

INTOSAI



# *Compliance Audit Guidelines:*

## *ISSAI 4000 - 4200*

INTOSAI



*Compliance Audit  
Guidelines –  
General Introduction*

INTOSAI PROFESSIONAL STANDARDS COMMITTEE

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# 1 Introduction

1. Compliance audit deals with the responsibility of the SAI to audit whether the activities of public sector entities are in accordance with the relevant laws, regulations and 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 regulation, budgetary resolutions, policy, established codes, or agreed upon terms, such as the terms of a contract or the terms of a funding agreement. Compliance audit tasks performed by SAIs may cover a wide range of subject matters and may vary widely on an international basis.
2. The objective, 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 laws and regulations that are relevant to the audited entity. However, in general, the objective of compliance auditing is to enable the SAI to report to the appropriate bodies on the audited entity's compliance with a particular set of criteria. Such criteria may be derived from relevant financial reporting frameworks, laws, regulations, parliamentary decisions, terms of contracts or agreements, or may be other criteria deemed by the auditor to be suitable criteria.
3. The Compliance Audit Guidelines represent the fourth level (Auditing Guidelines) of the International Standards of Supreme Audit Institutions (ISSAI) Framework, where the Founding Principles constitute level 1, the Codes for SAIs the second level and the Fundamental Auditing Principles the third level (including the INTOSAI Auditing Standards).
4. For compliance audits performed together with the audit of financial statements, the Compliance Audit Guidelines supplement the INTOSAI Financial Audit Guidelines (ISSAI 1000 – 2999).
5. Depending on the structure of the public sector and the mandate of the SAI, the Compliance Audit Guidelines cover compliance audit at all levels of government: central, regional as well as local. Furthermore, the guidelines may also be applied to audits of private entities when they are involved in the management of public property or services, for instance through partnership arrangements or as recipients of public grants or subsidies.
6. The Compliance Audit Guidelines are written from two main perspectives:
  - **ISSAI 4100** deals with compliance audit performed separately from the audit of financial statements, for example as a separate audit task or related to performance audit
  - **ISSAI 4200** deals with compliance audit related to the audit of financial statements

The two ISSAIs are written as consistent, stand-alone documents. Much of the material related to planning and performing compliance audit is therefore very similar or even the

same. However, where there is a need to differentiate, the guidance has been tailored to the specific purposes.

## **2 Authority of the Guidelines**

7. The INTOSAI Compliance Audit Guidelines have been developed to assist SAIs in applying the INTOSAI Auditing Standards, particularly in their work on reporting on compliance. As is the case for the INTOSAI Auditing Standards, the Compliance Audit Guidelines do not have mandatory application within INTOSAI and each SAI must judge the extent to which they are compatible with the SAI's mandate.
8. The guidelines are intended to be relevant to compliance audit in SAIs representing both the Auditor General system and the Court of Account system, but do not cover particularities related to the judgement part of compliance auditing in SAIs of the court type.

## **3 Diversity in Organizing and Reporting on Compliance Audit**

9. SAIs organize compliance audit in the way that is deemed most efficient in light of the mandate and role of the SAI within the particular constitutional system. In practice, this gives rise to a great degree of international diversity in organizing and reporting on compliance audit. Compliance audit may be carried out as part of the audit of financial statements or as part of a performance audit. Compliance audit may also be carried out as a separate audit task, for example at the request of the legislature or other bodies to which the SAI reports, or at the initiative of the SAI itself.<sup>1</sup>
10. In addition, some SAIs may have special compliance audit tasks and responsibilities established by their mandate or otherwise. Such tasks may include:
  - a) The judicial function of SAIs organised as Courts of Accounts,
  - b) Activities related to suspected fraud and corruption,
  - c) Investigation of suspected illegal acts or other misconduct for the purpose of decisions on the sanctioning of individuals or reporting to law enforcement authorities,
  - d) Assessment of the truth and completeness of information submitted by ministers to a parliament.
11. Compliance audit reports may take different forms, such as:

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<sup>1</sup> Compliance audit is the typical audit in the case of the 'a priori audit' foreseen by the audit mandate of several SAIs.

- a) Separate compliance audit reports which may be either short form or long form reports depending on the needs of the users of the report
  - b) Opinions on compliance, which may be included in the auditor's report on the financial statements, or in a separate report
  - c) Opinions stating whether activities or transactions that have come to public sector auditors' attention in the course of discharging other audit responsibilities were carried out in compliance with authorities,
  - d) Reports on specific instances of non-compliance,
  - e) Reports that no instances of non-compliance have come to the auditors' attention during the course of the audit.
12. These variations are discussed in the Compliance Audit Guidelines together with examples of reports where appropriate.

