

ISSAI 4000

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INTOSAI



# *ISSAI 4000*

## *Compliance Audit*

### *Standard of INTOSAI*

*First draft for CAS hearing 18<sup>th</sup>-29<sup>th</sup> of August 2014*

Explanations of color codes:  
Black: Existing ISSAI 400/4000 series text  
Red: comments and drafted sections from CAS secretariat  
Green: Proposals from maintenance group nr.2  
Purple: Proposals from maintenance group nr. 3

*INTOSAI Professional Standards Committee*

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ISSAI 4000 – Compliance Audit Standard of INTOSAI

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## INTRODUCTION

1. INTOSAI's Lima Declaration explains public sector auditing as follows: 'The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust. Audit is not an end in itself but an indispensable part of a regulatory system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent – or at least render more difficult – such breaches.'
2. Compliance auditing is one of the three main types of public sector auditing as set out in INTOSAI's Lima Declaration and ISSAI 100. Compliance auditing departs from the decisions of legislatures provided in the form of requirements and expectations to the public sector and its entities when delegating powers of decision making and the management of public funds.
3. The SAI is a part of a national constitutional system of accountability, and compliance auditing assesses whether the activities of public sector entities are in accordance with the relevant laws, regulations and other authorities that govern such entities. This involves reporting on the degree to which the audited entity is accountable for its actions and exercises good public governance. More specifically, these elements may involve auditing to what extent the audited entity follows rules, laws and regulations, budgetary resolutions, policy, established codes, or agreed upon terms, such as the terms of a contract or the terms of a funding agreement, or generally accepted behaviour.
4. Compliance audit tasks performed by SAIs may cover a wide range of subject matters and may vary widely on an international basis. The scope and nature of a particular compliance audit depends on a number of factors such as the SAIs assessment of materiality and risk, the mandate and constitutional role of the SAI, as well as the authorities that are governing the audited entity.

## SCOPE OF THIS ISSAI

5. The ISSAI 4000 Compliance Audit Standard of INTOSAI provides requirements and explanations of these requirements for compliance audits performed by Supreme Audit Institutions. ISSAI 4000 applies to the following ways of performing compliance audits: attestation engagements and direct reporting engagements resulting in conclusions or opinions which explicitly convey the level of assurance, giving both reasonable assurance and limited assurance, and audits providing long form or short form reporting.
6. The requirements of this ISSAI apply to compliance audits performed both as a separate audit and in a combination with other audit types. The ISSAI further includes requirements and explanations for compliance audits when conducted by court of accounts.
7. In performing combinations of compliance and financial auditing, auditors use their professional judgement to decide whether the financial statements or compliance is the primary objective of the audit, and whether to apply the ISSAIs on compliance auditing, financial auditing or both. In performing combinations of compliance and performance auditing, auditors use their professional judgement to decide whether

**Merknad [MOP1]:** Depending on the conclusions of the court group.

performance or compliance is the primary objective of the audit, and whether to apply the ISSAIs on performance auditing, compliance auditing or both.

8. SAIs may choose to adopt the ISSAI 4000 as their authoritative standard. Reference to the ISSAI applied may be made by stating:

... *We conducted our audit[s] in accordance with the International Standards of Supreme Audit Institutions.*

9. In order to enhance transparency, the statement may further specify which ISSAI or range of ISSAIs the auditor has considered relevant and applied. This may be done by adding the following phrase:

*The audit[s] was [were] based on ISSAI 4000 Compliance Audit Standard of INTOSAI.*

10. In cases where the ISSAI 4000 is used and referred to as the authoritative auditing standards, the auditor will determine whether it is the financial, performance and compliance audit standards that apply to the audit before commencing the audit process and comply with all relevant requirements. In this ISSAI the word 'shall' is used to provide such requirements.

## DEFINITION OF COMPLIANCE AUDITING

11. Compliance auditing is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. Compliance audits are carried out by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities which govern the audited entity.
12. Compliance auditing is often an integral part of an SAI's mandate for the audit of public-sector entities. This is because legislation and other authorities are the primary means by which legislatures exercise control of income and expenditure, management and the rights of citizens to due process in their relations with the public sector. Public-sector entities are entrusted with the sound management of public funds. It is the responsibility of public-sector bodies and their appointed officials to be transparent about their actions and accountable to citizens for the funds with which they are entrusted, and to exercise good governance over those funds.
13. Compliance auditing promotes **transparency** by providing reliable reports as to whether funds have been administered, management exercised and citizens' rights to due process honored as required by the applicable authorities. It promotes **accountability** by reporting deviations from and violations of authorities, so that corrective action may be taken and those accountable may be held responsible for their actions. It promotes **good governance** both by identifying weaknesses and deviations from laws and regulations and by assessing propriety where there are insufficient or inadequate laws and regulations. Fraud and corruption are, by their very nature, elements which counteract transparency, accountability and good stewardship. Compliance auditing therefore promotes good governance in the public sector by considering the risk of fraud in relation to compliance.

### *Authorities*

14. *Authorities are relevant acts or resolutions of the legislature or other statutory instruments, directions and guidance issued by public sector bodies with powers*

provided for in statute, with which the audited entity is expected to comply. These elements are sometimes collectively referred to as 'legislative authorities' or just 'authorities'. They are more specifically rules, laws and regulations, budgetary resolutions, policy, established codes, agreed terms or the general principles governing sound public-sector financial management and the conduct of public officials which lay down the rules and procedures to be adhered to by the audited entity and provide a framework within which the subject matter is being exercised.

15. Authorities are subject to interpretation, which would normally take into account the intentions of the legislator, and they are part of a legal and regulatory hierarchy. It may be that the hierarchy of authorities present a legal void which could be between general and specific legislation issued by the same or different authoritative bodies. A legal void should be taken into account if this is relevant for the audited subject matter. The same legal hierarchy of authorities may present mutually conflicting legal provisions which would lead to conflicting interpretation. Such conflicting provisions shall be discussed with the auditee during or preferably prior to the audit in order to facilitate its interpretation.
16. Authorities as defined above for the purposes of compliance auditing standards are different from authoritative persons, bodies or legal entities which may have executive, judicial or legislative powers. Any of the latter are, for the purposes of compliance auditing standards, referred to as an 'authoritative body'.
17. 'Authorities' for audit of propriety would encompass less specific provisions in relation to the management of the subject matter such as financial codes, codes of ethics and codes of conduct and similar relevant guidelines for the audited entity. It may also be that a relevant 'authoritative body' such as Legislature or Public Accounts Committee has issued specific directions or pronouncements and/or guidance concerning management of resources and/or incurring public expenditure and/or corporate governance. Generally accepted standards of conduct, behaviour and general principles of sound financial management could also form part of 'authorities' for propriety. These authorities shall however, be discussed with the audited entity preferably before commencing audit. Authorities may include a general reference to sound financial management. This does not mean that compliance auditing can systematically or on an ad hoc basis encompass performance auditing elements, but it refers to management's obligation to observe this principle.
18. The objective of public-sector compliance auditing, therefore, is to enable the SAI to assess whether the activities of public-sector entities are in accordance with the authorities governing those entities. This involves reporting on the degree to which the audited entity complies with established criteria. Reporting may vary between brief standardized opinions and various forms of conclusions, presented in short or long form. Compliance auditing may be concerned with *regularity* (adherence to formal criteria such as relevant laws, regulations and agreements) or with *propriety* (observance of the general principles governing sound financial management and the conduct of public officials). While regularity is the main focus of compliance auditing, propriety may also be pertinent given the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials. Depending on the mandate of the SAI, the audit scope may therefore include aspects of propriety.

### *Regularity*

19. Is the concept that the subject matter is in accordance with authorising legislation, regulations issued under governing legislation and other relevant legal documents which lay down the rules and procedures to be adhered to by the audited entity which

provide a legal framework within which the subject matter is being exercised, and these are properly sanctioned.

### *Propriety*

20. Officials entrusted with management or stewardship of public funds and public entities are expected to act with propriety in all matters concerning the discharge of their responsibilities. While expending public funds, those responsible for such expenditure should not only ensure the regularity of that expenditure in terms of compliance with the authorities, but also its propriety as to whether the expenditure is in accordance with the 'spirit' and 'intention' of such authorities. Depending on the mandate of the SAI, the audit scope may therefore, include aspects of propriety. Propriety issues are relevant for compliance audits performed in a standalone mode or in combination with financial or performance audits.
21. Standards of public governance vary across nations. Auditors have professional competence and accumulated experience of public sector auditing over several decades which will help in assessing the quality of public governance and the professional and ethical conduct of public officials. Where standards of professional conduct are less than acceptable, even though the subject matter prima facie complies with the authorities, the auditor could focus on propriety issues to ensure that audit conclusion does not provide a misleading picture of the state of public financial management and the stewardship of public moneys. Further, where public financial management is concerned, providing assurance on compliance with regularity alone does not address the issue of whether the managers charged with protecting public funds have discharged their fiduciary responsibilities in a proper manner.

### *Mandate*

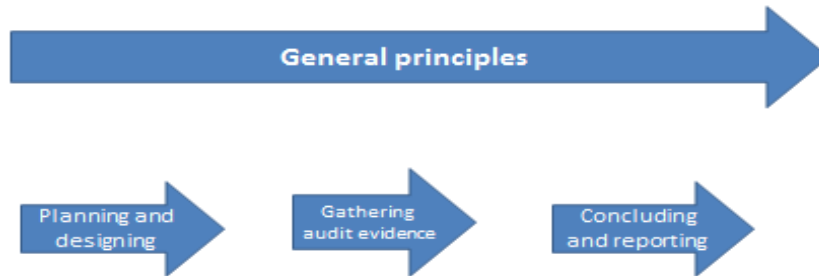
22. Compliance auditing may also lead SAIs with jurisdictional powers to pronounce judgments and sanctions on those responsible for managing public funds. Some SAIs are mandated to refer facts liable to criminal prosecution to the judicial authorities. In this context, the objective of the compliance audit may be extended, and the auditor should take due account of the relevant specific requirements when devising the audit strategy or planning and throughout the audit process.
23. Depending on the organizational structure of the public sector and the mandate of the SAI, compliance auditing may cover all levels of government: central, regional and local. Compliance audits of private entities are also possible, focusing, for revenue, on tax payers and, for expenditure, on those involved in the management of public property or services, for instance through partnership arrangements or as recipients of public grants or subsidies.

Merknad [MOP2]: To be elaborated by proposals from the court group.

## **REQUIREMENTS OF THE COMPLIANCE AUDIT PROCESS**

24. The requirements below are fundamental to the conduct of a compliance audit. The nature of the audit is iterative and cumulative. But for the purposes of presentation, the requirements and following explanations are divided into requirements that the auditor shall consider prior to commencement and at more than one point during the audit process (general requirements) and those related to steps in the audit process itself.

# The compliance audit process



INTOSAI



## GENERAL REQUIREMENTS OF COMPLIANCE AUDITING

### *Professional judgment and skepticism*

#### Requirement

25. Auditors ~~should~~ shall plan and conduct the audit with professional skepticism and exercise professional judgment throughout the audit process.

#### Explanation

26. The terms "professional skepticism" and "professional judgment" are relevant when formulating requirements regarding the auditor's decisions about the appropriate course of action **for the audit to provide the users with the necessary assurance about information provided by the auditor or another party.**
27. Professional judgment implies the application of collective knowledge, skills and experience to the audit process. The auditor applies professional judgment at all stages of the audit process. The concept refers to the application of relevant training, knowledge and experience, within the context provided by auditing standards, so that informed decisions can be made about the courses of action that are appropriate given the circumstances of the audit.
28. Professional skepticism is fundamental to all audits. Professional skepticism means maintaining professional distance and an alert and questioning attitude when assessing the sufficiency and appropriateness of evidence obtained throughout the audit. It also entails remaining open-minded and receptive to all views and arguments. The auditor will plan and conduct the audit with an attitude of professional skepticism, recognizing that certain circumstances may cause the subject matter to diverge from the criteria. An attitude of professional skepticism means the auditor making a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit.



