of Accountable Entity]** staff to obtain information needed for the audit. This assistance may include locating, copying, and providing selected documents, as well as participating in meetings. We will need draft Fund Accountability Statements and any other information to be included in the document containing our auditor's report in sufficient time for us to complete our audit in accordance with the proposed timetable. We will discuss this assistance with **[name of Accountable Entity]** staff and arrive at mutually acceptable time frames.

We will conduct an Entrance Conference with **[name of Accountable Entity]** staff on **[or by] [date]**. We plan to issue our report on a mutually agreed-upon date. **[Insert any additional details as appropriate regarding report timing.]** We will also provide periodic status reports on our work upon your request. If we encounter problems that will affect the reporting date, we will discuss them with you in a timely manner. We look forward to working with **[name of Accountable Entity]** and appreciate its cooperation in working with us to complete the audit in a timely manner.

This assignment will be conducted under my direction, with assistance from **[name and title of manager]**, who can be reached at **[phone number]** or by e-mail at **[e-mail]**, and **[name and title of site auditor]**, who can be reached at **[phone number]** or by e-mail at **[e-mail]**.

The attached acknowledgment page should be signed by management and returned to us to indicate your acknowledgment of, and agreement with, the terms and arrangements of our audit of the financial statements and to indicate management's acknowledgment and understanding of our respective responsibilities.

Should this letter not represent your understanding of the nature of this engagement, or should you have any questions or need further information, please contact me at **[phone number]** or by e-mail at **[e-mail]**.

We look forward to a successful engagement.
Sincerely yours,

[Auditor's name and title]

APPENDIX II

ILLUSTRATIVE MANAGEMENT REPRESENTATION LETTER

The following illustrations of management representation letters will provide useful example of a Management Letter that will satisfy the requirements of these Guidelines. For additional guidance, the auditors should refer to the applicable American Institute of Certified Public Accountants (AIC-PA) Statements on Auditing Standards (SAS).

TO COMPLY WITH THESE GUIDELINES, THE FORMAT AND CONTENT OF THE MANAGEMENT LETTER SHOULD CLOSELY FOLLOW THE FOLLOWING ILLUSTRATIVE LETTER.

Illustrative Management Representation Letter

(For the Consolidated Fund Accountability Statement)

[Date of Auditor’s Report and Completion of the Audit]⁶⁴

[Name and Title of Audit Organization Head]

[Address of Audit Organization]

Dear **[Name of Audit Organization Head]**:

We are providing this letter in connection with your audit of the Fund Accountability

Statement(s) of **[name of Accountable Entity]** as of **[dates]** and the related notes to the Fund Accountability Statement(s) (hereinafter referred to as the “financial statements”).

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, as of **[date of auditor’s report]**, the following representations made to you during your audit(s):

- 1) We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter, dated **[insert date of engagement letter]**, for the preparation and fair presentation of the financial statements in accordance with Generally Accepted Accounting Principles (GAAP) or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis). The financial statements are fairly presented in accordance with GAAP or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis). **[If there are departures from the basis of accounting, this statement should be modified to disclose all known instances of departure]**
- 2) Significant assumptions that we used in making accounting estimates, including those measured at fair value, are reasonable
- 3) We have provided you with all relevant information and access, as agreed upon in the terms of the audit engagement letter, including the following:
 - a) Access to all information that is relevant to the preparation and fair presentation of the financial statements (e.g., records, documentation, other matters)
 - b) Additional information that you have requested from us for the purpose of the audit, including, but not limited to:

⁶⁴ This date should be the date that the client presents and signs the letter. In no event should the letter be presented and signed prior to the date of the accountant’s review report.

- i) Minutes of meetings or summaries of actions of recent meetings for which minutes have not been prepared of the [Board of Directors, Stockholders, directors, or other similar bodies of those charged with governance]
 - c) Unrestricted access to and full cooperation of personnel within the entity from whom you determined it necessary to obtain audit evidence
- 4) Except as disclosed to you in writing, there have been none of the following:
 - a) Circumstances that have resulted in communications from [name of Accountable Entity's] legal counsel reporting evidence of a material violation of law or breach of fiduciary duty or similar violations by [name of Accountable Entity] of any agent thereof
 - b) Communications from MCC, USAID OIG, governmental representatives, employees, or others concerning investigations or allegations of noncompliance with laws or regulations; deficiencies in financial reporting practices; or other matters that could have a material adverse effect on the financial statements
- 5) All transactions have been recorded in the accounting records and are reflected in the financial statements
- 6) There are no uncorrected misstatements in the financial statements, as we have corrected the financial statements for any misstatements that you have identified during the audit and communicated to us **OR [The effects of uncorrected financial statement misstatements in the attached summary are immaterial, both individually and in the aggregate, to the financial statements taken as a whole]**
- 7) We have no plans or intentions that may materially affect the recognition, measurement, presentation, disclosure, or classification of assets and liabilities
- 8) We have disclosed to you all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the financial statements **OR [We are not aware of any pending or threatened litigation and claims whose effects should be considered when preparing the financial statements]**
- 9) All events or transactions subsequent to Month XX, 20X2 [**or date of latest audited financial statements**] and for which GAAP or other comprehensive basis of accounting (including the cash receipts and disbursements basis and modifications of the cash basis) requires adjustment or disclosure have been adjusted or disclosed in the financial statements
- 10) We have properly recorded or disclosed in the financial statements changes in the accounting principle that affect the consistency of the financial statements between the periods presented **OR [There are no changes in accounting principle that affect the consistency of the financial statements between the periods presented.]**

Internal Control

- 11) We acknowledge and fulfilled our responsibility for maintaining effective internal control over the programs, including the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error
- 12) We acknowledge and fulfilled our responsibility for the design, implementation, and maintenance of effective internal control to prevent and detect fraud within the programs
- 13) We have **[no knowledge of any] OR [disclosed to you all information that we are aware of regarding]** fraud or suspected fraud affecting the entity involving 1) management or employees who have significant roles in Internal Control Over Financial Reporting (ICOFR) or 2) others when the fraud could have a material effect on the financial statements. **[If there is knowledge of any instances, including those that do not result in a material misstatement to the financial statements, describe them]**
- 14) We have **[no knowledge of any] OR [disclosed to you all information that we are aware of regarding]** allegations of fraud or suspected fraud affecting the financial statements communicated by employees, former employees, or others
- 15) We have no knowledge of any officer of **[name of Accountable Entity]** or any other person acting under the direction thereof, having taken any action to fraudulently influence, coerce, manipulate, or mislead you during your audit
- 16) We are responsible for complying with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]**
- 17) There are no instances of noncompliance or suspected noncompliance with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]** whose effects should be considered when preparing the financial statements **OR** We have disclosed to you all instances of noncompliance or suspected noncompliance with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]** whose effects should be considered when preparing financial statements.

[Signed by Accountable Entity Head]

[Signed by Chief Financial Officer]

Enclosure(s)

Illustrative Management Representation Letter

*(For the Cost-Sharing Schedule)***[Date of Auditor’s Report and Completion of the Audit]**⁶⁵**[Name and Title of Audit Organization Head]****[Address of Audit Organization]**Dear **[Name of Audit Organization Head]**:

We are providing this letter in connection with your review of the cost-sharing schedule of **[name of Accountable Entity]** as of **[dates]** and the related notes to the cost-sharing schedule for the purpose of obtaining limited assurance that there are no material modifications that should be made to the accompanying cost-sharing schedule in order for it to be in conformity with the basis of accounting used to prepare the cost-sharing schedule. We confirm that we are responsible for the fair presentation of the cost-sharing schedule in accordance with the basis of accounting used to prepare the cost-sharing schedule.