#### **4 Relationship to Other Auditing Standards**

13. The Compliance Audit Guidelines build upon INTOSAI's Fundamental Auditing Principles and standards promulgated by other standard setting organisations with which INTOSAI has a cooperation agreement, such as IFAC and The Institute of Internal Auditors (IIA).
14. The International Framework for Assurance Engagements, issued by IFAC's International Auditing and Assurance Standards Board, concerns engagements in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria. Within this framework the International Standards on Auditing (ISAs) apply to engagements of assurance of financial statements (historical financial information). The International Standards on Assurance Engagements (ISAEs) apply to engagements on assurance of other subject matter information than financial statements.
15. SAIs carry out compliance audit by virtue of their mandate and role within the constitutional system. They have an important role in promoting public accountability and in contributing to improved public sector management. Although the ISAs and ISAEs are relevant for work carried out by public sector auditors, the scope of compliance audits and related reporting responsibilities are often broader than those envisaged in the ISAs and ISAEs.
16. International Standards for the Professional Practice of Internal Auditing issued by the IIA define internal auditing as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. The internal audit activity should evaluate risk exposures and the adequacy and effectiveness of controls encompassing the organization's governance, operations, and information systems

including compliance with laws, regulations, and contract terms and conditions. If the compliance audit activities of a SAI involve reliance on internal auditors, the SAI may also consider to what extent the IIA standards have been applied by internal auditors.

INTOSAI



# *Compliance Audit*

## *Guidelines –*

*For Audits Performed  
Separately from the Audit of  
Financial Statements*

INTOSAI PROFESSIONAL STANDARDS COMMITTEE

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## **Preface**

The suite of compliance audit guidelines comprises the following:

- ISSAI 4000: A general introduction to guidelines on compliance audit
- ISSAI 4100: Compliance audit guidelines for audits performed separately from the audit of financial statements. Such work may be carried out as part of a performance audit or as a separate audit type.
- ISSAI 4200: Compliance audit guidelines related to the audit of financial statements

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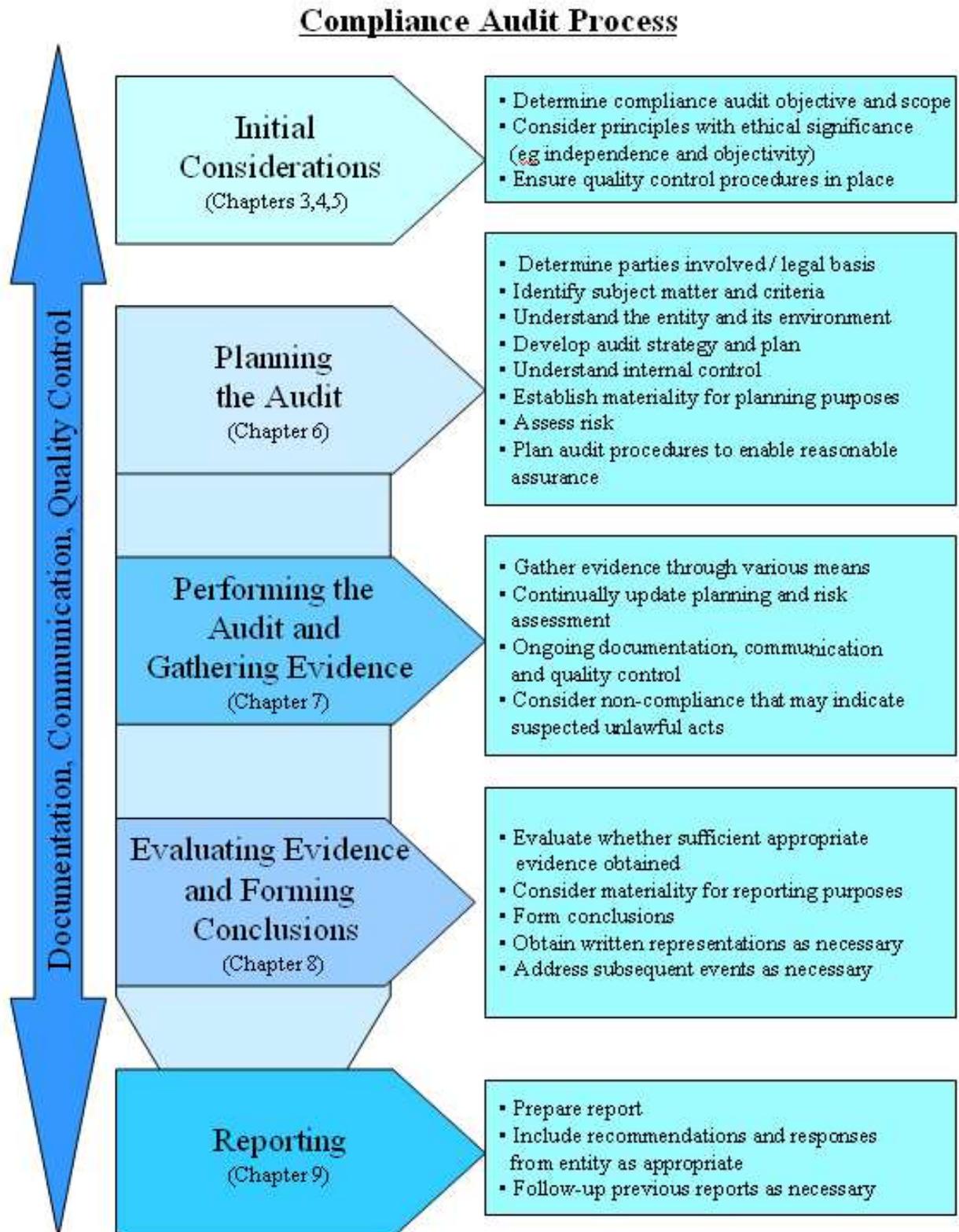
# 1 Introduction