29. The necessary competencies for maintaining professional judgment and skepticism in compliance auditing are a) considering special situations, as for example, indication of fraud and the need of the work of an expert, b) the ability to analyze the structure and content of public authorities as a basis for identifying suitable criteria or gaps in legislation, in the event that laws and regulations are entirely or partially lacking, c) to apply professional audit concepts in the approach to known and unknown subject matters, d) deciding between qualitative and quantitative sampling and performing further evidence-gathering procedures to reduce audit risk to an acceptable level. The auditor will be capable of appraising a variety of types of audit evidence by their source and relevance to the audit scope and subject matter, and of evaluating the sufficiency and appropriateness of all evidence obtained during the audit.
30. In addition, where compliance audit involves consideration of propriety aspects, the auditor has to possess a very high degree of experience, skills, domain knowledge and professional judgment, since it may not be possible to draw a general conclusion or provide assurance on a homogenous population. This is because the deviations from ethical standards or non-compliance with generally accepted public financial management principles normally occur in individual cases and not across the entire audit population. These individual cases could however, be significant enough to be reported to the stakeholders/audited entity.

#### Requirement

31. **Professional judgment and skepticism in compliance auditing shall be applied when identifying the audit scope and evaluating the audit evidence in relation to the assurance level and the form of conclusion provided by the audit.**

#### Explanation

32. Professional judgment and skepticism are used throughout the compliance audit process to assess systematically the elements of the audit, the subject matter, suitable criteria, the audit scope, risk, materiality and the audit procedures to be used in response to the defined risks in reporting and in determining the form, content and frequency of communication throughout the audit. To obtain the desired assurance level of the audit, professional judgment and skepticism are to be documented when identifying the audit scope, when evaluating the audit evidence and instances of non-compliance and forming conclusions.

### *Quality control*

#### Requirement

33. **Auditors ~~should~~ shall take responsibility for the overall quality of the audit.**

#### Explanation

34. The auditor is responsible for the performance of the audit and should implement quality control procedures throughout the audit process. Professional judgment and skepticism is essential, and a questioning mind through the whole audit process makes it transparent at all stages of the audit process. Such procedures must be decided at the planning stage of the audit, and will be aimed at ensuring that the audit

complies with the applicable standards and that the audit report, conclusion or opinion is appropriate given the circumstances.

35. The role of the supervisor is essential to the maintenance of the overall quality of the audit as it enhances the confidence that the audit complies with applicable standards.

### *Audit team management and skills*

#### Requirement

36. Auditors ~~should~~ shall have access to the necessary skills.

#### Explanation

37. The individuals in the audit team will collectively possess the knowledge, skills and expertise necessary to successfully complete the audit. This includes a) an understanding and practical experience of the type of audit being undertaken, b) familiarity with the applicable standards and authorities, c) an understanding of the audited entity's operations and d) the ability and experience to exercise professional judgement. Common to all audits is the need to recruit personnel with suitable qualifications, offer staff development and training, prepare manuals and other written guidance and instructions concerning the conduct of audits, and assign sufficient audit resources. Auditors should maintain their professional competence through ongoing professional development. Audits may require specialised techniques, methods or skills from disciplines not available within the SAI. External experts may be used in different ways, e.g. to provide knowledge or conduct specific work. Auditors shall evaluate whether experts have the necessary competence, capabilities and objectivity and determine whether their work is adequate for the purposes of the audit.

### *Audit risk*

#### Requirement

38. Auditors ~~should~~ shall consider audit risk throughout the audit process.

#### Explanation

39. Compliance audits are conducted in such a way as to manage, or reduce, the audit risk to an acceptably low level. The audit risk is the risk that the audit report – or more specifically the auditor's conclusion or opinion - will be inappropriate in the circumstances of the audit. Consideration of audit risk is relevant in both attestation and direct engagements. In performing compliance audits, public sector auditors assess audit risk and perform audit procedures as necessary throughout the audit. This is done in order to reduce audit risk to an acceptably low level in the particular circumstances, so as to obtain reasonable or limited assurance as the basis for the auditor's conclusion or opinion.
40. Considerations of audit risk are an essential part of performing an audit with assurance. Due to the inherent limitations of an audit, a compliance audit does not provide a guarantee or absolute assurance that all instances of non-compliance will be detected. Inherent limitations in a compliance audit may include factors such as:

- Judgment may be applied by management in interpreting laws and regulations
- Human errors occur
- Systems may be improperly designed or function ineffectively
- Controls may be circumvented
- Evidence may be concealed or withheld

The factors that may give rise to audit risk will vary depending on the particular subject matter and circumstances of the audit.

Requirement

41. Auditors ~~should~~ shall consider the three dimensions of audit risk

Explanation

42. The three different dimensions of audit risk are – a) inherent risk, b) control risk and c) detection risk. The relative significance of these dimensions of audit risk depends on the nature of the subject matter, whether the audit is to provide reasonable or limited assurance and whether it is a direct reporting or an attestation engagement. Compliance auditors consider the three dimensions of audit risk in relation to the subject matter and the particular situation. In addition, the probability that the matter will occur, and the possible consequences arising if the matter should occur, are also taken into account in assessing risk.

43. In a limited assurance audit, the objective is to control the audit risk to a level that is acceptable in the circumstance, but still higher than in a reasonable assurance audit.

*Confidence and assurance in compliance auditing*

Requirement

44. Auditors shall provide confidence for the intended users by managing the audit risk.

Explanation

45. The intended users will wish to be confident about the reliability and relevance of the information which they use as the basis for taking decisions. Audits therefore provide information based on sufficient and appropriate evidence, and auditors should perform procedures to reduce or manage the risk of reaching inappropriate conclusions. The level of assurance that can be provided to the intended user should be communicated in a transparent way. Due to inherent limitations, however, audits can never provide absolute assurance<sup>1</sup>.

46. Compliance auditing carried out by obtaining assurance enhances the confidence of the intended users in the information provided by the auditor or another party. As users of compliance audit reports generally include the legislature as representatives of citizens making decisions and priorities concerning the calculation and purpose of public sector expenditure and income, the quality of information provided by the auditor or another party is crucial for the audit to contribute to good governance in providing the basis for informed decisions.

<sup>1</sup> ISSAI 100 para. 31.

47. In compliance auditing there are two levels of assurance:

**Reasonable assurance**, which is high but not absolute. Reasonable assurance audits include assessing risks, performing audit procedures to respond to the assessed risks, and evaluating the sufficiency and appropriateness of the evidence obtained. The audit conclusion is expressed positively, conveying that, in the auditor's opinion, the subject matter is or is not in compliance, in all material respects, with the stated criteria, such as 'in our opinion the subject matter is / is not in compliance, in all material respects, with the stated criteria...'.

**Limited assurance**, which is lower than the reasonable assurance. The procedures performed in a limited assurance audit are limited compared with what is necessary to obtain reasonable assurance, but the level of assurance is expected, in the auditor's professional judgment, to be meaningful to the intended users. In performing a limited assurance, procedures are usually limited to analytical procedures and inquiries. The audit conclusion is expressed negatively, conveying that, based on the procedures performed, nothing has come to the auditor's attention to cause him/her to believe that the subject matter is not compliant with the criteria, such as 'nothing has come to our attention that would indicate that the subject matter is not in compliance, in all material respects, with the criteria...'.

48. Both reasonable and limited assurance are possible in both direct reporting and attestation engagements in compliance auditing. The nature, timing and extent of procedures performed in both reasonable assurance audits and limited assurance audits are determined by public sector auditors applying professional judgment. In a limited assurance audit, the auditor will accept a higher audit risk than in a reasonable assurance audit.

## Materiality

### Requirement

49. Auditors ~~should~~ shall consider materiality throughout the audit process.

### Comments from CAS secretariat:

*To be considered for needs of further explanations of the existing text: Considerations of materiality in the process of identifying the subject matter and criteria might be added from maintenance group nr. 3. Explanations of materiality considerations in each phase of the audit is in need of further elaborations, with a focus both on value, nature and context.*

### Explanation

50. Determining materiality is a matter of professional judgment and depends on the auditor's interpretation of the users' needs. A matter may be judged material if knowledge of it would be likely to influence the decisions of the intended users. This judgment may relate to an individual item or to a group of items taken together. Materiality is often considered in terms of value, but it also has other quantitative as well as qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs.

51. As stated above, materiality in compliance auditing has both quantitative and qualitative aspects, although the qualitative aspects generally play a greater role in the public sector. Materiality should be considered for the purposes of planning,

evaluating the evidence obtained and reporting. An essential part of determining materiality is to consider whether reported cases of compliance or non-compliance (potential or confirmed) could reasonably be expected to influence decisions by the intended users. Factors to be considered within this judgment assessment are a) mandated requirements, b) public interest or expectations, c) specific areas of legislative focus, d) requests and e) significant funding. Issues at a lower level of value or incidence than the general determination of materiality, such as fraud, may also be considered material. The assessment of materiality requires comprehensive professional judgment on the part of the auditor and is related to the audit scope.

#### Requirement

**52. Compliance auditors shall plan and perform the audit to determine whether the subject matter, in all material respects or to a degree meaningful to the intended user, is in compliance with the identified criteria.**

#### Explanation

53. During the planning process, information is gathered about the entity in order to assess risk and establish materiality levels for designing audit procedures. Evidence gathered must then be evaluated as a basis for forming conclusions and for reporting purposes. Materiality is significant to this evaluation.

**Merknad [MOP3]:** The perspective on materiality levels needs to be extended with value, nature and context.

Other matters that may be considered material at a lower level of value or incidence than the general determination of materiality include:

- a) Fraud
- b) Intentional unlawful acts or non-compliance.
- c) Incorrect or incomplete information to management, the auditor or to the legislature (concealment).
- d) Intentional disregard for follow-up of requests made by management, authoritative bodies or auditors.
- e) Events and transactions made despite knowledge of the lack of legal basis to carry out the particular event or transaction.

In other cases the determination of materiality is normally a matter of professional judgment.

#### Requirement

**54. Auditors shall consider materiality when evaluating audit evidence.**

#### Explanation

55. When evaluating evidence obtained, the determination of materiality may be influenced by quantitative factors such as the number of persons or entities affected by the particular subject matter, or the monetary amounts involved. In some cases, the qualitative factors are more important than the quantitative factors. The nature, visibility and sensitivity of the particular program area or subject matter may play a role. For example, the emphasis placed on the subject matter by users, a public accounts committee or similar committee of the legislature, or regulatory bodies may influence the determination of materiality. Public expectations and public interest are also qualitative factors that may impact the public sector auditor's determination of materiality. The seriousness of the non-compliance is also considered. While not necessarily unlawful, instances of excess spending over appropriations authorized by

the legislature or introduction of a new service not provided for in the approved appropriations, may be serious instances of non-compliance by their nature.

56. In evaluating the materiality of any non-compliance identified, matters such as the criteria, the conditions, the cause and the effect of non-compliance are also considered.

### *Documentation*

#### Requirement

57. Auditors ~~should~~ shall prepare sufficient audit documentation.

#### Explanation

58. Sufficient audit documentation is prepared at the appropriate time and provides a clear understanding of the criteria used, the scope of the audit, the judgments made, the evidence obtained and the conclusions reached. Sufficient audit documentation is detailed enough to enable an experienced auditor, with no prior knowledge of the audit, to understand the following: a) the relationship between the subject matter, the criteria, the audit scope, the risk assessment, the audit strategy and audit plan and the nature, timing, extent and results of the procedures performed; b) the evidence obtained in support of the auditor's conclusion or opinion; c) the reasoning behind all significant matters that required the exercise of professional judgement; and d) the related conclusions. The auditor prepares relevant audit documentation before the audit report is issued, and the documentation is retained for an appropriate period of time.

### *Communication*

#### Requirement

59. Auditors ~~should~~ shall maintain effective communication throughout the audit process.

#### Explanation

60. Good communication with the audited entity throughout the audit process may help make the process more effective and constructive. Communication takes place at all audit stages; a) before the audit starts, b) during initial planning, c) during the audit proper, and d) at the reporting phase. Any significant difficulties encountered during the audit, as well as instances of material non-compliance, should be communicated to the appropriate level of management or those charged with governance.
61. During the initial planning phase, communication include discussing with the appropriate level of management, and those charged with governance as appropriate - within the limits of laws and regulations - the audit strategy, timing, logistics, responsibilities, suitable audit criteria and other elements of planning.
62. Other less significant findings that are not deemed material, or do not warrant inclusion in the public sector auditor's report, may also be communicated to management during the audit. Communicating such less significant findings may also help the audited entity to remedy instances of non-compliance and avoid similar instances in the future.