Certain representations in this letter are described as being limited to matters that are material. Items are considered material, regardless of size, if they involve an omission or misstatement of accounting information that in the light of surrounding circumstances makes it probable that the judgment of a reasonable person relying on the information would be changed or influenced by the omission or misstatement.

We confirm, as of **[date of auditor’s report]**, the following representations made to you during your review:

- 1) We have fulfilled our responsibilities, as set out in the terms of the audit engagement letter dated **[insert date of engagement letter]**, for the preparation and fair presentation of the cost-sharing schedule in accordance with the basis of accounting used to prepare the cost-sharing schedule.
- 2) We have provided you with all relevant information and access, as agreed upon in the terms of the audit engagement letter, including the following:
 - a) Access to all information that is relevant to the preparation and fair presentation of the cost-sharing schedule, including records, documentation, and other matters
 - b) Additional information that you have requested from us for the purpose of the audit, including, but not limited to:
 - i) Minutes of meetings or summaries of actions of recent meetings for which minutes have not been prepared of the **[Board of Directors, Stockholders, directors, or other similar bodies of those charged with governance]**
 - c) Unrestricted access to and full cooperation of personnel within the entity from whom you determined it necessary to obtain audit evidence

⁶⁵ This date should be the date that the client presents and signs the letter. In no event should the letter be presented and signed prior to the date of the accountant’s review report.

- 3) Except as disclosed to you in writing, there have been none of the following:
 - a) Circumstances that have resulted in communications from [**name of Accountable Entity's**] legal counsel reporting evidence of a material violation of law or breach of fiduciary duty; or similar violations by [**name of Accountable Entity**] of any agent thereof
 - b) Communications from MCC, USAID OIG, governmental representatives, employees, or others concerning investigations or allegations of noncompliance with laws or regulations; deficiencies in financial reporting practices; or other matters that could have a material adverse effect on the financial statements
- 4) All transactions have been recorded in the accounting records and are reflected in the cost-sharing schedule
- 5) We have no plans or intentions that may materially affect the recognition, measurement, presentation, disclosure, or classification of assets and liabilities
- 6) We have disclosed to you all known actual or possible litigation, claims, and assessments whose effects should be considered when preparing the cost-sharing schedule **OR [We are not aware of any pending or threatened litigation and claims whose effects should be considered when preparing the cost-sharing schedule]**
- 7) We have properly recorded or disclosed in the cost-sharing schedule changes in accounting principles that affect the consistency of the cost-sharing schedule between the periods presented **OR [There are no changes in accounting principle that affect the consistency of the cost-sharing schedule between the periods presented]**
- 8) We acknowledge and fulfilled our responsibility for the design, implementation, and maintenance of effective internal control to prevent and detect fraud within the programs
- 9) We have [**no knowledge of any**] **OR [disclosed to you all information that we are aware of regarding]** fraud or suspected fraud affecting the entity involving 1) management or employees who have significant roles in preparing the cost-sharing schedule or 2) others when the fraud could have a material effect on the cost-sharing schedule [**If there is knowledge of any instances, including those that do not result in a material misstatement to the cost-sharing schedule, describe them**]
- 10) We have [**no knowledge of any**] **OR [disclosed to you all information that we are aware of regarding]** allegations of fraud or suspected fraud affecting the cost-sharing schedule communicated by employees, former employees, or others
- 11) We have no knowledge of any officer of [**name of Accountable Entity**] or any other person acting under the direction thereof, having taken any action to fraudulently influence, coerce, manipulate, or mislead you during your audit

- 12) We are responsible for complying with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]**

- 13) There are no instances of noncompliance or suspected noncompliance with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]** whose effects should be considered when preparing the cost-sharing schedule **OR** We have disclosed to you all instances of noncompliance or suspected noncompliance with laws, regulations, contracts, and grant agreements applicable to **[name of Accountable Entity]** whose effects should be considered when preparing cost-sharing schedule.

[Signed by Accountable Entity Head]

[Signed by Chief Financial Officer]

Enclosure(s)

APPENDIX III

ILLUSTRATIVE EXAMPLES OF CONSOLIDATED FUND ACCOUNTABILITY STATEMENT FOR COMPACT FUNDING – COMPACT IMPLEMENTATION FUNDING, COMPACT DEVELOPMENT FUNDING, 609(G), AND THRESHOLD PROGRAM FUNDING

The following illustrations of the Fund Accountability Statement will provide useful examples of the types of statements that will satisfy the requirements of these *Guidelines*.

TO COMPLY WITH THESE GUIDELINES, THE FORMAT AND CONTENT OF THE FUND ACCOUNTABILITY STATEMENTS SHOULD CLOSELY FOLLOW THE FOLLOWING ILLUSTRATIVE STATEMENTS.

Illustrative Fund Accountability Statement for Compact Funding/Threshold Program Funding

(ACCOUNTABLE ENTITY)

CONSOLIDATED FUND ACCOUNTABILITY STATEMENT

Month XX, 20XX to Month XX, 20XX

	<u>BUDGET</u>	<u>PRIOR PERIOD</u>	<u>ACTUAL COSTS CURRENT PERIOD</u>	<u>CUMULATIVE</u>	<u>INELIGIBLE</u>	<u>UNSUPPORTED</u>	<u>QUESTIONED COST</u>	<u>NOTES</u>
REVENUE	\$xxx	\$xxx	\$xxx	\$xxx				1
COSTS INCURRED								
1) Project 1								
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx		\$xxx		2
2) Project 2								
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx				
3) Project 3								
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx				3
TOTAL COSTS INCURRED	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>	<u>xxx</u>				
Excess of Revenue			\$xxx	\$xxx				
Over Costs Incurred						\$xxx		
Fund Balance Month XX, 20XX	<u>\$xxx</u>	<u>\$xxx</u>	<u>\$xxx</u>	<u>\$xxx</u>				
Fund Balance Month XX, 20XX ⁶⁶								

⁶⁶ Should reconcile with cash on hand and in bank accounts after considering any reconciling items. This reconciliation should be included in a note to the Fund Accountability Statement.

Illustrative Fund Accountability Statement - Compact Implementation Funding (CIF) or Compact Development Funding (CDF)

(ACCOUNTABLE ENTITY)
 CIF/CDF STATEMENT
 Month XX, 20XX to Month XX, 20XX

	<u>BUDGET</u>	<u>PRIOR</u>	<u>ACTUAL</u>	<u>QUESTIONED COST</u>		
	<u>PERIOD</u>	<u>PERIOD</u>	<u>CURRENT</u>	<u>INELIGIBLE</u>	<u>UNSUPPORTED</u>	<u>NOTES</u>
				<u>CUMULATIVE</u>		
<u>REVENUE</u>	\$xxx	\$xxx	\$xxx	\$xxx		1
<u>COSTS INCURRED</u>						
1) Project 1						
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx		
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx	\$xxx	2
2) Project 2						
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx		
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx		
3) Project 3						
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx		
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx		3
<u>TOTAL COSTS</u>						
<u>INCURRED</u>	xxx	xxx				
Excess of Revenue			\$xxx			
Over Costs Incurred			\$xxx			
Fund Balance Month XX,	\$xxx	\$xxx	\$xxx	\$xxx		
20XX						
Fund Balance Month XX,						
20XX ⁶⁷						

⁶⁷ Should reconcile with cash on hand and in bank accounts after considering any reconciling items. This reconciliation should be included in a note to the Fund Accountability Statement.