1. The concept of compliance audit is encompassed by the description of the purpose of a public sector audit as set out in INTOSAI's Lima Declaration: '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 audit deals with the degree to which the audited entity follows rules, laws and regulation, policy, established codes, or agreed upon terms, such as the terms of a contract or the terms of a funding agreement. The concept of compliance audit is introduced in INTOSAI's Fundamental Auditing Principles (ISSAI 100.38 and 39). The concept is further described in ISSAI 4000 – Introduction to the Compliance Audit Guidelines.
3. In the public sector, the concepts of transparency, accountability, stewardship and good governance are basic and important principles. Laws and regulations may set out what activities public sector entities are charged with carrying out for the citizens, any limits or restrictions on such activities, the overall objectives to be achieved and how due process rights of individual citizens are protected. Furthermore, public funds are entrusted to public sector entities for their proper management. It is the responsibility of these public sector bodies and their appointed officials to be transparent about their actions, accountable to the citizens for the funds with which they are entrusted, and to exercise good stewardship over such funds.
4. The need to monitor that the activities of public sector entities are in accordance with the relevant authorities that govern them, and that the due process rights of citizens are protected are important public sector control functions. Through public sector auditing in general, and compliance auditing specifically, public sector auditors help to monitor that the basic principles set out above are being followed and put into operation. In the context of compliance auditing, this responsibility includes determining whether information related to a particular subject matter is in compliance, in all material respects, with relevant criteria such as relevant laws, regulations, directives, terms of contracts and agreements, etc. The result of such auditing is reported to the audited entity and the legislature. In addition, the result is normally made available to the general public. This is done to support accountability and transparency in the public sector.
5. These guidelines address aspects of compliance audit in the public sector which, in many countries, is subject to very different mandates and objectives. In a democratic

system of government, accountability to the public, and particularly to its designated representatives, is an overriding aspect of the management of a public sector entity and an essential element of good public governance. Public sector entities are usually established by legislation and their operations governed by various authorities derived from legislation. Management of public sector entities is accountable for operating in accordance with the provisions of the relevant laws, regulations and other authorities governing them. Since legislation and other authorities are the primary means by which legislators control the raising and spending of money by the public sector, auditing for compliance with relevant authorities is usually an important and integral part of the audit mandate, or terms of engagement, for most audits of public sector entities. Because of the variety of authorities, their provisions may be conflicting with one another and may be subject to differing interpretations. Also, subordinate authorities may not be consistent with the directions or limits prescribed by the enabling legislation. As a result, an assessment of compliance with authority in the public sector requires considerable professional judgment and is of particular importance.

6. These guidelines (ISSAI 4100 on Compliance Audit Performed Separately from the Audit of Financial Statements) deal with compliance audit as an audit type of its own or as a part of performance audit, and not when specifically performed together with an audit of financial statements. They build upon INTOSAI's Fundamental Auditing Principles (referenced within this document as ISSAI 100 – ISSAI 400, previously referred to as the 'INTOSAI Auditing Standards') and have been designed to assist public sector auditors and SAIs in applying these principles.

7. The process generally followed in carrying out compliance audits is shown in the figure below and is described in the subsequent sections of the guidelines.