63. During the reporting phase, communication includes issuing written reports on a timely basis to the intended users, the audited entity and others as appropriate.
64. Some SAIs can, according to their audit mandate, order the audited entity to correct identified instances of non-compliance. In doing so, compliance auditors determine whether their independence and objectivity will be impaired, and take appropriate action to avoid such impairment.

Requirement

65. The auditor ~~should~~ shall inform the users and the responsible party of the audit criteria.

Explanation

66. The audit criteria are the benchmark used to evaluate or measure consistently and reasonably the subject matter. The SAI is responsible to give the Parliament (the primary user) sound information to take decisions. The Parliament is issuing the authorities that may be identified as criteria in compliance audit. The responsible party is responsible for the subject matter of the audit. Hence, in order for communication to enhance the transparency between the three parties of the audit process, the auditor is to inform the users and the responsible party of the audit criteria.

## REQUIREMENTS RELATED TO THE COMPLIANCE AUDITING PROCESS

### Planning and designing a compliance audit

#### *Audit scope*

Requirement

67. Auditors ~~should~~ shall determine the audit scope.

Explanation

68. Where the SAI's mandate or the applicable legislation does not prescribe the scope of the audit, this is decided by the auditor. The audit scope is a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The scoping of an audit is influenced by materiality and risk, and it determines which authorities and parts thereof will be covered. **The scoping of an audit requires specific skills and effort in direct reporting, where the auditor selects the subject matter and criteria in order to delimit the audit coverage. The scoping of each audit is determining the level of assurance to be provided.** The audit process as a whole will be designed to cover the entire audit scope.

Comments from CAS secretariat:

*To be considered for needs of further explanation: This is a new requirement in ISSAI 400 in need of thorough explanation and elaboration, with a specific focus on how concrete and detailed a scope needs to be expressed in terms of criteria and subject matter in order to conduct an audit with assurance.*



## Subject matter and criteria

### Requirement

69. Auditors ~~should~~shall identify the subject matter and suitable criteria.

### Explanation

70. Determination of the subject matter and criteria is one of the first steps in a compliance audit.

71. Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. Compliance auditing may cover a wide range of subject matters, which can take many forms and have different characteristics depending on the audit objective.

72. The subject matter and criteria may be laid down by law or in the mandate of the SAI. Alternatively, it may be identified by the auditor. For attestation engagements it may also be relevant to identify the subject matter information presented by the responsible party concerning the compliance of a given subject matter with identified criteria.

73. When compliance audit encompasses budgetary laws, or other relevant budgetary resolutions, the entity's revenue and financing are included, as well as its expenditure. A SAI's mandate may also encompass audits of compliance with the documented budgetary assumptions and premises, prior to the applicable resolution of the legislature.

74. When performed in connection with an audit of financial statements, the subject matter of a compliance audit is generally decisions and financial management in relation to the use of appropriated funds and execution of the budget. Such a compliance audit comprises the assessment of whether the activities, financial transactions and information reflected in the financial statements (the subject matter information) are in accordance with the authorities which govern them (the criteria). Such authorities may include the applicable law, including budgetary law in particular, basic principles of law, legislative acts, parliamentary decisions, and other authoritative decisions, directions and guidelines, and agreed upon terms and conditions. Whether the entity's income and expenditure have been applied to the purposes intended by the legislature, and to the entity's mandated program objectives and activities is generally also encompassed.

75. The subject matter and criteria must be updated if in the audit process, the auditor becomes aware that parts of the subject matter and criteria are outdated.

### Requirement

76. An appropriate subject matter ~~should~~shall be identifiable, and it ~~should~~shall lend itself to consistent evaluation or measurement against suitable criteria.

### Explanation

77. The subject matter may take many forms and have a variety of characteristics. When identifying the subject matter, the auditor will employ professional judgment and skepticism to analyze the audited entity and assess materiality and risk. It should be of such a nature that it enables sufficient and appropriate audit evidence to be gathered in support of the audit report, conclusion or opinion.



78. The determination of the subject matter and the subject matter information is one of the first steps to be carried out in planning and performing a compliance audit. Subject matters take many forms and have many different characteristics. Subject matters may be general or very specific in nature. Some are quantitative and can often be easily measured (for example financial performance or condition), while others are qualitative and more subjective in nature (for example behavior). Nonetheless, the subject matter should be identifiable and it should be possible to assess the subject matter against suitable criteria. Furthermore, the subject matter should be of a nature such that it is possible to gather evidence about the subject matter sufficient to support reporting in the form of a reasonable or limited assurance conclusion or opinion. In some cases the subject matter may be set out in the relevant law or audit mandate. In other cases the selection of the subject matter is a strategic choice to be made by the SAI or public sector auditors, and is based on risk assessment, professional judgement and materiality.
79. For attestation engagements on compliance, it is more relevant to focus on the subject matter information, which may be a statement of compliance in accordance with an established and standardised reporting framework.
80. In some cases, the subject matter may be set out in the relevant law or audit mandate. In other cases, the selection of the subject matter is a strategic choice to be made by the SAI or public sector auditors, and is based on risk assessment and professional judgement.
81. Subject matter can be identified both at macro as well as at micro level. At the macro level, the SAI decides which departments/themes will be audited in the forthcoming period. Based on the mandate of the SAI, request for audit topics may be coming from Parliament or the Government. After selecting the departments/themes, the SAI may select the subject matter within them at the micro level for compliance audits based on materiality and risk. The selection of subject matter both at the macro as well as micro level could be based on risk assessment and analysis of materiality of possible areas.
82. Sources of information used in selecting subject matters can be authorities in the form of budgets, documents from parliament and its committees, annual plans etc. and information on risk found in consultancy reports, activity reports, performance reports, annual reports from government bodies, local governments, media, earlier audit reports of the SAI and the experience of SAI's auditors and managers. In determining the subject matter, the SAI may use preliminary/pilot studies in order to collect more information about the entity or area to be audited.
83. The subject matter and the criteria should be part of the individual audit plan (or programme). The subject matter should focus on areas which are important or risky within the audited programme, area or organisation.
84. Subject matter and subject matter information is determined in the same manner while carrying out audit of propriety as with audit of regularity in compliance audit. However, the focus of auditors will be specifically on propriety issues of subject matter, which generally include the following:
- Procurement activities which have significant material value.
  - Transactions which lack transparency and where decisions are not documented clearly.
  - Transactions where approvals are not obtained from competent authoritative body or decisions are taken bypassing the delegated authoritative body.

Merknad [MOP4]: Is the Government then the user of the audit?

- Transactions which involve conflict of interest or related party transactions.
- Cases where public funds are used for personal purposes.

Comments from CAS secretariat:

*To be considered for needs of further explanation encompassing both direct reporting and attestation engagements, and compliance audit in combination with performance audit.*

Requirement

85. The auditor ~~should~~ shall identify suitable criteria to provide a basis for evaluating the audit evidence and developing audit findings and conclusions.

Explanation

86. The criteria, or the benchmarks against which the subject matter will be compared, must be identified in order to arrive at an audit scope. In performing compliance audits, the identification of the criteria is an essential step in the audit planning process.
87. Criteria may be formal, such as a law or regulation, ministerial directive or the terms of a contract or agreement. Criteria may also be less formal such as a code of conduct or principles of propriety, or they may relate to expectations regarding behavior, for example what may be considered acceptable in regard to class of travel or levels of hospitality and entertainment at government expense if such limits are not explicitly stated elsewhere. Administrative guidelines used as criteria should be in compliance with laws and regulations. The sources used as a basis for the audit criteria can in itself be part of the compliance audit.
88. The characteristics of suitable criteria are the following:
- Relevant – relevant criteria provide meaningful contributions to the information and decision making needs of the intended users of the audit report
  - Reliable – reliable criteria result in reasonably consistent conclusions when used by another auditor in the same circumstances
  - Complete – complete criteria are those that are sufficient for the audit purpose and do not omit relevant factors. They are meaningful and make it possible to provide the intended users with a practical overview for their information and decision making needs.
  - Objective – objective criteria are neutral and free from any bias on the part of the auditor or on the part of management of the audited entity. This means that criteria cannot be so informal such that assessment of the subject matter information against the criteria would be very subjective, and may lead other public sector auditors to reach a very different conclusion.
  - Understandable – understandable criteria are those that are clearly stated, contribute to clear conclusions and that are comprehensible to the intended users. They are not subject to wide variations in interpretation.
  - Comparable - comparable criteria are consistent with those used in similar audits of other similar agencies or activities, and with those used in previous audits of the entity

- g) Acceptable - acceptable criteria are those to which independent experts in the field, audited entities, the legislature, the media and the general public are generally agreeable
  - h) Available – criteria should be made available to intended users such that they understand the nature of the audit work performed and the basis for the audit report
89. Criteria include matters that may have a significant impact on the objective of a particular audit. Therefore, in performing compliance audit, public sector auditors determine that the criteria are suitable and relevant to the subject matter and the scope of the particular audit being performed. Once suitable criteria have been identified based on the characteristics set out above, they then must be appropriately 'operationalised' for the particular circumstances of each audit so as to be able to reach meaningful audit conclusions.
90. The determination of criteria can be straight forward, but in some cases the identification may be more complex. In some cases public sector auditors may find checklists a helpful means in gaining an overview of the suitable criteria to be used. Public sector auditors use a number of sources to assist in the identification of criteria.
91. In many compliance audits, the applicable criteria will be clearly identifiable. This may be the case where a clear and uncomplicated law or regulation forms the criteria. The documented intentions or premises for resolutions of the legislature may also assist the auditor in identifying the appropriate criteria.
92. If situations arise where there may be doubt as to what is the correct interpretation of the relevant law, regulation or authority, public sector auditors may find it useful to consider the intentions and premises set out in developing the law, or to consult with the particular body responsible for the legislation. The auditors may also consider relevant earlier decisions made by judicial authorities.
93. However, when propriety is the main principle governing the compliance audit, the criteria may become more difficult to identify as it may be less formal and may include public expectations in regard to the actions and behavior of public officials. In these cases, public sector auditors must be more thorough in their work to identify suitable criteria. The need to identify suitable criteria does not preclude public sector auditors from reporting identified breaches of what may be considered acceptable behavior by public officials, if circumstances so warrant.
94. In the process of identifying suitable criteria, public sector auditors consider materiality related to the risk of potential non-compliance for each topic subject to audit (budgetary law, other specific laws, terms of a contract etc, as well as propriety where relevant). Materiality considerations include both quantitative aspects (size) and qualitative aspects (nature and characteristics).
95. Public sector auditors ensure that the criteria to be used adequately reflect the topic subject to audit in its entirety. In rare cases, where the audit may be of limited scope and may only cover certain parts of a law or regulation, this limited scope should be clearly stated in the auditor's report. If public sector auditors make use of guidelines, checklists or other material provided by the audited entity or other administrative authorities for the purpose of identifying the suitable audit criteria, they must take due

care in assuring through appropriate audit procedures that the material used adequately reflects the applicable law, regulation, etc.

96. In some cases, provisions of relevant legislation may be unclear, for example where an act of legislation provides that more specific provisions should be set out by the relevant administrative body and these provisions have not yet been developed. In such cases, public sector auditors clearly state in the audit report what they believe the relevant legislation requires, or that the scope of the audit has been limited and the reasons for this limitation. For example, the report may state that insufficient clarity of law has limited the audit criteria applied and that there is a need for remedial measures to be taken.
97. In some rare cases, the criteria may be conflicting, for example when there is a conflict between different sources of law and the issue has not been solved by the relevant administrative or judicial authorities. In such cases it is very important to understand the intentions behind the particular criteria and to identify any consequences arising from such conflict. It may also be necessary to elaborate on instances of conflicting criteria in the auditor's report such that remedial measures may be taken by the appropriate bodies.
98. Approaches to help identify suitable criteria in these types of dilemmas may include:
- a) Applying a 'theoretical' approach, by allowing experts in the field to answer questions such as: 'what ought to be the ideal results under perfect conditions according to rational thinking or best-known comparable practice?' or
  - b) Defining and obtaining support for well-founded and realistic criteria by applying an 'empirical' approach involving discussions with stakeholders and decision makers
- The audit approach may also be broken down into parts, or the scope narrowed, such that clearly identifiable criteria may be applied.
99. Notwithstanding the above, the criteria should be made available to the intended users and others as appropriate, for example by including the criteria in the auditor's report, or making reference to the criteria if they are readily available in another format.
100. In situations where the audit criteria are, for whatever reason, not considered suitable, the SAI may encourage the appropriate bodies to formulate clearly the general principles to be followed in public sector entities for such matters.