Illustrative Fund Accountability Statement – 609(g) Funding

(ACCOUNTABLE ENTITY)
 609(g) FUNDING STATEMENT
 Month XX, 20XX to Month XX, 20XX

	<u>BUDGET</u>	<u>PRIOR PERIOD</u>	<u>ACTUAL COSTS CURRENT PERIOD</u>	<u>CUMULATIVE</u>	<u>INELIGIBLE</u>	<u>UNSUPPORTED</u>	<u>NOTES</u>
REVENUE	\$xxx	\$xxx	\$xxx	\$xxx			1
COSTS INCURRED							
1) Project 1							
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx			
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx		\$xxx	2
2) Project 2							
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx			
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx			
3) Project 3							
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx			
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx			3
TOTAL COSTS INCURRED	xxx	xxx	xxx	xxx			
Excess of Revenue			\$xxx	\$xxx			
Over Costs Incurred						\$xxx	
Fund Balance Month XX, 20XX	\$xxx	\$xxx	\$xxx	\$xxx			
Fund Balance Month XX, 20XX ⁶⁸							

⁶⁸ Should reconcile with cash on hand and in bank accounts after considering any reconciling items. This reconciliation should be included in a note to the Fund Accountability Statement.

APPENDIX IV

ILLUSTRATIVE EXAMPLES OF COST SHARING SCHEDULE

The following illustrations of the cost share schedule will provide useful examples of the types of schedules that will satisfy the requirements of these Guidelines.

TO COMPLY WITH THESE GUIDELINES, THE FORMAT AND CONTENT OF THE AUDIT REPORTS SHOULD CLOSELY FOLLOW THE FOLLOWING ILLUSTRATIVE REPORTS.

Illustrative Cost-Sharing Schedule for Agreements with Life-of-Project Cost-Sharing Budgets That Have Not Yet Ended and Annual Cost-Sharing Budgets

(ACCOUNTABLE ENTITY)
 COST-SHARING SCHEDULE
 FROM Month XX, 20XX TO Month XX, 20XX

	<u>BUDGET</u>	<u>ACTUAL</u>	<u>CURRENT</u>	<u>CUMULATIVE</u>	<u>INELIGIBLE</u>	<u>QUESTIONED COST⁶⁹</u>	<u>UNSUPPORTED</u>	<u>NOTES⁷⁰</u>
<u>CASH</u>								
1) Project 1								1
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx				
2) Project 2								
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx				
<u>IN-KIND</u>	\$xxx	\$xxx	\$xxx	\$xxx			\$xxx	2
<u>TOTAL</u>	\$xxx	\$xxx	\$xxx	\$xxx			\$xxx	

⁶⁹ All questioned cost-sharing costs will be listed here. All material questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance.

⁷⁰ The notes to the cost-sharing schedule should briefly describe both material and immaterial questioned costs and should be cross-referenced to any corresponding findings in the report on compliance.

Illustrative Cost-Sharing Schedule for Close-Out Audits of Awards with Life-of-Project Cost-Sharing Budgets, and Audits of Awards with Annual Cost-Sharing Budgets

(ACCOUNTABLE ENTITY)
 COST-SHARING SCHEDULE
 FROM JANUARY 1, 20XX TO DECEMBER 31, 20XX

	<u>BUDGET</u> ⁷²	<u>ACTUAL</u>	<u>CUMULATIVE</u>	<u>SHORTFALL</u> ⁷³	<u>INELIGIBLE</u>	<u>QUESTIONED COST</u> ⁷⁴	<u>UNSUPPORTED</u>	<u>NOTES</u> ⁷⁴
<u>CASH</u>								
1) Project 1								
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx				
2) Project 2								
a. Activity 1	\$xxx	\$xxx	\$xxx	\$xxx				
b. Activity 2	\$xxx	\$xxx	\$xxx	\$xxx				
<u>IN-KIND</u>								
<u>TOTAL</u>								

⁷¹ All questioned cost-sharing costs will be listed here. All material questioned costs resulting from instances of noncompliance with agreement terms and applicable laws and regulations must be included as findings in the report on compliance.

⁷² For closeout audits of awards with life-of-project cost-sharing budgets, the auditors will use the life-of-project budget. For audits with annual cost-sharing budgets, the auditors will use the budget for the period under audit.

⁷³ This column will show required cost-sharing contributions that were not provided by the recipient. Since questioned costs are not considered as provided by the recipient, they might have an impact on the "shortfall" column. All material cost-sharing shortfalls must be included as findings in the report on compliance. All cost-sharing shortfalls will be briefly described in the notes to the cost-sharing schedule, and be cross-referenced to any corresponding findings in the report on compliance.

⁷⁴ The notes to the cost-sharing schedule should briefly describe both material and immaterial questioned costs and should be cross-referenced to any corresponding findings in the report on compliance.

APPENDIX V

ILLUSTRATIVE AUDIT REPORTS

The following illustrations of auditor's reports will provide useful examples of the types of reports that will satisfy the requirements of these Guidelines. For additional guidance, the auditors should refer to the applicable American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SAS).

TO COMPLY WITH THESE GUIDELINES, THE FORMAT AND CONTENT OF THE AUDIT REPORTS SHOULD CLOSELY FOLLOW THE FOLLOWING ILLUSTRATIVE REPORTS.

Illustrative Auditor’s Report on a Fund Accountability Statement with an Unmodified Opinion

[Auditor letterhead]

Independent Auditor’s Report⁷⁵

Board of Directors

Name of Accountable Entity

Complete Mailing Address

Report on the Financial Statements

We have audited the accompanying Fund Accountability Statement of **[name of Accountable Entity]** and related notes to the fund accountability statement for the year ended Month XX, 20XX and have issued our report on it dated Month XX, 20XX. We also reviewed the separate cost-sharing schedule (if applicable).

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the Fund Accountability Statement in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal controls relevant to the preparation and fair presentation of fund accountability statement that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility⁷⁶

Our responsibility is to express an opinion on the Fund Accountability Statement based on our audit. Except as discussed in the following paragraph, we conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the fund accountability statement is free of material misstatement.

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁷⁷

We did not have an external Quality Control Review (QCR) by an unaffiliated audit organization, as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the **[your country]**. We believe that the effect of this departure from *Government*

⁷⁵ For guidance on these reports, refer to AICPA SAS No. 58, “Reports on Audited Financial Statements,” SAS No. 62, “Special Reports,” and SAS No. 79, “Amendment to Statement on Auditing Standards No. 58, Reports on Audited Financial Statements.”

⁷⁶ The lack of a satisfactory continuing education program and/or external quality control review program must be disclosed in the auditor responsibility paragraph of the report and additional an explanatory paragraphs.

⁷⁷ Use this paragraph if applicable.

Auditing Standards is not material because we **[include a statement to describe the firm’s internal QCR program]**.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Fund Accountability Statement. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the fund accountability statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the Fund Accountability Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the fund accountability statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the Fund Accountability Statement referred to above presents fairly, in all material respects, program revenues, costs incurred and reimbursed, and assets and technical assistance directly procured by Millennium Challenge Corporation (MCC) for the year then ended in accordance with the terms of the agreements and in conformity with the basis of accounting described in **[Note X]**.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our reports dated Month XX, 20XX, on our consideration of **[name of Accountable Entity]**’s Internal Control Over Financial Reporting (ICOFR) and our tests of its compliance with certain provisions of laws, regulations, contracts, grant agreements, and other matters. The purpose of that report is solely to describe the scope of our testing of ICOFR and compliance and the results of that testing, not to provide an opinion on the effectiveness of the **[name of Accountable Entity]**’s ICOFR or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this Independent Auditor’s Report in considering the results of our audit.