## 2 Scope of the guidelines

### 2.1 Scope and Nature of a Compliance Audit

8. In general, the mandate of the SAI determines whether the SAI carries out compliance audit activities or not. When the SAI carries out compliance audits, it is the SAI itself that is normally responsible for determining the scope and nature of the work to be performed and the appropriate audit approach. In some cases, the legislative body, such as a parliament, may request the SAI to perform a certain type of audit. Such requests may be accepted as long as the auditor's independence is not compromised. (ISSAI 200, 2.2.16) Nonetheless, it should be up to the SAI to determine the appropriate audit approach and methodology to be employed.
9. The subject matters of compliance audits are wide ranging and may vary significantly from one audit to the next. A subject matter may be general in nature or may be very specific. More guidance on compliance audit subject matters is set out in section 6.2 below.
10. The Fundamental Auditing Principles explain that compliance audit is important because government agencies, programs and activities are often the result of particular laws and regulations. Decision makers need to know whether relevant laws and regulations are being followed, whether they have the desired results, and if not, what revisions are necessary (ISSAI 300, 3.4.2). Laws, regulations, and other compliance requirements pertaining to the audited entity may be significant to the particular audit objectives, whether it is performed as a separate audit type, or related to performance audit or to an audit of financial statements. Public sector auditors therefore plan and perform work of a scope and nature that will allow them to provide a constructive report to the appropriate parties.
11. In some cases, the audit mandate may set out the audit subject matter and scope of a particular compliance audit. In other cases, the subject matter and scope of the compliance audit may be based on the professional judgement of the public sector auditor. Factors that may influence public sector auditors' determination of the audit subject matter and scope may include:
  - a) Requirements set out in the audit mandate or relevant laws and regulations, such as an appropriations act or procurement act
  - b) Previous instances of non-compliance by the entity, for example compliance deviations identified in previous audits
  - c) Findings and recommendations in audits performed by auditors outside the SAI
  - d) Risk assessments performed in connection with financial or performance audits indicating specific areas where there is risk of non-compliance (for example across sectors such as procurement, or large sector-specific program areas such as revenue collection, defence, welfare benefits, etc)

- e) Public interest or expectations (for example suspected fraud, mismanagement or areas of non-compliance identified by the media etc)
  - f) Specific areas that are the subject of significant legislative focus (for example environmental issues and compliance with international environmental agreements)
  - g) Requests by legislative bodies, funding agencies or donor organisations (for example compliance with the terms of funding agreements)
  - h) Significant funding is received by the entity from donor organisations and the continued provision of such funding is subject to compliance with the terms of a contract or agreement
12. In situations where the scope and nature of the compliance audit do not follow directly from the audit mandate or relevant legislation, but are based on the public sector auditor's professional judgement, it may be useful to inform the audited entity of the scope and nature of the audit in writing. This may assist in clarifying the understanding of the roles and responsibilities of the various parties, including what is to be covered by the audit and any particular limitations, information to be provided, the type of report to be issued and to whom, timetables, etc.
13. References to 'compliance audit' throughout this document are understood to be in the context of work carried out by SAIs, or for which the SAI is responsible.
14. Additional guidance on informing the entity about the scope and nature of the audit may be found in:
- ISSAI 1210 and 1300
  - INTOSAI's Implementation Guidelines for Performance Auditing section 2.3 – The institutions concerned should be properly informed
  - IFAC's International Standard for Assurance Engagements (ISAE) 3000

## **2.2 Reasonable vs. Limited Assurance**

15. The Fundamental Auditing Principles related to compliance state that the audit should be designed to provide reasonable assurance of detecting errors, irregularities and illegal acts that may significantly affect the audit objectives (ISSAI 300, 3.4.1).
16. In most types of engagements there are two types of assurance levels: reasonable (positive) assurance and limited (negative) assurance. Reasonable assurance is high, but not absolute assurance. Due to the inherent limitations of an audit (see section on risk assessment below), an audit does not normally provide 100% assurance. In general, reasonable assurance audits are designed to result in a positive form of expressing a conclusion, such as 'in our opinion the subject matter is / is not in compliance, in all material respects, with the stated criteria...' Limited assurance work is not considered an audit, but rather a review-level engagement. It provides a lower level of assurance than an audit, and is designed to result in a negative form of expressing a conclusion, 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...'

17. Both reasonable assurance audits and limited assurance reviews involve understanding the subject matter and obtaining sufficient appropriate evidence to support the public sector auditor's conclusion. 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. In performing a limited assurance review, procedures are usually limited to analytical procedures and inquiries. The nature, timing and extent of procedures performed in both reasonable assurance audits and limited assurance reviews are determined by public sector auditors applying professional judgement. A limited assurance review may be appropriate for subject matters across entities, which may involve more complex issues than subject matters within a specific entity.
18. These guidelines apply to auditing tasks where the purpose is to obtain sufficient appropriate evidence to support the findings. The conclusion may be expressed in a formalized statement of assurance or in a more elaborated form.