## *Understanding the entity*

### Requirement

101. **Auditors should shall understand the audited entity in the light of the relevant authorities.**

### Explanation

102. Determining the subject matter and suitable criteria as explained above are among the first steps in performing compliance audits. The process of determining the subject matter and the criteria involves public sector auditors obtaining an understanding of the audited entity and the circumstances surrounding the audit. This understanding provides public sector auditors with a frame of reference to be used in applying

professional judgement throughout the entire audit process. An understanding of the entity, its environment and relevant program areas is especially important as it will be used in determining materiality and in assessing risks.

103. Compliance auditing cover all levels of government. As a consequence, the standards are applicable as appropriate for a combination of entities for which an audit across the entities is planned and performed. The auditor(s)'s responsibility for the audit across entities should be clearly set out.

104. The auditor will need to be familiar with the structure and operations of the audited entity and its procedures for achieving compliance. The auditor will use this knowledge to determine materiality and assess the risk of non-compliance.

105. In addition to authorities for subject matter of compliance relating to regularity aspects, authorities for propriety issues would also involve the financial code and code of ethics of the concerned government and generally accepted principles of financial propriety in management of public funds. Where Public Accounts Committee of Legislature gives specific directions to be followed in incurring public expenditure, these would also form part of authorities for propriety audit.

*Comments from CAS secretariat:*

*To be considered for needs of further explanations: Guidance in this section should focus on what audited entities are in the public sector, who to identify as "the entity" seen in relation to the authorities and how to understand the entity.*

## *Understanding control environment and internal controls*

### Requirement

106. **Auditors ~~should~~ shall understand the control environment and the relevant internal controls and consider whether they are likely to ensure compliance.**

### Explanation

107. Understanding internal control is normally an integral part of understanding the entity and the relevant subject matter. In performing a compliance audit, public sector auditors understand and evaluate the reliability of internal control. In compliance audit, this includes understanding and evaluating controls that assist management in complying with authorities.

108. An understanding of the audited entity and/or the subject matter relevant to the audit scope depends on the auditor's knowledge of the control environment. The control environment is the culture of honesty and ethical behavior that provides the foundation for the system of internal controls to ensure compliance with the authorities. In compliance auditing, a control environment that focuses on achieving compliance is of particular importance.

109. In order to understand the audited entity or the subject matter, the auditor also needs to understand the system of internal controls. The particular type of controls which the auditor focuses on will depend on the subject matter and the specific nature and scope of the audit. As the subject matter may be qualitative or quantitative, the auditor will focus on quantitative or qualitative internal controls, or a combination thereof, according to the audit scope. In evaluating internal controls, the auditor assesses the risk that they may not prevent or detect material instances of non-compliance. The

auditor should consider whether the internal controls are in harmony with the control environment so as to ensure compliance with the authorities in all material respects.

110. The particular type of controls evaluated depends on the subject matter, and the nature and scope of the particular compliance audit. The internal control system in an entity may also include controls designed to correct identified instances of non-compliance. Public sector auditors obtain an understanding of internal control relevant to the audit objective, and test controls on which they expect to rely. The assurance derived from the assessment of the internal controls will help the auditors determine the confidence level and hence, the extent of the audit procedures to perform.
111. In the context of compliance audits, an internal control system is composed of policies, structure, procedures, processes, tasks and other tangible and intangible factors that help the audited entity to respond appropriately to risks of non-compliance with the criteria. An effective system should safeguard the audited entity's assets, facilitate internal and external reporting and help the audited entity to comply with relevant authorities.
112. Where compliance audit involves scrutiny of propriety issues, the focus is on compliance with the 'spirit' and 'intention' of authorities, in addition to reliance solely on compliance with formal authorities, and emphasis on substantive testing of transactions to provide assurance that public servants have been honest and behaved in a proper manner in managing public funds. Sample selection for quantitative sampling is critical while auditing propriety aspects. Rather than random statistical sampling, the emphasis is on identification of potential risk factors to ensure that all cases falling under these categories are covered. One of the key risk factors is past trends, especially past audit findings which point to the existence of such situations and whether the entity is prone to such cases. Adequacy and effectiveness of internal controls is an important area for audit examination.

Comments from CAS secretariat:

*To be considered for needs of elaborations: To be added the control environment and explanations of relevant internal controls on compliance of both quantitative and qualitative nature, and how to assess them within an audit.*

## Risk assessment

### Requirement

113. **Auditors ~~should~~ shall perform a risk assessment to identify risks of non-compliance**

### Explanation

114. In the light of the audit criteria, the audit scope and the characteristics of the audited entity, the auditor performs a risk assessment to determine the nature, timing and extent of the audit procedures to be performed. In this the auditor considers the risks that the subject matter will not comply with the criteria. Non-compliance may arise due to fraud, error, the inherent nature of the subject matter and/or the circumstances of the audit. The identification of risks of non-compliance and their potential impact on the audit procedures will be considered throughout the audit process. As part of the risk assessment, the auditor should evaluate any known instances of non-compliance in order to determine whether they are material.

Comments from CAS secretariat:

*To be considered for needs of explaining further the risk of non-compliance.*

115. Relationships between various public sector entities are considered when assessing the risk of non-compliance, and especially when assessing the risk of fraud or non-compliance. Such risks may, for example, relate to one entity exerting influence over another entity to take inappropriate actions. The result of these actions may be non-compliance with authorities, and in some cases the result may be an unlawful act. Furthermore, in the public sector there may be specific requirements related to activities and transactions between various public sector entities. There may also be specific reporting requirements related to such activities or transactions that may impact the planned audit procedures, the audit opinion or the auditor's report.

*Risk of fraud*

Requirement

116. Auditors **should shall** consider the risk of fraud.

Explanation

117. If the auditor comes across instances of non-compliance which may be indicative of fraud, he or she will exercise due professional care and caution so as not to interfere with any future legal proceedings or investigations. Fraud in compliance auditing relates mainly to the abuse of public authority, but also to fraudulent reporting on compliance issues. Instances of non-compliance with authorities may constitute deliberate misuse of public authority for improper benefit. The execution of public authority includes decisions, non-decisions, preparatory work, advice, information handling and other acts in the public service. Improper benefits are advantages of a non-economic or economic nature gained by an intentional act by one or more individuals among management, those charged with governance, employees or third parties.

118. While detecting fraud is not the main objective of compliance audit, auditors include fraud risk factors in their risk assessments and remain alert to indications of fraud when carrying out their work.

119. As part of the audit, public sector auditors identify and assess fraud risk and gather sufficient appropriate evidence related to identified fraud risks through the performance of suitable audit procedures. When suspected fraud has been identified, public sector auditors take action to ensure that they respond appropriately based upon the mandate of the SAI and the particular circumstances.

120. Fraud risks are considered in the context of the broader scope of compliance auditing. Examples of areas and situations that may typically give rise to fraud risks in the public sector include:

- a) Grants and benefits to third parties
- b) Procurement
- c) Exercise of public officials' duties and power
- d) Intentional misstatement or misrepresentation of results or information
- e) Privatization of government entities
- f) Relationships between public sector officials or entities.



121. Fraud risks are also generally linked to breach of propriety and need to be looked at closely by public auditors.

### *Audit strategy and audit plan*

#### Requirement

122. Auditors **should shall** develop an audit strategy and an audit plan.

#### Explanation

123. Audit planning should involve discussion between members of the audit team with a view to developing an overall audit strategy and an audit plan **to cover the audit scope and provide the level of assurance identified for the audit**. The purpose of the audit strategy is to devise an effective response to the risk of non-compliance. It should include consideration of the planned audit responses to specific risks through the development of an audit plan. Both the audit strategy and the audit plan are documented in writing. Planning is not just a distinct phase of the audit, but a continuous and iterative process. The overall audit strategy and plan are updated as necessary throughout the audit. Planning also involves considerations related to the direction, supervision and review of the audit team.

124. In establishing the overall audit strategy for the compliance audit, public sector auditors consider:

- a) The scope, subject matter, criteria and other characteristics of the compliance audit, taking into account the mandate of the SAI and the elements contained in the compliance audit definition
- b) Reporting responsibilities and scope, as well as to whom and when such reporting will take place, and in what form
- c) Significant factors that may influence the direction of the audit.
- d) Materiality, risk and audit risk assessment
- e) Knowledge gained from previous or related audits
- f) Composition and work allocation of the audit team, including any need for experts
- g) Timing of the audit
- h) Level of assurance to be provided

125. Public sector auditors develop an audit plan for the compliance audit. The audit strategy is essential input to the audit plan. The audit plan includes:

- a) A description of identified criteria related to the scope and characteristics of the compliance audit and to the legal, regulatory or appropriations framework;
- b) A description of the nature, timing and extent of risk assessment procedures sufficient to assess the risks of non-compliance, related to the various audit criteria;
- c) A description of the nature, timing and extent of planned audit procedures related to the various compliance audit criteria and risk assessments and the expected level of assurance.

126. Planning also involves:

- a) Obtaining a general understanding of the legal, regulatory and appropriations framework, as well as relevant, agreed upon terms and conditions applicable to the scope of the audit and to the audited entity



- b) Obtaining an understanding of management's assessment of applicable laws and regulations including management's internal controls that help ensure compliance with authorities
- c) Obtaining an understanding of the relevant authorities, including rules, laws, regulations, policies, codes, significant contracts or grant agreements etc, and
- d) Defining the characteristics of the audit sampling procedures that better meet audit's objectives.

127. For audits of propriety aspects, the auditor should also understand the 'spirit' and 'intention' of authorities, in addition to reliance solely on compliance with formal authorities since regularity is concerned more with compliance with laws and regulations, while propriety is concerned with standards of conduct, behavior and corporate governance. It includes matters such as fairness, integrity, the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the letting of contracts and the avoidance of waste and extravagance.

### Gathering audit evidence

#### *Sufficient and appropriate audit evidence*

##### Requirement

128. Auditors ~~should~~ shall gather sufficient appropriate audit evidence to cover the audit scope.

##### Explanation

129. The auditor gathers sufficient and appropriate audit evidence to provide the basis for the conclusion or opinion. **Sufficiency** is a measure of the quantity of evidence, while **appropriateness** relates to the quality of evidence – its relevance, validity and reliability. The quantity of evidence required depends on the audit risk (the greater the risk, the more evidence is likely to be required) and on the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated.

130. However, merely obtaining more evidence does not compensate for its poor quality. The reliability of evidence is influenced by its source and nature, and is dependent on the specific circumstances in which it was obtained. The auditor considers both the relevance and the reliability of the information to be used as audit evidence, and must respect the confidentiality of all audit evidence and information received.

131. The evidence gathering process is systematic and iterative and involves:

- a) Gathering evidence by performing appropriate audit procedures
- b) Evaluating the evidence obtained as to its sufficiency (quantity) and appropriateness (quality)
- c) Re-assessing risk and gathering further evidence as necessary

The evidence gathering process continues until the compliance auditor is satisfied that sufficient, appropriate evidence exists to provide the proper level of assurance to support a basis for the auditor's conclusion or opinion.

#### Requirement

**132. The nature and sources of the necessary audit evidence shall be determined by the criteria, the subject matter and the scope of the audit.**

#### Explanation

133. The audit procedures are to be appropriate in the circumstances of the audit and suited to the purpose of obtaining sufficient and appropriate audit evidence. As the subject matter may be qualitative or quantitative, the auditor will focus on quantitative or qualitative audit evidence, or a combination thereof, according to the audit scope. Compliance auditing thus includes a variety of procedures for gathering evidence of both a quantitative and a qualitative nature. The compliance auditor will often need to combine and compare evidence from different sources in order to meet the requirements for sufficiency and appropriateness.

134. Audit evidence is gathered using a variety of techniques such as:

- a) Observation
- b) Inspection
- c) Inquiry
- d) Re-performance
- e) Confirmation
- f) Analytical procedures

Procedures to gather audit evidence are generally grouped into two major categories:

- a) Tests of controls
- b) Substantive tests, such as analytical procedures or tests of details

#### *Observation*

Observation involves looking at a process or procedure being performed. In performing compliance audit, this may include looking at how a bid tendering process is carried out or observing how benefit payments are processed.