This report is intended for the information of **[name of Accountable Entity]** and MCC. However, upon release by MCC, this report is a matter of public record and its distribution is not limited.

[Auditor’s signature]

[Auditor’s location]

[Date of the auditor’s report]

Illustrative Auditor’s Report on a Fund Accountability Statement with a Modified Opinion Due to a Material Misstatement

(Circumstance could include the following: Inventories are misstated. The misstatement is deemed to be material but not pervasive to the financial statements.)

[Auditor letterhead]

Independent Auditor’s Report⁷⁸

Board of Directors

Name of Accountable Entity

Complete Mailing Address

Report on the Financial Statements

We have audited the accompanying Fund Accountability Statement of **[name of Accountable Entity]** and related notes to the Fund Accountability Statement for the year ended Month XX, 20XX and have issued our report on it dated Month XX, 20XX. We also reviewed the separate cost-sharing schedule (if applicable).

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these fund accountability statement in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal control relevant to preparation and fair presentation of the Fund Accountability Statement that are free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility⁷⁹

Our responsibility is to express an opinion on the Fund Accountability Statement based on our audit. Except as discussed in the following paragraph, we conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Fund Accountability Statement is free of material misstatements.

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁸⁰

⁷⁸ For guidance on these reports, refer to AICPA SAS No. 58, “Reports on Audited Financial Statements,” SAS No. 62, “Special Reports,” and SAS No. 79, “Amendment to Statement on Auditing Standards No. 58, Reports on Audited Financial Statements.”

⁷⁹ The lack of a satisfactory continuing education program and/or external Quality Control Review (QCR) program must be disclosed in the auditor responsibility paragraph of the report and additional explanatory paragraphs.

⁸⁰ Use this paragraph if applicable.

We did not have an external QCR by an unaffiliated audit organization as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the [your country]. We believe that the effect of this departure from *Government Auditing Standards* is not material because we **[include a statement to describe the firm’s internal QCR program]**.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the Fund Accountability Statement. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of The Fund Accountability Statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the Fund Accountability Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the Fund Accountability Statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our modified audit opinion.

Basis for Modified Opinion (Example below)

The Company has stated inventories at cost in the accompanying balance sheets. Accounting principles generally accepted in the United States of America require inventories to be stated at the lower of cost or market. If the Company stated inventories at the lower of cost or market, a write-down of \$XXX and \$XXX would have been required as of Month XX, 20X1 and 20X0, respectively. Accordingly, cost of sales would have been increased by \$XXX and \$XXX, and net income, income taxes, and stockholders’ equity would have been reduced by \$XXX, \$XXX, and \$XXX, and \$XXX, \$XXX, and \$XXX, as of and for the years ended Month XX, 20X1 and 20X0, respectively.

Opinion

In our opinion, except for the effects of the matter described in the Basis for Qualified Opinion paragraph, the fund accountability statement referred to above presents fairly, in all material respects, program revenues, costs incurred and reimbursed, and assets and technical assistance directly procured by MCC for the year then ended in accordance with the terms of the agreements and in conformity with the basis of accounting described in **[note X]**.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our reports dated Month XX, 20XX, on our consideration of **[name of Accountable Entity]**’s internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the **[name of Accountable Entity]**’s internal control over financial reporting or on compliance.

That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this Independent Auditor's Report in considering the results of our audit.

This report is intended for the information of **[name of Accountable Entity]** and MCC. However, upon release by MCC, this report is a matter of public record and its distribution is not limited.

[Auditor's signature]

[Auditor's location]

[Date of the auditor's report]

Illustrative Auditor’s Report on a Fund Accountability Statement with an Adverse Opinion Due to a Material Misstatement

[Auditor letterhead]

Independent Auditor’s Report⁸¹

Board of Directors

Name of Accountable Entity

Complete Mailing Address

Report on the Financial Statements

We have audited the accompanying Fund Accountability Statement of **[name of Accountable Entity]** and related notes to the fund accountability statement for the year ended Month XX, 20XX and have issued our report on it dated Month XX, 20XX. We also reviewed the separate cost-sharing schedule (if applicable).

Management’s Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of the Fund Accountability Statement in accordance with accounting principles generally accepted in the United States; this includes the design, implementation, and maintenance of internal controls relevant to preparation and the fair presentation of the Fund Accountability Statement that is free from material misstatement, whether due to fraud or error.

Auditor’s Responsibility⁸²

Our responsibility is to express an opinion on the Fund Accountability Statement based on our audit. Except as discussed in the following paragraph, we conducted our audit in accordance with *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the Fund Accountability Statement is free of material misstatement.

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁸³

We did not have an external QCR by an unaffiliated audit organization, as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the

⁸¹ For guidance on these reports, refer to American Institute of Certified Public Accountants (AICPA) Statement on Auditing Standards (SAS) No. 58, “Reports on Audited Financial Statements,” SAS No. 62, “Special Reports,” and SAS No. 79, “Amendment to Statement on Auditing Standards No. 58, Reports on Audited Financial Statements.”

⁸² The lack of a satisfactory continuing education program and/or external Quality Control Review (QCR) program must be disclosed in the auditor responsibility paragraph of the report and additional an explanatory paragraphs.

⁸³ Use this paragraph if applicable.

[your country]. We believe that the effect of this departure from *Government Auditing Standards* is not material because we **[include a statement to describe the firm’s internal QCR program, if applicable]**.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the fund accountability statement. The procedures selected depend on the auditor’s judgement, including the assessment of the risks of material misstatement of the fund accountability statement, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the Fund Accountability Statement in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the Fund Accountability Statement.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Basis for Adverse Opinion (Example Below)

As described in [Note X], the [name of Accountable Entity] has not consolidated the financial statements of subsidiary [XYZ company] that it acquired during 20X1 because it has not yet been able to ascertain the fair values of certain of the subsidiary’s material assets and liabilities at the acquisition date. This investment is therefore accounted for on a cost basis by the Company. Under accounting principles generally accepted in the United States of America, the subsidiary should have been consolidated because it is controlled by the Company. Had [XYZ Company] been consolidated, many elements in the accompanying consolidated financial statements would have been materially affected. The effects on the consolidated financial statements of the failure to consolidate have not been determined.

Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the Fund Accountability Statement referred to above do not present fairly the financial position of program revenues, costs incurred and reimbursed, and assets and technical assistance directly procured by the Millennium Challenge Corporation (MCC) for the year then ended in accordance with the terms of the agreements and in conformity with the basis of accounting described in [Note X].

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our reports dated Month XX, 20XX, on our consideration of [name of Accountable Entity]’s Internal Control Over Financial Reporting (ICOFR) and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is solely to describe the scope of our testing of ICOFR and compliance and the results of that testing, not to provide an opinion on the effectiveness of the [name of Accountable Entity]’s ICOFR or on compliance. That report is an integral part of an audit performed in accor-

dance with *Government Auditing Standards* and should be read in conjunction with this Independent Auditor's Report in considering the results of our audit.

This report is intended for the information of **[name of Accountable Entity]** and MCC. However, upon release by MCC, this report is a matter of public record and its distribution is not limited.