### **2.3 Assertion Based Reporting vs. Direct Reporting**

19. In some cases, management at the audited entity may prepare a specific assertion or a statement of compliance. In other instances the assertion may be implicit.
20. For example, in compliance audits performed as a separate audit task or together with performance audits, the assertion could be a statement of compliance with laws or regulations, a statement of compliance with the terms of a contract, or a statement as to the effectiveness of a specific process or system. An example of an implicit assertion may be when key performance indicators are subject to audit and they are presented on the inherent assumption that there has been no undisclosed non-compliance in achieving the levels of performance as set out in the key performance indicators.
21. In many public sector audits, there are no specific assertions or statements of compliance that the audited entity makes available to users. Rather, the subject matter information is embedded in the auditor's report – either in the form of data/information or as an explicit statement in the form of a conclusion. These types of audits are referred to as direct reporting audits. Audit findings are reported in an appropriate manner to relevant parties such as the audited entity and the legislature. Reports are usually made available to the general public.
22. The form of reporting may vary depending on the auditor's professional judgement as to how to communicate most effectively with the intended users. Reports may be either short-form or long-form reports. More guidance on reporting is set out in the reporting section of this document.
23. These guidelines are developed based on direct reporting audits, but may be applied to assertion based reporting as appropriate.

### **3 Objectives to be Achieved**

24. The particular objectives of a compliance audit must be tailored to the circumstances, based on the subject matter and criteria involved. In general, the objectives of public sector auditors in performing compliance audits are to:
  - a) Gather sufficient appropriate audit evidence to conclude whether the information on a particular subject matter is in compliance, in all material respects, with a particular set of criteria, and
  - b) Report the findings and conclusions to the legislature and/or other bodies as appropriate
  
25. For SAIs representing the Court of Accounts system, the objective is also to communicate compliance deviations to the appropriate bodies or open the process leading to a formal judgement in aspects related to the judicial function of the courts such as identification of the responsible authority/agent and determination of any potential offence.

## 4 Definitions

26. For purposes of these guidelines the following terms have the meanings set out below:
1. **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.
  2. **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.
  3. **Compliance audit** – compliance audit 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. 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.

In performing compliance audits in the context of the INTOSAI Fundamental Auditing Principles, there are two concepts of significant relevance:

- a) **Regularity** – the concept that activities, transactions and information pertaining to an audited entity are in accordance with authorising legislation, regulations issued under governing legislation and other relevant, laws, regulations and agreements, including budgetary laws and are properly sanctioned.
- b) **Propriety** – general principles of sound public sector financial management and conduct of public sector officials.

Depending on the mandate of the SAI, a compliance audit may be an audit of regularity, or propriety, or both.

Because propriety is not readily susceptible to objective verification, it may be difficult, and in some cases impossible to audit propriety to a level of reasonable

assurance. There are often no clear and objective benchmarks against which to measure propriety – what may be acceptable in one part of the public sector may not be acceptable elsewhere.

Where SAIs have a mandate to audit propriety, criteria may not be clearly defined at the outset. The issue of suitable criteria is addressed in more detail in the following sections of this document. Where the audit mandate requires an audit of propriety, the principles outlined in these guidelines may be applied as appropriate in the circumstances. The form and content of reports on propriety may vary depending on the mandate of the SAI and the particular circumstances.

4. **Compliance deviation** – the audited entity's failure to comply with:
  - a) Authorities – for compliance audits of regularity; or
  - b) General principles for sound public sector financial management and conduct of public sector officials – for compliance audits of propriety.
  
5. **Conclusion** – The auditor's report on compliance subject matters normally contains a conclusion based on the audit work performed. When compliance audit is performed together with the audit of financial statements, the conclusion may take the form of an opinion (see Opinion). The conclusion may also be expressed as a more elaborated answer to specific audit questions.
  
6. **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.
  
7. **Opinion** – The auditor's report on the financial statements may contain a clear written expression of opinion on compliance in addition to the opinion on the financial statements. An unqualified opinion may be expressed when the auditor concludes that, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.
  