#### *Inspection*

Inspection involves examining books, records and other case files or physical assets. In performing compliance audit, inspection may include examining the books and records to determine how project funds have been accounted for and comparing the accounting to the terms of the project agreement. Inspection of case files may involve examining all relevant documents to determine if recipients of benefits met eligibility requirements. Inspection may also involve examining an asset, such as a bridge or a building, to determine if it meets the applicable building specifications.

Public sector auditors consider the reliability of any documents inspected and keep in mind the risk of fraud and the possibility that documents inspected may not be authentic. In cases of fraud, sometimes two different sets of books and records have been kept. Public sector auditors may also inquire with different persons as to the source of the documents, or the controls over their preparation or maintenance.

### *Inquiry*

Inquiry involves seeking information from relevant persons, both within and outside the audited entity. Inquiry may range from formal written inquiries to more informal oral discussions. It may involve interviewing and asking questions of relevant persons, including experts. Such interviews may take place in person or virtually (for example phone calls or web-meetings). Inquiry may also involve preparing and sending questionnaires or surveys.

Inquiry is generally used extensively throughout an audit and complements other audit procedures. For example, when observing processes being performed, such as the benefits payment process mentioned above, inquiries are often made of relevant persons in regard to how relevant legislation, including changes and updates, is identified and interpreted. Results of inquiries may indicate that the processes are performed in different ways in different locations; which may lead to instances of non-compliance.

Inquiries are often made of persons outside the particular function subject to audit. For example, in addition to making inquiries of accounting personnel, it may also be relevant to make inquiries of legal or technical personnel.

Inquiry is generally not sufficient appropriate evidence on its own. In order to obtain sufficient appropriate evidence, inquiry is performed together with other types of procedures. Inquiry is most effective when conducted with relevant and knowledgeable persons, ie persons in positions of authority who are authorized to speak or give opinions on behalf of the entity.

### *Confirmation*

Confirmation is a type of inquiry and involves obtaining, independently from the audited entity, a reply from a third party in regard to some particular information. In compliance audits, confirmation may involve the auditor obtaining feedback directly from beneficiaries that they have received the grants or other funds that the audited entity asserts have been paid out, or confirming that funds have been used for the particular purpose set out in the terms of a grant or funding agreement. Confirmation may also involve receiving guidance from the legislature as to how a specific piece of legislation is meant to be interpreted.

Written confirmations may also be obtained from management in regard to oral representations made during the audit. These written management representations may, for example, relate to:

- a) Management's assertion of compliance with a relevant piece of legislation, the terms of an agreement, etc
- b) Management's disclosure of all instances of non-compliance of which it is aware
- c) Management having provided the auditor with complete information about the subject matter.

### *Re-performance*

Re-performance involves independently carrying out the same procedures already performed by the audited entity. Re-performance may be done manually or by computer assisted audit techniques. For example, case file studies may be performed to test whether the audited entity made the correct decisions or provided the appropriate service in accordance with the relevant criteria. Process steps may be re-performed to test the appropriateness of visas or resident permits issued, or the exercise of budget authority. If the criteria for making child benefit payments involve payments to parents with children under a certain age, the audited entity's selection of recipients from a public database may

be re-performed by public sector auditors using computer assisted audit techniques to test the accuracy of the entity's process. Also, if the selection of bids from a tender process is dependent upon meeting certain criteria, the bid selection process may be re-performed to test that the correct bids have been selected. Where highly technical matters are involved (for example re-performance of pension calculations or engineering models), experts may be involved.

### *Analytical Procedures*

Analytical procedures involve comparing data, or investigating fluctuations or relationships that appear inconsistent. In compliance auditing, such procedures may, for example, involve comparing an increase in pension benefits payments from one year to the next with demographic information such as the number of citizens having reached retirement age within the last year. If the criteria relate to the terms of an agreement which state, for example, that project funding is provided based on performance levels such as the number of job placements made, then any changes in project funding might be compared to changes in employment statistics.

Regression analysis techniques or other mathematical methods may assist public sector auditors in comparing actual to expected results.

135. In some rare cases it may be difficult or almost prohibitively expensive to obtain sufficient, appropriate audit evidence in order to form conclusions. In these cases, public sector auditors must consider the relationship between the costs and the benefits of gathering the evidence, as well as the consequences lack of sufficient appropriate evidence will have on the achievement of the audit scope and on the auditor's report. The auditor's response to this situation may vary in the circumstances depending on the mandate, public interest considerations, public expectations and the ability to report such findings. The auditor may find it necessary to report on this matter specifically to the legislature or other intended users. However, such difficulty or expense is not, in itself, sufficient grounds for omitting the planned evidence-gathering procedures, even if there are no satisfactory alternative procedures.

136. The extent of procedures for gathering evidence will vary in each audit, depending on the particular subject matter, the evidence needed, the evidence availability, the information needs of the intended users and the SAI's timetable and resource constraints. The audit scope must be adjusted to these circumstances

### *Audit sampling*

#### Requirement

137. Auditors shall define if audit objectives demand the use of a sample and, if it does, whether it must be a quantitative or a qualitative approach.

#### Explanation

138. A sample may be quantitative or qualitative; both require the use of professional judgment. It is often not possible to collect information from a whole population or an entire subject matter. The auditor must therefore make a judgment as to whether which approach to sampling is the appropriate way of obtaining the audit evidence required.

139. Quantitative sampling is mandatory if the auditor needs evidence from a large and homogenous population. When the auditor seek to draw conclusions about a whole population by testing a sample of items selected from it, it is essential that the sample is representative of the population from which it is drawn. In this situation, a quantitative approach has to be applied to produce a reliable conclusion associated to a well-known level of error. However, the technical requirements of quantitative sampling do require certain statistical techniques. If the audit team do not have the skills to apply them, a statistician expert must be required.
140. Qualitative sampling is the selection procedure conducted as a deliberate and systematic process of identifying the factors of variation in the subject matter. The auditors might sample on the basis of characteristics of individuals, groups, activities, processes or the audited entity as a whole. Qualitative sampling always requires careful assessment and sufficient knowledge of the subject matter.
141. The need for quantitative and/or qualitative sampling depends on the audit scope. Auditors shall apply professional judgment on this decision. Both of them, however, must have their premises and limitations exposed at auditor's report to avoid misinterpretations on conclusions extent.

#### Concluding and reporting

##### *Evaluating audit evidence and forming conclusions*

###### Requirement

142. Auditors **should shall** evaluate whether sufficient and appropriate audit evidence has been obtained and form relevant conclusions.

###### Explanation

143. After completing the audit proper the auditor will review the audit evidence in order to reach a conclusion or issue an opinion. The auditor evaluates whether the evidence obtained is sufficient and appropriate so as to reduce the audit risk to an acceptably low level. The evaluation process entails considering evidence that both supports and seems to contradict the audit report, conclusion or opinion on compliance or non-compliance. It also includes considerations of materiality. After evaluating whether the evidence is sufficient and appropriate to cover the audit scope and the assurance level of the audit, the auditor considers how best to conclude in the light of the evidence.
144. If audit evidence obtained from one source is inconsistent with that obtained from another, or if there are any doubts about the reliability of the information to be used as evidence, the auditor determines what modifications or additions to the audit procedures would resolve the matter and considers the implications, if any, for other aspects of the audit. After completing the audit, the auditor will review the audit documentation to determine whether the subject matter has been sufficiently and appropriately examined. The auditor should also determine whether the risk assessment and initial determination of materiality were appropriate in the light of the evidence collected, or whether they need to be revised.
145. Evidence obtained is evaluated in relation to identified materiality in order to identify potential instances of material non-compliance. Determining the significance of findings is based on the concept of materiality as set out above. Findings from compliance audits must also be placed in proper perspective, for example reported instances of non-compliance may be based on the number of cases of non-

compliance or the related monetary value SAs operating in a Court of Accounts environment have the ability to render judgment on the accounts. In cases of non-compliance, this may result in imposing reimbursements, fines or other penalties.

Merknad [MOP5]: For consideration in court group.

Compliance auditors' assessment of what represents a material compliance deviation is a matter of professional judgment and includes considerations of context as well as quantitative and qualitative aspects of the subject matter concerned.

A number of factors are taken into account in applying professional judgement to determine whether or not the non-compliance is material. Such factors may include the:

- a) Importance of amounts involved (monetary amounts or other quantitative measures such as number of citizens or entities involved, carbon emissions levels, time delays in relation to deadlines, etc)
- b) Circumstances
- c) Nature of the non-compliance
- d) Cause leading to the non-compliance
- e) Possible effects and consequences non-compliance may have
- f) Visibility and sensitivity of the program in question, (for example, is it the subject of significant public interest, does it impact vulnerable citizens, etc)
- g) Needs and expectations of the legislature, the public or other users of the audit report
- h) Nature of the relevant authorities
- i) Extent or monetary value of the non-compliance

146. Public sector auditors evaluate whether, based on the evidence obtained, there is reasonable or limited assurance that the subject matter is in compliance, in all material respects, with the identified criteria.

#### Written Representations from Responsible Officials

147. In evaluating evidence and forming conclusions, written representations may be obtained, as considered necessary in the circumstances, to support audit evidence obtained by public sector auditors. Such representations may state that the activities, financial transactions and information reflected in the financial statements of the entity are in compliance with the authorities which govern them, or that particular control systems have functioned effectively throughout the period under audit.

#### Subsequent Events

148. Public sector auditors perform audit procedures to determine if there are events that have occurred after the completion of the field work and up until the date of the compliance audit report that may result in material non-compliance, and therefore may require particular disclosure or may impact the auditor's conclusion or report. Such procedures normally involve inquiry, obtaining written representations from management or reviewing relevant correspondence, minutes from meetings, published reports or financial information for subsequent periods (monthly, quarterly) etc. The amount of subsequent events work done may depend on the nature of the matters involved and the elapsed time between the completion of field work and the issuance of the report.

## Reporting

### Requirement

149. Auditors ~~should~~ **shall** prepare a report based on the principles of **completeness, objectivity, timeliness and a contradictory process.**

### Explanation

150. Reporting is an essential part of a compliance audit and involves reporting deviations and violations so that corrective actions may be taken, and so that those accountable may be held responsible for their actions. A written report, setting out findings and conclusions in an appropriate form, is to be prepared at the end of each audit. Compliance auditors take care to ensure that reports presented are factually correct, and that findings are presented in the proper perspective and in a balanced manner.

151. The principle of completeness requires the auditor to consider all relevant audit evidence before issuing a report. The principle of objectivity requires the auditor to apply professional judgement and skepticism in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and balanced manner. The principle of timeliness implies preparing the report in due time. The principle of a contradictory process implies checking the accuracy of facts with the audited entity and incorporating responses from responsible officials as appropriate. In both form and content, a compliance audit report conforms to all these principles.

152. The forms of reporting may be defined in law or by the mandate of the SAI. Nonetheless, the audit report normally contains a conclusion based on the audit work performed. The report may also provide constructive and practical recommendations for improvement where appropriate. In an attestation engagement the report is generally referred to as the Auditor's Report.

153. Reporting may vary between brief standardized opinions and various forms of conclusions, presented in short or long form. However it appears, the report will be complete, accurate, objective, convincing and as clear and concise as the subject matter permits. Any limitations in the audit scope should be described. The report clearly states the relevance of the criteria used and the level of assurance provided.