[Auditor's signature]

[Auditor's location]

[Date of the auditor's report]

Illustrative Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statement Performed in Accordance with Government Auditing Standards

(No Material Weaknesses Identified; No Significant Deficiencies Identified; No Reportable Instances of Non-compliance or Other Matters Identified)

[Auditor letterhead]

Independent Auditor’s Report

Board of Directors
Name of Accountable Entity
Complete Mailing Address

Except as discussed in the following paragraph, we have audited in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United

States, the fund accountability statement of **[name of Accountable Entity]** as of and for the year ended Month XX, 20XX, and have issued our report on it dated Month XX, 20XX. We also reviewed the separated cost-sharing schedule (if applicable).

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁸⁴

We did not have an external Quality Control Review (QCR) by an unaffiliated audit organization, as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the **[your country]**. We believe that the effect of this departure from *Government Auditing Standards* is not material because we **[include a statement to describe the firm’s internal QCR program, if applicable]**.

Internal Control over Financial Reporting (ICOFR)

In planning and performing our audit of the financial statements, we considered **[name of Accountable Entity]**’s ICOFR (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control. Accordingly, we do not express an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control.

⁸⁴ Use this paragraph if applicable.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses.

However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether **[name of Accountable Entity]**’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

[Auditor’s signature]

[Auditor’s city and country]

[Date of the auditor’s report]⁸⁵

⁸⁵ Because this report relates to an engagement to audit the Fund Accountability Statement, and is based on the GAAS audit procedures performed, it is subject to the provisions of AU-C section 700. Therefore, it should be dated the same date as the auditor’s report on the financial statements, which according to paragraph .41 of AU-C section 700, is “no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the financial statements”

Illustrative Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statement Performed in Accordance with Government Auditing Standards

(No Material Weaknesses Identified; Significant Deficiencies Identified; Reportable Instances of Noncompliance or Other Matters Identified)

[Auditor letterhead]

Independent Auditor’s Report

Board of Directors

Name of Accountable Entity

Complete Mailing Address

Except as discussed in the following paragraph, we have audited in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the fund accountability statement of **[name of Accountable Entity]** as of and for the year ended Month XX, 20XX, and have issued our report on it dated Month XX, 20XX. We also reviewed the separated cost-sharing scheduled (if applicable).

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁸⁶

We did not have an external Quality Control Review (QCR) by an unaffiliated audit organization, as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the **[your country]**. We believe that the effect of this departure from *Government Auditing Standards* is not material because we **[include a statement to describe the firm’s internal QCR program, if applicable]**.

Internal Control over Financial Reporting (ICOFR)

In planning and performing our audit of the financial statements, we considered **[name of Accountable Entity]**’s ICOFR (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control. Accordingly, we do not express an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in

⁸⁶ Use this paragraph if applicable.

internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. We did identify certain deficiencies in internal control, described in the accompanying schedule of audit findings and questioned costs as items that we considered to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether **[name of Accountable Entity]**’s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*⁸⁷ and which are described in the accompanying schedule of audit findings and questioned costs as items.

[Name of Accountable Entity]’s Response to Findings

[Name of Accountable Entity]’s response to the findings identified in our audit is described in the accompanying schedule of audit findings and questioned costs. **[Name of Accountable Entity]**’s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.⁸⁸

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity’s internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

⁸⁷ See the discussion beginning at paragraph 4.24 for information regarding *Government Auditing Standards* criteria for fraud, abuse, and noncompliance with provisions of law, grants, contracts, and grant agreements.

⁸⁸ See paragraph 4.33 of *Government Auditing Standards*.

[Auditor's signature]

[Auditor's city and country]

[Date of the auditor's report]⁸⁹

⁸⁹ Because this report relates to an engagement to audit the Fund Accountability Statement, and is based on the GAAS audit procedures performed, it is subject to the provisions of AU-C section 700. Therefore, it should be dated the same date as the auditor's report on the financial statements, which according to paragraph .41 of AU-C section 700, is "no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements"

Illustrative Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statement Performed in Accordance with Government Auditing Standards

(Material Weaknesses Identified; No Significant Deficiencies Identified; Reportable Instances of Noncompliance or Other Matters Identified)

[Auditor letterhead]

Independent Auditor’s Report

Board of Directors
Name of Accountable Entity
Complete Mailing Address

Except as discussed in the following paragraph, we have audited in accordance with the auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United

States, the Fund Accountability Statement of **[name of Accountable Entity]** as of and for the year ended Month XX, 20XX, and have issued our report on it dated Month XX, 20XX. We also reviewed the separated cost-sharing schedule (if applicable).

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁹⁰

We did not have an external Quality Control Review (QCR) by an unaffiliated audit organization, as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the **[your country]**. We believe that the effect of this departure from *Government Auditing Standards* is not material because we **[include a statement to describe the firm’s internal QCR program, if applicable]**.

Internal Control over Financial Reporting (ICOFR)

In planning and performing our audit of the financial statements, we considered **[name of Accountable Entity]**’s ICOFR (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control. Accordingly, we do not express an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control.

⁹⁰ Use this paragraph if applicable.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompany schedule of audit findings and questioned costs as items that we considered to be material weaknesses.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether **[name of Accountable Entity]**'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*⁹¹ and which are described in the accompanying schedule of audit findings and questioned costs as items.

[Name of Accountable Entity]'s Response to Findings

[Name of Accountable Entity]'s response to the findings identified in our audit is described in the accompanying schedule of audit findings and questioned costs. **[Name of Accountable Entity]**'s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.⁹²

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

⁹¹ See the discussion beginning at paragraph 4.24 for information regarding *Government Auditing Standards* criteria for fraud, abuse, and noncompliance with provisions of law, grants, contracts, and grant agreements.

⁹² See paragraph 4.33 of *Government Auditing Standards*.

[Auditor's signature]

[Auditor's city and country]

[Date of the auditor's report]⁹³

⁹³ Because this report relates to an engagement to audit the Fund Accountability Statement, and is based on the Generally Accepted Auditing Standards (GAAS) audit procedures performed, it is subject to the provisions of AU-C section 700. Therefore, it should be dated the same date as the auditor's report on the financial statements, which, according to paragraph .41 of AU-C section 700, is "no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements"

Illustrative Auditor’s Report on Internal Control over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statement Performed in Accordance with Government Auditing Standards

(Material Weaknesses and Significant Deficiencies Identified; Reportable Instances of Noncompliance or Other Matters Identified)

[Auditor letterhead]

Independent Auditor’s Report

Board of Directors
Name of Accountable Entity
Complete Mailing Address

Except as discussed in the following paragraph, we have audited in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the fund accountability statement of **[name of Accountable Entity]** as of and for the year ended Month XX, 20XX, and have issued our report on it dated Month XX, 20XX. We also reviewed the separated cost-sharing scheduled (if applicable).

We do not have a continuing education program that fully satisfies the requirement set forth in Chapter 4, paragraph 4.16 of *Government Auditing Standards*. However, our current program provides for at least **[number]** hours of continuing education and training every **[number]** years. We are taking appropriate steps to implement a continuing education program that fully satisfies the requirement.⁹⁴

We did not have an external Quality Control Review (QCR) by an unaffiliated audit organization, as required in Chapter 5 paragraph 5.60 of *Government Auditing Standards*, since no such program is offered by professional organizations in the **[your country]**. We believe that the effect of this departure from *Government Auditing Standards* is not material because we **[include a statement to describe the firm’s internal QCR program, if applicable]**.