8. **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

## **5 Initial Considerations**

### **5.1 Ethical Considerations**

27. The Fundamental Auditing Principles set out principles with ethical significance that are taken into consideration prior to commencing the audit (ISSAI 200, 2.2.1). These principles relate to:
  - a) The independence of the SAI and the auditor, including political neutrality
  - b) Avoidance of conflict of interest between the auditor and the audited entity
  - c) The need for the auditor and the SAI to possess the necessary competence
  - d) Exercise of due care and concern by the SAI and the auditor in complying with the Fundamental Auditing Principles
28. If for some reason, the SAI or the auditor is not in a position to comply with the Fundamental Auditing Principles that have ethical significance, appropriate actions are taken to ensure that the threats to non-compliance are eliminated before commencing the audit. This may, for example, involve re-allocating staff assigned to the audit, additional training or involvement of experts.
29. Additional guidance may also be found in:
  - INTOSAI's Code of Ethics
  - INTOSAI's Implementation Guidelines for Performance Auditing Section 2.2 and 2.3
  - IFAC's ISAE 3000

### **5.2 Quality Control**

30. As with other types of auditing, it is important in performing compliance audits that the SAI have processes and procedures in place to ensure that the work carried out is of sufficient quality, that the public sector auditors performing such audits collectively have the necessary competence and skills, and that the work of the team is appropriately directed, supervised and reviewed. INTOSAI's Fundamental Auditing Principles establish benchmarks and provide guidance for ensuring the quality of work (ISSAI 200, 2.1.26 and 2.2.36).
31. Further guidance on quality control may be found in:
  - INTOSAI's [proposed] Code of Quality and ISSAI 1220
  - INTOSAI's Implementation Guidelines for Performance Auditing Appendix 4
  - IFAC's International Standard on Quality Control (ISQC)1
  - IFAC's ISAE 3000

## **6 Planning and Designing a Compliance Audit**

32. The Fundamental Auditing Principles state that the auditor should plan the audit in a manner which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner (ISSAI 300 3.1.1). Furthermore, those planning the audit need to be knowledgeable of the compliance requirements that apply to the entity being audited (ISSAI 300, 3.4.3).
33. Public sector auditors plan and perform audits while maintaining an attitude of professional skepticism.

### **6.1 Identification of the Parties Involved / Legal Basis**

34. Public sector auditors ensure that the necessary preconditions exist in order to effectively perform the audit. In planning compliance audits, this may involve identifying at the outset the relevant parties involved. This is important in order to establish the legal basis for performing the audit, such as the mandate of the SAI, including the responsibilities of public sector auditors, and the constitutional status and responsibilities of the audited entity.
35. In addition, it is important to identify the users of the audit report. The form and content of the report are influenced by the auditor's professional judgement as to how to communicate most effectively with the intended users. The needs of users may vary depending upon whether the users are the legislature, a funding agency, a donor organisation, the citizens or other relevant stakeholders.

### **6.2 Subject Matter and Subject Matter Information**

36. 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.
37. 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 behaviour). 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 sufficient evidence about the subject matter information to support a conclusion.
38. 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.

39. When compliance audit encompasses budgetary laws, or other relevant budgetary resolutions, the entity's revenue and financing are included, as well as its expenditure.
40. 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.
41. Some examples of subject matters and subject matter information in relation to compliance auditing are set out in Appendix 1.

### 6.3 Criteria

42. The criteria, or the benchmarks against which the subject matter will be compared, must also be identified. In performing compliance audits, the identification of the criteria is an essential step in the audit planning process. Some examples of criteria in relation to compliance auditing are set out in Appendix 1.
43. 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 behaviour, 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.
44. The criteria should be suitable. This means that the criteria should have the following characteristics:
  - a) **Relevant** – relevant criteria provide meaningful contributions to the information and decision making needs of the intended users of the audit report
  - b) **Reliable** – reliable criteria result in reasonably consistent conclusions when used by another auditor in the same circumstances
  - c) **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.
  - d) **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.

- e) **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.
  - f) **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
45. 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 objectives 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.
46. 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. Some examples of such sources are set out in Appendix 2.
47. 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.
48. 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.
49. However, when propriety is the subject matter of 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 behaviour 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 behaviour by public officials, if circumstances so warrant.

50. 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).
51. 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.
52. 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.
53. 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.
54. 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
55. The audit approach may also be broken down into parts, or the scope narrowed, such that clearly identifiable criteria may be applied.
56. 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.

57. 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.

## **6.4 Understanding the Audited Entity and its Environment**

58. 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 auditing 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. Some examples of sources that may be used in gaining this understanding are set out in Appendix 2.
59. According to ISSAI 4000, paragraph 5, the Compliance Audit Guidelines cover compliance audit at all levels of government. As a consequence, the guidelines 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.