### Requirement

154. Compliance audit reports ~~should~~ **shall** include the following elements (although not necessarily in this order):

- a) Title
- b) Addressee
- c) Scope of the audit, including the time period covered
- d) Identification or description of the subject matter
- e) Identified criteria
- f) Identification of the auditing standards applied in performing the work
- g) A summary of the work performed
- h) Findings
- i) A conclusion/opinion
- j) Replies from the audited entity (as appropriate)
- k) Recommendations (as appropriate)
- l) Report date
- m) Signature

### Explanation

155. The form of the written report may vary depending on the circumstances. However, consistency in the audit report may help users of the report to understand the audit work done and conclusions reached, and to identify unusual circumstances when they arise.
156. The factors that may influence the form of the compliance audit report are numerous. These factors include, but are not limited to, the mandate of the SAI, applicable legislation or regulation, the objective of the particular compliance audit, customary reporting practice and the complexity of the reported issues. Furthermore, the form of the report may depend on the needs of the intended users, including whether the report is to be submitted to the legislature or to other third parties such as donor organizations, international or regional bodies, or financial institutions.
157. Depending on the abovementioned factors, a SAI may find it appropriate to prepare either a short form report or a long form report. Long form reports (sometimes referred to as 'compliance audit special reports') generally describe in detail the audit findings and conclusions, including potential consequences and constructive recommendations, while short form reports are more condensed and generally in a more standardized format. When compliance audit is performed together with the audit of financial statements, an opinion on compliance may form part of the auditor's report on the audit of the financial statements. In such cases, the opinion on compliance is clearly set apart from the opinion on the financial statements and from the 'report on other legal and regulatory requirements' included in ISSAI 1700.

Further guidance and explanation is given below on the form and content of compliance audit reports.

### Compliance Audit Reports

The compliance audit report includes the following elements (although not necessarily in the following order):

#### *Title*

The title should briefly give a picture of the audit scope for an outside reader.

#### *Addressee*

An addressee identifies the party or parties to whom the audit report is directed. The audit report is ordinarily addressed to the responsible party, but in some cases there may be other intended users.

#### *Scope of the audit, including the time period covered*

The introduction part of the report sets out the audit scope in the form of a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The introduction also includes the time period covered by the audit.

#### *Identification or description of the subject matter*

Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. This should be clearly described in the audit report.



### *Identified Criteria*

The criteria against which the subject matter is assessed are identified in the auditor's report. In performing compliance audits, the criteria may differ greatly from audit to audit. Clear identification of suitable criteria in the compliance audit report is therefore important so that the users of the report can understand the basis for public sector auditors' work and conclusions. The criteria may be included in the report itself, or the report may make reference to the criteria if they are contained in an assertion from management, or otherwise available from a readily accessible and reliable source.

In cases where the criteria are not readily identifiable, or have had to be derived from relevant sources, the criteria applied in the audit are clearly stated in the relevant section of the auditor's report. In cases where the criteria are conflicting, the conflict is explained. In such a case, the potential consequences of the situation are explained to the extent possible and recommendations are provided as appropriate.

### *Identification of the auditing standards applied in performing the work*

Where a SAI's auditing standards are based on or consistent with the INTOSAI Fundamental Auditing Principles, these may be referred to in audit reports by stating:

*... We conducted our audit in accordance with [standards], which are based on [or consistent with] the Fundamental Auditing Principles (ISSAIs 100-999) of the International Standards of Supreme Audit Institutions.*

SAIs in some jurisdictions may choose to adopt the Compliance Audit Standards as the authoritative standards for their work. In this case, reference may be made by stating:

*... We conducted our [compliance] audit[s] in accordance with the International Standards of Supreme Audit Institutions [on compliance auditing].*

The reference may be included in the audit report or communicated by the SAI in a more general form covering a defined range of engagements.

### *A summary of the work performed*

The summary of the work performed helps the intended users understand the auditor's conclusion. For many audits, infinite variations in procedures are possible in theory. In practice, however, these are difficult to communicate clearly and unambiguously. Hence, the summary of the work performed should give a brief explanation for an outside reader of how the audit was performed.

### *Findings*

The findings section comprises the auditor's description of the gathered evidence compared with the criteria. It is structured in a logical manner, based on the identified criteria in a way that assists the reader in following the logical flow of a particular argument.

### *Conclusion/opinion*

**The conclusion is a statement of the auditor covering the audit scope on the basis of the findings and conveying explicitly the level of assurance of the audit. The conclusion may take the form of a clear written statement of opinion on compliance.**

### *Responses from the Audited Entity*

Incorporating responses from the audited entity by reporting the views of responsible officials is part of the principle referred to as the principle of contradiction. The principle of contradiction is a unique and important feature of compliance auditing. It relates to the presentation of weaknesses or critical findings in such a way as to encourage correction. This involves agreeing the facts with the audited entity to help ensure that they are complete, accurate and fairly presented. It may also involve, as appropriate, incorporating the audited entity's response to matters raised, whether verbatim or in summary.

### *Providing Constructive Recommendations*

For audits to be constructive, the audit report may include, as appropriate, recommendations designed to result in improvements. While such recommendations may be constructive for the audited entity, they should not be of such a detailed nature that the compliance auditor's objectivity may be impaired in future audits.

### *Report Date*

The report is dated no earlier than the date public sector auditors have obtained sufficient appropriate audit evidence to support the opinion or conclusion.

### *Signature*

The report is signed by the person with appropriate authority to represent the SAI. This may be the Auditor General, an authorized officer, or possibly co-signatures of two officers to whom appropriate authority has been delegated.

### Reporting on Compliance Audit related to the Audit of Financial Statements

When performing compliance audit related to the audit of financial statements, the conclusion on compliance with authorities may be incorporated as a compliance opinion in the auditor's report on the financial statements. In some cases a separate compliance audit report may be issued. Guidance on auditor's reports on the financial statements is set out in the ISSAI 1700 and 1800 series.

### Additional Reporting Considerations

In addition to the short form report (which may include opinions on both the financial statements and compliance), in some cases a SAI may issue a more detailed compliance audit special report. The purpose of such a report may be to provide the legislature, public accounts committee or similar committee of the legislature, the audited entity, or other bodies charged with governance as appropriate, with a detailed explanation beyond that given in the auditor's report on the financial statements. Public sector auditors report such compliance issues in sufficient detail to enable the relevant users to properly understand and consider these matters.

In other cases, SAIs may issue a report with an opinion on compliance which is separate from the auditor's report on the financial statements. When such a separate report with an opinion on compliance is issued, public sector auditors may include appropriate references to the separate report in the auditor's report on the financial statements.

**Merknad [MOP6]:** To be considered in format in accordance with common subcommittee approaches to cross-references.

### Compliance Audit Special Reports (long form reports)

Depending on the needs of users, and the particular objective of the compliance audit, a SAI may decide to report the results of a compliance audit in a compliance audit special report. Such special reports are more akin to those reports common in performance audits and set out in greater detail the observations, conclusions and recommendations arising from the audit than the short form reports. In some cases, this type of report may be in addition to a compliance audit short form report.

As with compliance audit reports, some consistency in the form of compliance audit special reports may help users of the report to understand the audit work done and conclusions reached, and to identify unusual circumstances when they arise.

In general, compliance audit special reports include all of the elements set out in the guidance on compliance audit reports, but are normally added the following sections (the order of which may vary):

- a. Title page
- b. Table of contents
- c. Glossary (if necessary)
- d. Executive summary
- e. Introduction and scope
- f. Observations and findings
- g. Conclusions and recommendations
- h. Responses from the audited entity
- i. Appendices (if necessary)

#### *Title page, table of contents and glossary*

The title page clearly sets out the title of the report, the report date, to whom the report is addressed and the preparer of the report. The preparer of the report is normally the SAI.

Including a table of contents, especially if the report is voluminous, helps give the report structure and guide the reader to areas of particular interest.

A glossary may also be helpful to readers if technical or unfamiliar terminology, acronyms, abbreviations or words with a particular contextual meaning are used repeatedly throughout the report.

#### *Executive Summary*

The executive summary is critical as it is often the part of the report most read by users. The executive summary should reflect fully and accurately, while at the same time in a concise and balanced fashion, the content of the report. To be effective, an executive summary is normally one to two pages in length.

The main focus of the executive summary is on the identified criteria (significant questions to be answered) and a summary of the main audit conclusions and recommendations in relation to such criteria (answers to the questions).

In some cases, a chart or diagram may display significant audit conclusions in a form that makes it easier for users to grasp complicated or voluminous information. In such cases it may be helpful to users to include graphical information in the executive summary.

#### *Introduction and scope*

The introduction sets out the context of the audit including the scope of the audit, identification or description of the subject matter, the identified criteria and the responsibilities of the various parties involved.

The introduction is generally short without a lot of detail. If necessary, relevant detailed information may be included in appendices.

#### *Observations and findings*

The observations and findings section comprises the main body of the compliance audit special report. It is structured in a logical manner, normally around the identified criteria, and in a way that assists the reader in following the logical flow of a particular argument.

When presenting audit observations and findings, making the following four elements apparent to users assists them in gaining a better understanding of the audit work performed and the significance and consequences of the audit findings:

- a) Criteria – the benchmark or measure against which performance is compared or evaluated
- b) Conditions – the situation observed
- c) Cause – the source and reasons giving rise to the conditions observed
- d) Effect – the impact and consequences of the conditions observed (the materiality of the findings, their impact on the budget, citizens or users, implications for principles of sound public sector management, etc).

When significant amount of evidence is included to support audit findings, such evidence may be more appropriately included in appendices.

#### *Conclusions and recommendations*

The primary purpose of the conclusions and recommendations section of the report is two-fold:

- a) to provide clear answers (conclusions) to the audit questions (identified criteria), and
- b) to provide constructive and practical recommendations for improvement where appropriate.

Recommendations are most effective when they are positive in tone and results-oriented, setting out clearly what needs to be done, when and by whom. Cost considerations are borne in mind when determining the practicality of recommendations.

**Merknad [MOP7]:** In this section the relationship to performance audit is close and might need an explanation.

Where significant compliance deviations are reported, recommendations are provided in cases where there is potential for significant improvement. It may be helpful to users for public sector auditors to highlight ongoing corrective actions.

While constructive and practical recommendations assist in promoting sound public sector management, public sector auditors are careful not to provide such detailed recommendations so as to be taking on the role of management and thereby impairing their own objectivity.

#### *Responses from the audited entity*

As set out in the guidance above on compliance audit reports, the principle of contradiction –the process of a checking the accuracy of facts and incorporating responses from the audited entity - is also applied in preparing compliance audit special reports. Responses from the audited entity to matters raised may be incorporated in the report, either verbatim or in summary.

Responses from the audited entity may be included in a separate section of the special report or as an appendix, depending on the volume of the responses.

Incorporating the views of responsible officials assists in ensuring the practicality of the recommendations and in making the responsible officials accountable for their actions.

#### *Appendices*

Where appropriate, appendices may be used to provide users with detailed or supplementary information related to the audit. The information may be in text or table format, or it may be more graphical in nature such as diagrams, charts or pictures. Such information may assist users in understanding the audit findings, as well as the causes and effects thereof.

#### Considerations related to the Reporting of Suspected Unlawful Acts

While detecting potential unlawful acts, including fraud, is normally not the main objective of performing a compliance audit, compliance auditors do include fraud risk factors in their risk assessments, and remain alert for indications of unlawful acts, including fraud, in carrying out their work.

In performing compliance audits, if compliance auditors come across instances of non-compliance which may be indicative of unlawful acts or fraud, they exercise due professional care and caution so as not to interfere with potential future legal proceedings or investigations. Compliance auditors may consider consulting with legal counsel or appropriate regulatory authorities. Furthermore, they may communicate their suspicions to the appropriate levels of management or to those charged with governance, and then follow up to ascertain that appropriate action has been taken. In regard to instances of non-compliance related to fraud or serious irregularities, because of the different mandates and organizational structures that exist internationally, it is up to the SAI to determine the appropriate action to be taken.

Due to the inherent limitations of an audit, there is an unavoidable risk that unlawful acts, including fraud, corruption or theft may occur and not be detected by compliance auditors. Fraud may consist of acts designed to intentionally conceal its existence. There may be collusion between management, employees or third parties, or falsification of documents. For example, it is not reasonable to expect public sector auditors to identify forged documentation in support of claims for grants and benefits, unless they are reasonably

obvious forgeries. In addition, public sector auditors may not have investigative powers or rights of access to individuals or organizations making such claims.

Only a court of law can determine whether a particular transaction is illegal. Although public sector auditors do not determine if an illegal act has occurred, they do have a responsibility to assess whether the transactions concerned are in compliance with applicable laws and regulations.

Merknad [MOP8]: Could this be expanded by the court group?

Fraudulent transactions are, by their nature, not in compliance with the applicable law. Public sector auditors may also determine that transactions where fraud is suspected, but not yet proven, are not in compliance with the applicable law. Material unlawful acts normally result in a modified audit opinion or conclusion.