Internal Control over Financial Reporting (ICOFR)

In planning and performing our audit of the financial statements, we considered **[name of Accountable Entity]**’s ICOFR (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control. Accordingly, we do not express an opinion on the effectiveness of **[name of Accountable Entity]**’s internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or signifi-

⁹⁴ Use this paragraph if applicable.

cant deficiencies and, therefore, material weaknesses or significant deficiencies may exist that have not been identified. However, as described in the accompanying schedule of audit findings and questioned costs, we did identify certain deficiencies in internal control that we consider to be material weaknesses significant deficiencies.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency or a combination of deficiencies in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. We considered the deficiencies described in the accompanying schedule of audit findings and questioned costs as items to be material weaknesses.

A *significant deficiency* is a deficiency or a combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We considered the deficiencies described in the accompanying schedule of audit findings and questioned costs as items to be significant deficiencies.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether **[name of Accountable Entity]**'s financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*⁹⁵ and which are described in the accompany schedule of audit findings and questioned costs as items.

[Name of Accountable Entity]'s Response to Findings

[Name of Accountable Entity]'s response to the findings identified in our audit is described in the accompanying schedule of audit findings and questioned costs. **[Name of Accountable Entity]**'s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.⁹⁶

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing*

⁹⁵ See the discussion beginning at paragraph 4.24 for information regarding *Government Auditing Standards* criteria for fraud, abuse, and noncompliance with provisions of law, grants, contracts, and grant agreements.

⁹⁶ See paragraph 4.33 of *Government Auditing Standards*.

Standards in considering the entity’s internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

[Auditor’s signature]

[Auditor’s city and country]

[Date of the auditor’s report]⁹⁷

⁹⁷ Because this report relates to an engagement to audit the Fund Accountability Statement and is based on the Generally Accepted Auditing Standards (GAAS) audit procedures performed, it is subject to the provisions of AU-C section 700. Therefore, it should be dated the same date as the auditor’s report on the financial statements, which, according to paragraph .41 of AU-C section 700, is “no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor’s opinion on the Fund AccountabilityStatement.”

APPENDIX VI

Illustrative Auditor’s Report on the Cost Sharing Schedule for Agreements with Life-of-Project Cost-Sharing Budgets and Annual Cost-Sharing Budgets

(No Significant Deficiencies Identified)

[Auditor letterhead]

Independent Accountant’s Review Report

Board of Directors

Name of Accountable Entity

Complete Mailing Address

We have reviewed the accompanying cost-sharing schedule of **[name of Accountable Entity]** for the period **[date of beginning of current audit period]** to **[date of end of current audit period]**. A review includes primarily applying analytical procedures to financial data and making inquiries of Accountable Entity personnel. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion on the cost-sharing schedule. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the cost-sharing schedule in accordance with the basis of accounting described in **[note X]** to the cost-sharing schedule and for designing, implementing, and maintaining internal control related to the provision of and accounting for cost-sharing contributions.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services (SSARS) issued by the American Institute of Certified Public Accountants (AICPA). Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the cost-sharing schedule. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, we are not aware of any material modifications that should be made to the accompanying cost-sharing schedule in order for it to be in conformity with the basis of accounting used to prepare the cost-sharing schedule.

This report is intended for the information of **[name of Accountable Entity]** and the Millennium Challenge Corporation (MCC). However, upon release by MCC, this report is a matter of public record and its distribution is not limited.

[Audit Firm’s Signature]

[Date]

Illustrative Auditor's Report on the Cost-Sharing Schedule for Agreements with Life-of-Project Cost-Sharing Budgets and Annual Cost-Sharing Budgets

(Questioned Cost Identified)

[Auditor letterhead]

Independent Accountant's Review Report

Board of Directors

Name of Accountable Entity

Complete Mailing Address

We have reviewed the accompanying cost-sharing schedule of **[name of Accountable Entity]** for the period **[date of beginning of current audit period]** to **[date of end of current audit period]**. A review includes primarily applying analytical procedures to financial data and making inquiries of Accountable Entity personnel. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion on the cost-sharing schedule. Accordingly, we do not express such an opinion.

Management is responsible for the preparation and fair presentation of the cost-sharing schedule in accordance with the basis of accounting described in **[note X]** to the cost-sharing schedule and for designing, implementing, and maintaining internal control related to the provision of and accounting for cost-sharing contributions.

Our responsibility is to conduct the review in accordance with Statements on Standards for Accounting and Review Services (SSARS) issued by the American Institute of Certified Public Accountants (AICPA). Those standards require us to perform procedures to obtain limited assurance that there are no material modifications that should be made to the cost-sharing schedule. We believe that the results of our procedures provide a reasonable basis for our report.

Based on our review, with the exception of the matter(s) described in the following paragraph(s), we are not aware of any material modifications that should be made to the accompanying cost-sharing schedule in order for it to be in conformity with the basis of accounting used to prepare the cost-sharing schedule.

The results of our review disclosed the following material questioned costs, as detailed in the cost-sharing schedule:

- 1) \$XXX in ineligible costs which were not fairly presented in accordance with the basis of accounting used by the Accountable Entity to prepare the cost-sharing schedule
- 2) \$XXX in unsupported costs which were not fairly presented in accordance with the basis of accounting used by the Accountable Entity to prepare the cost-sharing schedule.

(Include paragraphs summarizing the internal control and compliance findings related to the cost-sharing schedule, with references to the findings in the reports on internal control and compliance, as applicable, as well as the notes to the cost-sharing schedule.)⁹⁸

This report is intended for the information of **[name of Accountable Entity]** and the Millennium Challenge Corporation (MCC). However, upon release by MCC, this report is a matter of public record and its distribution is not limited.

[Audit Firm's Signature]

[Date]

⁹⁸ The two paragraphs are illustrative only and can be modified or excluded based on the type of findings contained in the report.

APPENDIX VII

OUTLINE OF AN ILLUSTRATIVE AUDITOR'S STATEMENT OF WORK

I. BACKGROUND

This section must contain a brief description of the Millennium Challenge Corporation (MCC) program objectives, implementing agencies, and their responsibilities in the MCC programs, amount, type, and purpose of MCC and other program contributions, duration of the program, and other significant requirements.

II. TITLE

This section must contain the title and number of the MCC programs.

III. OBJECTIVES

This section must state that this is a financial audit of the MCC-funded programs and the period covered. It should also contain the requirements from Chapter 5 of these *Guidelines*.

IV. AUDIT SCOPE

This section must include the requirements of Chapter 6 of these *Guidelines*. In addition, the cognizant Accountable Entity may expand the scope of the audit to include additional requirements to address special concerns it may have.

V. REPORTS

This section must include the requirements of Chapter 7 of these *Guidelines*.

VI. INSPECTION AND ACCEPTANCE OF AUDIT WORK AND REPORTS

This section will discuss the responsibilities of MCC and the Office of Inspector General (OIG) in the inspection and acceptance of the audit work and reports.

VII. RELATIONSHIPS AND RESPONSIBILITIES

This section should establish the relationships and responsibilities between the independent auditor, the Accountable Entity, MCC, and the OIG.

VIII. TERMS OF PERFORMANCE

This section requires timely completion of the audit report after the end of the Fiscal Year (FY). MCC must receive the audit report no later than ninety days after the end of the audited period. This section must also describe how payments to the independent auditor are to be made. The final payment cannot be made until after MCC approves the report.