## **6.5 Audit Strategy and Plan**

60. Planning the audit so that it will be performed effectively involves discussions with relevant members of the audit team, and developing an overall audit strategy and an audit plan. Both the audit strategy and the audit plan should be documented in writing. Planning is not a distinct phase of the audit, but is a continual 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 engagement team.
61. In establishing the overall audit strategy for the compliance audit, public sector auditors consider:
  - a) The objectives, 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 objectives, 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 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
62. 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.
63. 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) For audits of propriety – obtaining an understanding of relevant principles of sound public sector financial management and expectations regarding the conduct of public sector officials
64. Further guidance on audit planning and on audit criteria may be found in:
- ISSAIs 1210 and 1300
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 3 and Appendix 2
  - IFAC's Assurance Framework and ISAE 3000

## **6.6 Understanding Internal Control at the Audited Entity**

65. Understanding internal control is normally an integral part of understanding the entity and the relevant subject matter. The Fundamental Auditing Principles explain that in performing an audit, public sector auditors understand and evaluate the reliability of internal control (ISSAI 300, 3.3.1). In compliance audit, this includes understanding and evaluating controls that assist management in complying with laws and regulations (ISSAI 300, 3.3.2).
66. The particular type of controls evaluated depends on the subject matter, and the nature and scope of the particular compliance audit. In evaluating internal control, public sector auditors assess the risk that the control structure may not prevent or detect material non-compliance (ISSAI 300, 3.4.6). 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.
67. Further guidance on understanding the audited entity may be found in:
  - ISSAI 1315
  - INTOSAI's Implementation Guidelines for Performance Auditing Section 3.3, Subsection - Understanding the program and Appendix 1, Subsection 2- Formulating the audit question or defining the audit problem
  - INTOSAI Guidelines for Internal Control Standards for the Public Sector
  - IFAC's ISAE 3000

## **6.7 Materiality**

68. Materiality consists of both quantitative and qualitative factors. In performing compliance audits, materiality is determined for:
  - a) Planning purposes
  - b) Purposes of evaluating the evidence obtained and the effects of identified instances of non-compliance, and
  - c) Purposes of reporting the results of the audit work.
69. Public sector auditors plan and perform the audit to determine whether the subject matter information, in all material respects, is in compliance with the stated criteria.
70. As stated in the Fundamental Auditing Principles, 'Materiality is often considered in terms of value but the inherent nature or characteristics of an item or group of items may also render a matter material--for example, where the law or regulation requires it to be disclosed separately regardless of the amount involved.' (ISSAI 100, 1.0.10) Furthermore, the principles explain that in cases where compliance audit is carried

out in relation to performance auditing, materiality by nature or by context is a more important consideration than materiality by amount. (ISSAI 400, 4.0.29).

71. 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.
72. The determination of materiality for planning purposes may be straight forward. This might be the case in situations where a law or regulation, or agreed-upon terms establish an unconditional requirement for compliance, for example if the constitution prohibits overspending in relation to the approved budget.
73. 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
74. In other cases the determination of materiality is normally a matter for professional judgement.
75. 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.
76. 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.

77. Further guidance on materiality in relation to identified non-compliance is discussed in the section on Evaluating Evidence and Forming Conclusions below.
78. Further guidance on materiality may be found in:
- ISSAIs 1320 and 1450
  - INTOSAI's Implementation Guidelines for Performance Auditing Section 5.3, Subsection – Materiality, relevance and objectivity, and Appendix 3 part 1.2, Subsection - Sufficiency of evidence
  - IFAC's ISAE 3000

## **6.8 Risk Assessment**

79. Risk assessment is an essential part of performing a reasonable assurance audit. 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:
- a) Judgement may be applied by management in interpreting laws and regulations
  - b) Human errors occur
  - c) Systems may be improperly designed or function ineffectively
  - d) Controls may be circumvented
  - e) Evidence may be concealed or withheld
80. In performing compliance audits, public sector auditors assess 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 assurance as the basis for the auditor's conclusion.
81. The risks and the factors that may give rise to such risks will vary depending on the particular subject matter and circumstances of the audit. In general, public sector auditors consider the three elements of audit risk - inherent risk, control risk and detection 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.

### **6.8.1 Risk Assessment Considerations in regard to Fraud**

82. 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.

83. Fraud risks and assessments of materiality in relation to fraud are considered in the context of the broader scope of public sector 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.

#### **6.8.2 Risk Assessment Considerations in regard to Relationships between Public Sector Entities**

84. Relationships between various public sector entities are considered when assessing audit risk, 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 conclusion or the auditor's report.
85. Examples of factors related to assessing risk in compliance audits are set out in Appendix 3. In addition, an illustrative example of risk factors related to a compliance audit of procurement is set out in Appendix 4.
86. Further guidance on risk assessment, and fraud risk may be found in:
- ISSAIs 1240, 1315 and 1550
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 3.2, Subsection - Risks or uncertainties
  - IFAC's Assurance Framework and ISAE 3000

#### **6.9 Planning Audit Procedures**

87. Planning audit procedures involves designing procedures to respond to the identified risks of non-compliance. The exact nature, timing and extent of the audit procedures to be performed may vary widely from one audit to the next. Nonetheless, compliance audit procedures in general involve establishing the relevant criteria, ie the authorities which govern the entity, and then measuring the relevant subject matter information against such authorities. More information on audit procedures is

provided in the section on performing compliance audits and gathering evidence below.