If suspicion of unlawful acts arises during the audit, compliance auditors, where permitted by law, may communicate to the appropriate levels of management and those charged with governance. In this case, those charged with governance are likely to be ministerial or administrative bodies higher up in the reporting hierarchy. Compliance auditors follow up and ascertain that management or those charged with governance have taken appropriate action in response to the suspicion, for example by reporting the incident to the relevant law enforcement authorities. Compliance auditors may also report such incidents directly to the relevant law enforcement authorities.

#### Incidental Findings

Compliance auditors may often come across examples of non-compliance in connection with other types of audit work being performed. Even though the auditor was not actively looking for the existence or absence of the particular condition, public expectations might influence the decision to report such incidental findings. Although compliance auditors may report such findings, these findings are outside the scope of the compliance audit. Unless the scope of the audit is re-evaluated and the incidental findings are incorporated into the ongoing compliance audit, the auditor does not obtain or provide assurance with respect to the existence or absence of the condition related to the incidental findings. It may, however, be possible to express a conclusion with limited assurance depending on the circumstances. In any event, when such situations are reported, it is important to inform the reader of the relevant assurance level (reasonable or limited), if any.

#### Limited assurance

In a limited assurance audit, the conclusion (with appropriate wording inserted in the brackets as applicable) is normally expressed as follows: *'Nothing has come to our attention that leads us to believe that [the audited entity's subject matter information] is not in compliance, in all material respects, with [the applied criteria].'*

In a limited assurance report, the description of the nature, timing, and extent of evidence-gathering procedures performed is essential to understanding the assurance provided. It may be appropriate to indicate evidence-gathering procedures that were not performed that would ordinarily be performed and to document in the working papers the reasons surrounding the limitations.

In the special circumstances where limited assurance compliance audit work is performed as part of a reasonable assurance audit of financial statements, the limited assurance on compliance is clearly stated in the auditor's report and set apart from the opinion on the financial statements.

### Matter paragraph

Public sector auditors may conclude that there is a need to elaborate on particular matters which do not affect the compliance opinion or conclusion. In these circumstances, public sector auditors disclose these matters through the use of an:

- a) Emphasis of Matter paragraph (when the matter is presented and disclosed in the financial statements and is not materially misstated, for example to highlight a systematic weakness or an uncertainty dependent on future events such as when a competent authority has yet to determine if an item complies with the law); or
- b) Other Matter(s) paragraph (for matters other than those presented and disclosed in the financial statements, and not affecting the opinion or conclusion on compliance, for example the need for the legislature to take action when a conflict between different sources of law has been identified).

### *Conclusion*

158. **The auditor shall reach a conclusion on the audit scope based on the findings.**

#### Explanation

159. **The conclusion is a statement of the auditor covering the audit scope on the basis of the findings assessed against the criteria and conveying explicitly the level of assurance of the audit.** The nature of the wording may be influenced by the mandate of the SAI and the legal framework under which the audit is conducted, **yet will mainly depict the criteria, the subject matter of the audit and the final considerations of the auditor.**

160. The conclusion may be expressed as an elaborate answer to specific audit questions or take the form of a clear written statement of opinion on compliance, often in addition to the opinion on the financial statements. While an opinion is common in attestation engagements, the answering of specific audit questions is more often used in direct reporting engagements.

### *Opinion*

#### Requirement

161. **Where an opinion is provided the auditor ~~should~~ shall state whether it is unmodified or has been modified on the basis of the evaluation of materiality and pervasiveness.**

#### Explanation

162. **An opinion is a statement of the auditor expressed in a standardized form of a clear written expression of modification or unmodification.**

163. Where an opinion is provided the auditor states whether it is unmodified or has been modified on the basis of the evaluation of materiality and pervasiveness. Delivering an opinion would normally require a more elaborate audit strategy and approach **that encompasses a tangible population covered both by quantitative and qualitative sampling during the audit.**

164. When compliance audit is performed together with the audit of financial statements, the conclusion may take the form of an opinion. The nature of the wording may be influenced by the mandate of the SAI and the legal framework under which the audit is conducted.

165. Where no material instances of non-compliance have been identified, the opinion is unqualified. An example of the form for an unmodified opinion (where appropriate wording is inserted in the brackets as applicable) may be as follows: *'Based on the audit work performed, we found that [the audited entity's subject matter] is in compliance, in all material respects, with [the applied criteria].'*

166. Compliance auditors modify their opinions appropriately in cases of:

a) Material instances of non-compliance. Depending on the extent of the non-compliance, this may result in:

- i. A qualified opinion or conclusion (*'Based on the audit work performed, we found that, except for [describe exception], the audited entity's subject matter is in compliance, in all material respects with [the applied criteria]....'*), or
- ii. An adverse opinion or conclusion (*'Based on the audit work performed, we found that the subject matter is not in compliance...'*); or

b) Scope limitation. Depending on the extent of the limitation, this may result in:

- iii. A qualified opinion or conclusion (*'Based on the audit work performed, we found that, except for [describe exception], the audited entity's subject matter information is in compliance, in all material respects with [the applied criteria]....'*), or
- iv. A disclaimer (*'Based on the audit work performed, we are unable to, and therefore do not express a conclusion...'*)

Compliance auditors provide information as to the reasons for the modified opinion. This may be done by describing the particular instances of significant non-compliance in the report, for example in a paragraph or section preceding the opinion that describes the basis for that opinion.

#### Unmodified Compliance Opinions

When public sector auditors conclude that the activities, financial transactions and information reflected in the financial statements are, in all material respects, in compliance with the authorities which govern them, an unmodified opinion is expressed.

#### Modified Compliance Opinions

When public sector auditors conclude that there are material compliance deviations, the opinion expressed is either:

- a) qualified (if compliance deviations are material, but not pervasive, or if public sector auditors are unable to obtain sufficient, appropriate audit evidence, and the possible effects are material, but not pervasive); or
- b) adverse (if compliance deviations are material and pervasive).



When public sector auditors are unable to obtain sufficient, appropriate audit evidence on compliance with authorities, and the possible effects are material and pervasive, public sector auditors disclaim an opinion on compliance.

When the compliance opinion is modified, the reasons for the modification are explained in an appropriate 'Basis for the Modified Opinion' paragraph.

When the compliance opinion is modified, public sector auditors consider the wider implications for the financial statements as a whole and for the auditor's opinion thereon.

### *Follow-up*

#### Requirement

167. **Auditors ~~should~~ shall follow up instances of non-compliance when appropriate.**

#### Explanation

168. A follow-up process facilitates the effective implementation of corrective action and provides useful feedback to the audited entity, the users of the audit report and the auditor (for future audit planning). The need to follow up previously reported instances of non-compliance will vary with the nature of the subject matter, the non-compliance identified and the particular circumstances of the audit. At some SAIs, including courts of accounts, the follow-up may include issuing legally binding reports or judicial decisions. In audits carried out on a regular basis the follow-up procedures may form part of the subsequent year's risk assessment.

169. The need for any follow-up of previously reported instances of non-compliance will vary with the nature of the non-compliance and the particular circumstances. This may include formal reporting by the auditor to the legislature, as well as to the audited entity or other appropriate bodies. Other follow-up processes may include reports, internal reviews and evaluations prepared by the audited entity or others, a follow-up audit, conferences and seminars held for, or by, the audited entity, etc. In general, a follow-up process facilitates the effective implementation of corrective actions and provides useful feedback to the audited entity and to the users of the report and to public sector auditors in planning future audits. Follow-up processes may be set out in the mandate of the SAI.

170. While such recommendations may be constructive for the audited entity, they should not be of such a detailed nature that the compliance auditor's objectivity may be impaired in future audits.

#### Comments from CAS secretariat:

Consider adding a short explanation on the follow up in regular vs. unregular audits.

## **APPENDIX**

### *Compliance Audit glossary*

(Containing existing ISSAI 4100/4200 definitions. In need of changes and elaborations. To be considered if in need of further concepts - and as a possible input to a common glossary of terms of public sector auditing for CAS, FAS and PAS)

**Accountable:** Governments must be held accountable for the collection of taxes and other revenues and the level, quality and cost of services they provide.

**Analytical Procedures:** Involve comparing data, or investigating fluctuations or relationships that appear inconsistent.

**Assurance:** The intended users will wish to be confident about the reliability and relevance of the information which they use as the basis for taking decisions. Audits therefore provide information based on sufficient and appropriate evidence, and auditors should perform procedures to reduce or manage the risk of reaching inappropriate conclusions. Due to inherent limitations, however, audits can never provide absolute assurance.

Compliance auditing carried out by obtaining assurance enhances the confidence of the intended users in the information provided by the auditor or another party. As users of compliance audit reports generally include the legislature as representatives of citizens making decisions and priorities concerning the calculation and purpose of public sector expenditure and income, the quality of information provided by the auditor or another party is crucial for the audit to contribute to good governance in providing the basis for informed decisions.

To achieve a successful accountability relationship and to have their informational needs met public sector users need the assurance that information prepared by the auditor or another party is credible and has been prepared according to the relevant authorities in manner unbiased and transparent.

**Assertion:** A representation, explicit or implicit, that is embodied in the activities, financial transactions and information pertaining to the audited entity, used by the auditor in considering different types of potential deviations. In the context of compliance audit, the compliance assertion would mean that the entity, including responsible public sector officials, is acting in accordance with applicable authorities (and for audits of propriety - relevant public expectations). Assertions may be embodied in subject matter information presented by the audited entity or stated explicitly in a management representation letter.

**Attestation engagement:** In attestation engagements the responsible party measures or evaluates the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion.

**Audit mandate:** the auditing responsibilities, powers, discretions and duties conferred on a SAI under the constitution or other lawful authority of a country.

**Audit plan:** Public sector auditors develop an audit plan for the compliance audit. The audit strategy is essential input to the audit plan. The audit plan includes a description of identified criteria related to the scope and characteristics of the compliance audit and to the legal, regulatory or appropriations framework. A description of the nature, timing and extent of planned audit procedures related to the various compliance audit criteria and risk assessments.

**Audit risk:** The audit risk is the risk that the audit report – or more specifically the auditor's conclusion or opinion - will be inappropriate in the circumstances of the audit.

**Audit strategy:** The purpose of the audit strategy is to devise an effective response to the risk of non-compliance. It should include consideration of the planned audit responses to specific risks through the development of an audit plan.

**Authorities:** Relevant acts or resolutions of the legislature or other statutory instruments, directions and guidance issued by public sector bodies with powers provided for in statute, with which the audited entity is expected to comply. These elements are sometimes collectively referred to as 'legislative authorities' or just 'authorities'. This should not be confused with 'authorities' in the sense of bodies or persons exercising power or command such as 'law enforcement authorities' or 'regulatory authorities'. Where the intention is to refer to such bodies or persons, they are referred to specifically as 'law enforcement authorities, 'regulatory authorities,' etc.

**Benchmark:** Evaluate or check (something) by comparison with a standard.

**Cause of non-compliance:** The source and reasons giving rise to the conditions observed.

**Compliance auditing:** Compliance auditing is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. Compliance auditing deals with the degree to which the audited entity follows rules, laws and regulation, policies, established codes, or agreed upon terms and conditions, etc. Compliance auditing may cover a wide range of subject matters. A compliance audit is a systematic process of objectively obtaining and evaluating evidence as to whether a given subject matter is in compliance with applicable authorities identified as criteria. In general, the purpose of a compliance audit is to provide assurance to intended users about the outcome of the evaluation or measurement of a subject matter against suitable criteria.

**Completeness:** The principle of completeness requires the auditor to consider all relevant audit evidence before issuing a report.

**Compliance audit process:** ISSAI 400 describes the principles of compliance auditing. These requirements are fundamental to the conduct of a compliance audit. As the nature of the audit is iterative and cumulative the auditor shall consider some requirements prior to commencement of any audit and also at more than one point during the audit process i.e. planning and designing, gathering and evaluating evidence and reporting. Other requirements shall be considered at steps in the audit process itself.

**Compliance deviation** – the audited entity's failure to comply with identified criteria.

**Conclusion:** The conclusion is a statement of the auditor covering the audit scope on the basis of the findings assessed against the criteria and conveying explicitly the level of assurance of the audit.