APPENDIX VIII

ILLUSTRATIVE SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS

NAME OF ACCOUNTABLE ENTITY
SCHEDULE OF AUDIT FINDINGS AND QUESTIONED COSTS
For the Period from Month Day, Year to Month Day, Year

Section I – Summary of Auditor’s Results

<i>Fund Accountability Statement</i>		
Type of report the auditor issued on whether the fund accountability statement was prepared in accordance with GAAP (<i>Unmodified, qualified, adverse, or disclaimer</i>)		
Internal control over financial reporting:		
• Material weakness(es) identified	_____yes	_____no
• Significant Deficiency(ies) identified	_____yes	_____none reported
Noncompliance material to financial statements noted?	_____yes	_____no

Section II– Schedule of Audit Findings

INTERNAL CONTROL

Title (Repeated)⁹⁹

Condition

(A description of the condition. Specifically, what the auditor observes through physical observation, scheduling, analysis, testing or other techniques. Generally, findings include conditions that result from internal accounting or administrative control weaknesses, instances of noncompliance with or without questioned costs, or potential errors, irregularities or illegal acts.)

Criteria

(A description of the criteria—law, regulation, and/or compact clause—is used to describe “what should be,” or the required or established method(s). Criteria may vary according to audit objectives and the type of engagement being performed. Written requirements (e.g., laws, regulations, contracts, procedures, manuals and directives, and good business practice) may be used as criteria on all types of engagements. Ordinarily, the most suitable criteria for financial audits are Generally Accepted Accounting Principles (GAAP) and standards. Types of criteria common for performance audits are technically developed standards or norms, expert opinions, performance of similar entities, and prior years’ performance.)

⁹⁹ Include, if applicable.

Cause

(Cause explains “why did it happen” and forms the basis for making constructive recommendations to achieve corrective action. When the auditor and management know why something happened, they can more readily determine what action is needed to prevent its recurrence.)

Effect

(A description of the effect; what harm was caused by not complying? Effect represents the actual or potential impact and can be either beneficial or undesirable. Efficiency, economy, and effectiveness are useful measures of effect and frequently can be stated in quantitative terms, including dollars, time, number of procedures and processes, or transactions. Where actual effects cannot be ascertained, potential effects may be presented.)

Recommendation

(State the auditor’s recommendation to correct the condition. The recommendation should take into consideration the cited cause that brought about the condition. Recommendations describe “what should be done.” The auditor should report recommendations for actions to correct problem areas, improve operations and effect compliance with laws and regulations. Recommendations are most constructive when they are directed at resolving the cause of identified problems, are action- oriented and specific, are addressed to parties that have the authority to act, are feasible, and, to the extent practical, are cost effective. If the recommended action is one the auditor believes should be acted on promptly, the consequences of delay should be clearly stated.)

Management’s Comments

Management must state whether it agrees or disagrees. If management disagrees with the finding, management must provide an explanation.)

Auditor’s Response

(Auditor’s response to management’s comments.)

COMPLIANCE

Title

Condition

(A description of the condition. Specifically, what the auditor observes through physical observation, scheduling, analysis, testing, or other techniques. Generally, findings include conditions that result from internal accounting or administrative control weaknesses, instances of noncompliance with or without questioned costs, or potential errors, irregularities, or illegal acts.)

Criteria

(A description of the criteria—law, regulation, and/or compact clause—is used to describe “what should be,” or the required or established method(s). Criteria may vary according to audit objectives and the type of engagement being performed. Written requirements, including laws, regulations, contracts, procedures, manuals and directives, and good business practice, may be used as criteria on all types of engagements. Ordinarily, the most suitable criteria for financial audits are GAAP and standards. Types of criteria common for performance audits are technically developed standards or norms, expert opinions, performance of similar entities, and prior years’ performance.)

Cause

(Cause explains “why did it happen” and forms the basis for making constructive recommendations to achieve corrective action. When the auditor and management know why something happened, they can more readily determine what action is needed to prevent its recurrence.)

Effect

(A description of the effect; what harm was caused by not complying? Effect represents the actual or potential impact, and can be either beneficial or undesirable. Efficiency, economy, and effectiveness are useful measures of effect and frequently can be stated in quantitative terms, including dollars, time, number of procedures and processes, or transactions. Where actual effects cannot be ascertained, potential effects may be presented.)

Recommendation

(State the auditor’s recommendation to correct the condition. The recommendation should take into consideration the cited cause that brought about the condition. Recommendations describe “what should be done.” The auditor should report recommendations for actions to correct problem areas, improve operations, and effect compliance with laws and regulations. Recommendations are most constructive when they are directed at resolving the cause of identified problems, are action- oriented and specific, are addressed to parties that have the authority to act, are feasible, and, to the extent practical, are cost effective. If the recommended action is one the auditor believes should be acted on promptly, the consequences of delay should be clearly stated.)

Management’s Comments

(Management must state whether it agrees or disagrees. If management disagrees with the finding, management must provide an explanation.)

Auditor’s Response

(Auditor’s response to management’s comments.)

Section III – Questioned Cost (EXAMPLE ONLY)

<u>NO.</u>	<u>TITLE</u>	<u>QUESTIONED COSTS</u>		
		<u>DESCRIPTION OF ISSUE</u>	<u>INELIGIBLE</u>	<u>UNSUPPORTED</u>
1	Outstanding Fund Balance Not Reconciled to Bank Balances	During the course of our audit, we observed that there was a difference of U.S. \$XXX between the outstanding fund balance and the bank balances as of Month Day, Year. However, we were unable to obtain an explanation for the difference and there were no alternative procedures that we could use to determine the nature of this difference.	\$XXXXXX	
			\$	\$
	TOTAL		\$XXXXXX	\$

APPENDIX IX

INDEPENDENCE SELF-ASSESSMENT CHECKLIST

Audit Title:

Date:

Part I: Threat Identification	Yes	No	Comments
a) Self-interest threat- The threat that a financial or other interest will inappropriately influence an auditor's judgment or behavior.			
b) Self-review threat- The threat that an auditor or audit organization that has provided non-audit services will not appropriately evaluate the results of previous judgments made or services performed as part of the non-audit services when forming a judgment significant to an audit.			
c) Bias threat- The threat that an auditor will, as a result of political, ideological, social, or other convictions, take a position that is not objective.			
d) Familiarity threat- The threat that aspects of a relationship with management or personnel of an audited entity, including a close or long relationship, or that of an immediate or close family member, will lead an auditor to take a position that is not objective.			
e) Management participation threat- The threat that results from an auditor's taking on the role of management or otherwise performing management functions on behalf of the entity undergoing an audit.			
f) Structural threat- The threat that an audit organization's placement within a Government entity, combined with the structure of the Government entity being audited, will affect the audit organization's ability to perform work and report results objectively.			
Part II: Complete only if a Threat is Identified			
a) Is the threat related to a non-audit service? If "no," go to step 3. If "yes," go to step 2.			
b) Is the non-audit service specifically prohibited in <i>Government Auditing Standards</i> paragraphs 3.36 or 3.49 through 3.58? If "no," go to step 3. If "yes," independence is impaired and the auditor should not proceed with the audit.			

<p>c) Assess the threat for significance.</p> <p>a) Is the threat significant? If “no,” the auditor can proceed with the audit. If “yes,” identify and apply safeguards. The auditor should discuss the safeguards with the audit team lead, engagement partner, and so on, if applicable.</p>			
<p>b) Is threat eliminated or reduced to an acceptable level? If “yes,” the auditor can proceed with the audit. If “no,” independence is impaired and the auditor should not proceed with the audit.</p>			
<p>Part III: Document Identified Threat</p>			
<p>The above steps have been documented in the audit workpapers.</p>			

Name

Title

Signature

Date

APPENDIX X

REQUESTED SUPPLEMENTAL DOCUMENTS TO MCC

The Millennium Challenge Corporation (MCC) reserves the right to request any working papers deemed relevant to the review of planning, draft audit report, and final audit report deliverables. Ensure planning documentation contains a calculation of materiality and assessment of risks identified during planning by financial statement assertion. Below is a listing of documents that should be provided throughout the audit:

- Entrance Conference meeting minutes
- Exit Conference meeting minutes
- The Engagement Team's Continuing Professional Education (CPE) documentation
- Audit Strategy Memorandum (or similar planning work papers)
- Engagement Acceptance and Continuous Procedures and Results
- Risk Assessments work papers
- Completed Audit Program
- Audit Summary Memorandum
- Period end trial balance and financial statements
- Independence Self-Assessment Checklist
- Independence Statements of the Engagement Team
- Confirmation of the field work end date for the audit

APPENDIX XI

REFERENCE MATERIALS

U.S. *Government Auditing Standards*, 2011 Revision, Dated December 2011: <http://www.gao.gov/yellowbook>

U.S. *Government Auditing Standards*, 2018 Revision, Dated July 2018: <http://www.gao.gov/yellowbook> (The 2018 revision of the Yellow Book is effective for financial audits, attestation engagements, and reviews of financial statements for periods ending on or after June 30, 2020 and for performance audits beginning on or after July 1, 2019.)

Federal Information System Controls Audit Manual (FISCAM), Government Accountability Office (GAO)-09-232G, Dated: Feb 2009: <https://www.gao.gov/products/GAO-09-232G>

American Institute of Certified Public Accountants (AICPA) Omnibus Statements on Standards for Accounting and Review Services (SSARS), AR-C section 90, *Review of Financial Statements*: <https://www.aicpa.org/content/dam/aicpa/research/standards/compilationreview/downloadabledocuments/ar-c-00090.pdf>

The following sections of the AICPA Codification of Statements on Auditing Standards (SAS) may be applicable to audits of Millennium Challenge Corporation (MCC) funds. The AICPA Codification of SASs may be obtained from the AICPA, 1211 Avenue of the Americas, New York, New York 10036-8775 or at <http://www.aicpa.org/index.htm>.

Original Standard No.	Title	Section in Professional Standards
SAS No. 122	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards	AU-C sec. 200
	Terms of Engagement	AU-C sec. 210
	Quality Control for an Engagement Conducted in Accordance with Generally Accepted Auditing Standards	AU-C sec. 220
	Audit Documentation	AU-C sec. 230
	Consideration of Fraud in a Financial Statement Audit	AU-C sec. 240
	Consideration of Laws and Regulations in an Audit of Financial Statements	AU-C sec. 250
	The Auditor's Communication With Those Charged With Governance	AU-C sec. 260
	Communicating Internal Control Related Matters Identified in an Audit	AU-C sec. 265
	Planning an Audit	AU-C sec. 300

Original Standard No.	Title	Section in Professional Standards
	Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	AU-C sec. 315
	Materiality in Planning and Performing an Audit	AU-C sec. 320
	Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	AU-C sec. 330
	Audit Considerations Relating to an Entity Using a Service Organization	AU-C sec. 402
	Evaluation of Misstatements Identified During the Audit	AU-C sec. 450
	Audit Evidence	AU-C sec. 500
	Audit Evidence—Specific Considerations for Selected Items	AU-C sec. 501
	External Confirmations	AU-C sec. 505
	Opening Balances—Initial Audit Engagements, Including Re-Audit Engagements	AU-C sec. 510
	Analytical Procedures	AU-C sec. 520
	Audit Sampling	AU-C sec. 530
	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures	AU-C sec. 540
	Related Parties This section addresses the auditor’s responsibilities relating to related party relationships and transactions in an audit of financial statements.	AU-C sec. 550
	Subsequent Events and Subsequently Discovered Facts This section addresses the auditor’s responsibilities relating to subsequent events and subsequently discovered facts in an audit of financial statements. It also addresses a predecessor auditor’s responsibilities for subsequent events and subsequently discovered facts when reissuing the auditor’s report on previously issued financial statements that are to be presented on a comparative basis with audited financial statements of a subsequent period.	AU-C sec. 560
	Written Representations This section addresses the auditor’s responsibility to obtain written representations from management and, when appropriate, those charged with governance in an audit of financial statements.	AU-C sec 580

Original Standard No.	Title	Section in Professional Standards
	<p>Consideration of Omitted Procedures After the Report Release Date</p> <p>This section addresses the auditor’s responsibilities when, subsequent to the report release date, the auditor becomes aware that one or more auditing procedures that the auditor considered necessary in the circumstances existing at the time of the audit were omitted from the audit of the financial statements.</p>	<p>AU-C sec. 585</p>
	<p>Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)</p> <p>This section addresses special considerations that apply to group audits, in particular those that involve component auditors.</p>	<p>AU-C sec. 600</p>
	<p>Using the Work of an Auditor’s Specialist</p> <p>This section addresses the auditor’s responsibilities relating to the work of an individual or organization possessing expertise in a field other than accounting or auditing when that work is used to assist the auditor in obtaining sufficient appropriate audit evidence.</p>	<p>AU-C sec. 620</p>
	<p>Forming an Opinion and Reporting on Financial Statements</p> <p>This section addresses the auditor’s responsibility to form an opinion on the financial statements. It also addresses the form and content of the auditor’s report issued as a result of an audit of financial statements.</p>	<p>AU-C sec. 700</p>
	<p>Modifications to the Opinion in the Independent Auditor’s Report</p> <p>This section addresses the auditor’s responsibility to issue an appropriate report in circumstances when, in forming an opinion in accordance with AU-C section 700, the auditor concludes that a modification to the auditor’s opinion on the financial statements is necessary.</p>	<p>AU-C sec. 705</p>

Original Standard No.	Title	Section in Professional Standards
	<p>Emphasis-of-Matter Paragraphs and Other- Matter Paragraphs in the Independent Auditor’s Report</p> <p>This section addresses additional communications in the auditor’s report when the auditor considers it necessary to draw users’ attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users’ understanding of the financial statements (emphasis-of-matter paragraph) or draw users’ attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users’ understanding of the audit, the auditor’s responsibilities, or the auditor’s report (other-matter paragraph).</p>	<p>AU-C sec. 706</p>
	<p>Consistency of Financial Statements</p> <p>This section addresses the auditor’s evaluation of the consistency of the financial statements between periods, including changes to previously issued financial statements and the effect of that evaluation on the auditor’s report on the financial statements.</p>	<p>AU-C sec. 708</p>
	<p>Other Information in Documents Containing Audited Financial Statements</p> <p>This section addresses the auditor’s responsibility with respect to other information in documents containing audited financial statements and the auditor’s report thereon. In the absence of any separate requirement in the particular circumstances of the engagement, the auditor’s opinion on the financial statements does not cover other information and the auditor has no responsibility for determining whether such information is properly stated. This section establishes the requirement for the auditor to read the other information of which the auditor is aware because the credibility of the audited financial statements may be undermined by material inconsistencies between the audited financial statements and other information.</p>	<p>AU-C sec. 720</p>

Original Standard No.	Title	Section in Professional Standards
	<p>Supplementary Information in Relation to the Financial Statements as a Whole</p> <p>This section addresses the auditor’s responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.</p>	<p>AU-C sec. 725</p>
	<p>Required Supplementary Information</p> <p>This section addresses the auditor’s responsibility with respect to information that a designated accounting standards setter requires to accompany an entity’s basic financial statements (hereinafter referred to as required supplementary information).</p>	<p>AU-C sec. 730</p>

Reducing Poverty Through Growth