**Conditions of non-compliance:** Conditions – the situation observed.

**Confirmation:** Is a type of inquiry and involves obtaining, independently from the audited entity, a reply from a third party in regard to some particular information. In compliance audits, confirmation may involve the auditor obtaining feedback directly from beneficiaries that they have received the grants or other funds that the audited entity asserts have been paid out, or confirming that funds have been used for the particular purpose set out in the terms of a grant or funding agreement. Confirmation may also involve receiving guidance from the legislature as to how a specific piece of legislation is meant to be interpreted.

**Contradictory process:** The principle of a contradictory process implies checking the accuracy of facts with the audited entity and incorporating responses from responsible officials as appropriate.

**Court of accounts:** SAls operating in a Court of Accounts environment have the ability to render judgement on the accounts. In cases of non-compliance, this may result in imposing reimbursements, fines or other penalties.

**Criteria:** The benchmark or measure against which performance is compared or evaluated. In performing compliance audits, the criteria may differ greatly from audit to audit. Clear identification of the criteria in the compliance audit report is therefore important so that the users of the report can understand the basis for public sector auditors' work and conclusions. The criteria may be included in the report itself, or the report may make reference to the criteria if they are contained in an assertion from management or otherwise available from a readily accessible and reliable source.

**Cumulative error:** An error which, in the course of the cumulation of a set of observations, does not tend to zero.

**Direct reporting engagement:** In direct reporting engagements it is the auditor who measures or evaluates the subject matter against the criteria. The auditor selects the subject matter and criteria, taking into consideration risk and materiality. The outcome of measuring the subject matter against the criteria is presented in the audit report in the form of findings, conclusions, recommendations or an opinion. The audit of the subject matter may also provide new information, analyses or insights.

**Effective communication:** Communication takes place at all audit stages; a) before the audit starts, b) during initial planning, c) during the audit proper, and d) at the reporting phase. Any significant difficulties encountered during the audit, as well as instances of material non-compliance, should be communicated to the appropriate level of management or those charged with governance.

**Entities:** Public-sector entities.

**Evidence:** The information used by the auditor in order to evaluate or measure whether the subject matter is or is not in compliance with the criteria.

**Evidence gathering techniques:** Procedures applied when gathering audit evidence.

**Executive Summary:** The executive summary is critical as it is often the part of the report most read by users. The executive summary should reflect fully and accurately, while at the same time in a concise and balanced fashion, the content of the report. To be effective, an executive summary is normally one to two pages in length.

**Findings:** Findings comprises the auditor's description of the gathered evidence compared with the criteria.

**Follow up:** Is the process of after having completed the audit, to reassess the subject matter and the criteria, after a certain period of time, in order to consider whether there are changes in the state of non-compliance or whether the responsible party has made improvements.

**Fraud:** Fraud in compliance auditing relates mainly to the abuse of public authority, but also to fraudulent reporting on compliance issues. Instances of non-compliance with authorities may constitute deliberate misuse of public authority for improper benefit. The execution of public authority includes decisions, non-decisions, preparatory work, advice, information handling and other acts in the public service. Improper benefits are advantages of a non-economic or economic nature gained by an intentional act by one or more individuals among management, those charged with governance, employees or third parties.

**Governance:** Patterns of rule or practices of governing. The study of governance generally approaches power as distinct from or exceeding the centralized authority of the modern state.

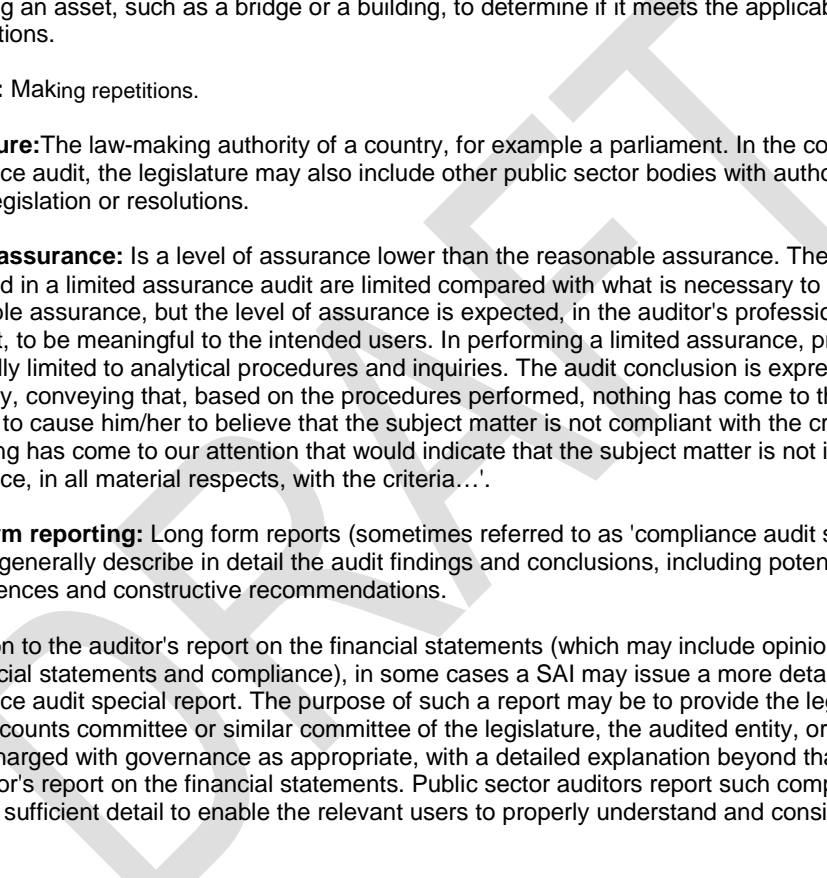
**Incidental Findings:** Examples of non-compliance discovered in connection with other types of audit work being performed.

**Inquiry:** Involves seeking information from relevant persons, both within and outside the audited entity. Inquiry may range from formal written inquiries to more informal oral discussions. It may involve interviewing and asking questions of relevant persons, including experts. Such interviews may take place in person or virtually (for example phone calls or web-meetings). Inquiry may also involve preparing and sending questionnaires or surveys.

**Inspection:** Involves examining books, records and other case files or physical assets. In performing compliance audit, inspection may include examining the books and records to determine how project funds have been accounted for and comparing the accounting to the terms of the project agreement. Inspection of case files may involve examining all relevant documents to determine if recipients of benefits met eligibility requirements. Inspection may also involve examining an asset, such as a bridge or a building, to determine if it meets the applicable building specifications.

**Iterative:** Making repetitions.

**Legislature:** The law-making authority of a country, for example a parliament. In the context of compliance audit, the legislature may also include other public sector bodies with authority for budget legislation or resolutions.

**Limited assurance:** Is a level of assurance lower than the reasonable assurance. The procedures performed in a limited assurance audit are limited compared with what is necessary to obtain reasonable assurance, but the level of assurance is expected, in the auditor's professional judgment, to be meaningful to the intended users. In performing a limited assurance, procedures are usually limited to analytical procedures and inquiries. The audit conclusion is expressed negatively, conveying that, based on the procedures performed, nothing has come to the auditor's attention to cause him/her to believe that the subject matter is not compliant with the criteria, such as 'nothing has come to our attention that would indicate that the subject matter is not in compliance, in all material respects, with the criteria...'.  


**Long form reporting:** Long form reports (sometimes referred to as 'compliance audit special reports') generally describe in detail the audit findings and conclusions, including potential consequences and constructive recommendations.

In addition to the auditor's report on the financial statements (which may include opinions on both the financial statements and compliance), in some cases a SAI may issue a more detailed compliance audit special report. The purpose of such a report may be to provide the legislature, public accounts committee or similar committee of the legislature, the audited entity, or other bodies charged with governance as appropriate, with a detailed explanation beyond that given in the auditor's report on the financial statements. Public sector auditors report such compliance issues in sufficient detail to enable the relevant users to properly understand and consider these matters.

**Materiality:** A matter may be judged material if knowledge of it would be likely to influence the decisions of the intended users. Materiality in compliance auditing has both quantitative and qualitative aspects, although the qualitative aspects generally play a greater role in the public sector. Materiality is considered throughout the audit process by looking at value, nature and context.

Value: Worth or quality as measured by a standard of equivalence.

Nature: The fundamental qualities of a person or thing; identity or essential character.

Context: The set of circumstances or facts that surround a particular event, situation, etc.

**Modified opinion:** Public sector auditors modify their conclusions appropriately in cases of:

- b) Material instances of non-compliance. Depending on the extent of the non-compliance, this may result in:
  - i. A qualified opinion or conclusion (*'Based on the audit work performed, we found that, except for [describe exception], the audited entity's subject matter is in compliance, in all material respects with [the applied criteria]...'*), or
  - ii. An adverse opinion or conclusion (*'Based on the audit work performed, we found that the subject matter is not in compliance...'*); or
- c) Scope limitation. Depending on the extent of the limitation, this may result in:
  - i. A qualified opinion or conclusion (*'Based on the audit work performed, we found that, except for [describe exception], the audited entity's subject matter information is in compliance, in all material respects with [the applied criteria]...'*), or
  - ii. A disclaimer (*'Based on the audit work performed, we are unable to, and therefore do not express a conclusion...'*)

When public sector auditors conclude that there are material compliance deviations, the opinion expressed is either:

- c) qualified (if compliance deviations are material, but not pervasive, or if public sector auditors are unable to obtain sufficient, appropriate audit evidence, and the possible effects are material, but not pervasive); or
- d) adverse (if compliance deviations are material and pervasive).

When public sector auditors are unable to obtain sufficient, appropriate audit evidence on compliance with authorities, and the possible effects are material and pervasive, public sector auditors disclaim an opinion on compliance.

**Objectivity:** The principle of objectivity requires the auditor to apply professional judgement and scepticism in order to ensure that all reports are factually correct and that findings or conclusions are presented in a relevant and balanced manner.

**Observation:** Involves looking at a process or procedure being performed. In performing compliance audit, this may include looking at how a bid tendering process is carried out or observing how benefit payments are processed.

**Opinion:** An opinion is a statement of the auditor expressed in a standardized form of a clear written expression of modification or unmodification.

**Pervasiveness:** The quality of filling or spreading throughout.

**Professional judgment:** The application of relevant training, knowledge and experience, within the context provided by auditing standards, so that informed decisions can be made about the courses of action that are appropriate given the circumstances of the audit.

**Professional skepticism:** An attitude of professional skepticism means the auditor making a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit.

**Propriety:** General principles of sound public sector financial management and conduct of public sector officials.

**Reasonable assurance:** Is high but not absolute assurance. Reasonable assurance audits include assessing risks, performing audit procedures to respond to the assessed risks, and evaluating the sufficiency and appropriateness of the evidence obtained. The audit conclusion is expressed positively, conveying that, in the auditor's opinion, the subject matter is or is not in compliance, in all material respects, with the stated criteria, such as 'in our opinion the subject matter is / is not in compliance, in all material respects, with the stated criteria...!'.

**Regularity:** Is the concept that the subject matter is in accordance with authorizing legislation, regulations issued under governing legislation and other relevant legal documents which lay down the rules and procedures to be adhered to by the audited entity which provide a legal framework within which the subject matter is being exercised, and these are properly sanctioned.

**Re-performance:** Involves independently carrying out the same procedures already performed by the audited entity.

**Risk assessment:** The performance to determine the nature, timing and extent of the audit procedures to be performed in the light of the audit criteria, the audit scope and the characteristics of the audited entity.

**Risk of non-compliance:**

**Scope:** A clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The scoping of an audit is influenced by materiality and risk, and it determines which authorities and parts thereof will be covered. The scope also includes the time period covered by the audit.

**Short form reporting:** A more condensed report generally in a more standardized format.

**Stakeholders:** Persons, groups, organizations or other types of entities with a concern or interest in public sector activities and operations, funding of public sector entities and the successful delivery of publicly funded programs.

**Subject matter:** Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. The scope and nature of a particular compliance audit depends on a number of factors, including the mandate and constitutional role of the SAI, as well as the authorities that are relevant to the audited entity. The subject matter can be quantitative or qualitative. Subject matters may be general or very specific in nature. Some are quantitative and can often be easily measured (for example financial performance or condition), while others are qualitative and more subjective in nature (for example behavior). In some cases the subject matter may be set out in the relevant law or audit mandate.

**Subject matter information:** Refers to the outcome of evaluating or measuring the subject matter against the criteria.

**Timeliness:** The principle of timeliness implies preparing the report in due time.

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