## **7 Performing Compliance Audits and Gathering Evidence**

88. The Fundamental Auditing Principles state that public sector auditors choose and perform audit steps and procedures that, in their professional judgement, are appropriate in the circumstances. (ISSAI 300, 3.4.5). The Fundamental Auditing Principles also state that the steps and procedures are designed to obtain sufficient, competent, and relevant evidence that will provide a reasonable basis for the auditor's judgements and conclusions (ISSAI 300, 3.5.1). Evaluating the entity's internal control systems and assessing the risks that the control systems may not prevent or detect instances of non-compliance are a normal part of performing compliance audits (ISSAI 300 3.4.6).
89. The audit procedures to be performed will depend on the particular subject matter and criteria identified, as well as the auditor's professional judgement. The procedures should be clearly linked to the identified risks. When the risks of non-compliance are significant and public sector auditors plan to rely on the controls in place, such controls must be tested. When controls are not considered reliable, public sector auditors plan and perform substantive procedures to respond to the identified risks. Furthermore, additional substantive procedures are performed when there are significant risks of non-compliance. If the audit approach consists only of substantive procedures, tests of details (not only analytical tests) are performed.
90. 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 objectives 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.
91. Some examples of compliance audit procedures for selected subject matters are set out in Appendix 5.

### **7.1 Gathering and Evaluating Evidence**

92. In performing a reasonable assurance audit, public sector auditors gather sufficient appropriate audit evidence to provide a basis for the auditors' conclusions. The Fundamental Auditing Principles state that 'competent, relevant and reasonable evidence should be obtained to support the auditor's judgement and conclusions regarding the organisation, program, activity or function under audit' (ISSAI 300, 3.5.1)

93. The sufficiency of evidence relates to the quantity of the evidence. The competence, relevance, reliability and appropriateness of evidence relates to the quality of the evidence. Public sector auditors exercise professional judgement in making the determination of sufficiency and appropriateness throughout the evidence gathering process.
94. 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
95. The evidence gathering process continues until the public sector auditor is satisfied that sufficient, appropriate evidence exists to provide a basis for the auditor's conclusion.
96. In many cases, audit sampling may be used as a means of testing to detect instances of non-compliance with authorities. The use of IT audit techniques is often helpful and in many cases is an integrated part of a compliance audit.
97. 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
98. 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

### **7.1.1 Observation**

99. 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.

### **7.1.2 Inspection**

100. 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.
101. 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.

### **7.1.3 Inquiry**

102. 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.
103. 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.
104. 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.
105. 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 authorised to speak or give opinions on behalf of the entity.

#### **7.1.4 Confirmation**

106. 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.
107. 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.

#### **7.1.5 Re-performance**

108. 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.

#### **7.1.6 Analytical Procedures**

109. 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.

110. Regression analysis techniques or other mathematical methods may assist public sector auditors in comparing actual to expected results.
111. Further guidance related to evidence and evidence gathering procedures may be found in:
- ISSAIs 1330, 1450, 1500, 1505, 1520, 1530, 1610 and 1620
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 4 and Appendix 3
  - IFAC's Assurance Framework and ISAE 3000

## **7.2 Documentation**

112. The Fundamental Auditing Principles state that audit evidence gathered must be adequately documented (ISSAI 300, 3.5.5 and 3.5.6). Documentation in regard to compliance audits includes documenting sufficiently matters that are significant in providing evidence to support the conclusions drawn and the report issued. The audit documentation should be sufficiently complete and detailed to enable an experienced auditor, having no previous connection with the audit, to understand what work was performed in support of the conclusions (ISSAI 300, 3.5.7).
113. Documentation takes place throughout the entire audit process. Public sector auditors prepare compliance audit documentation on a timely basis, and maintain such documentation which records the criteria used, the work done, evidence obtained, judgements made and review performed. Public sector auditors prepare relevant audit documentation before the auditor's report is issued. Audit documentation is retained for an appropriate period of time.
114. Further relevant guidance for documenting compliance audits may be found in:
- ISSAI 1230
  - INTOSAI's Implementation Guidelines for Performance Auditing Appendix 3
  - IFAC's ISAE 3000

## **7.3 Communications**

115. Good communication with the audited entity throughout the audit process may help make the process more effective and constructive. Communication takes place at various phases and at various levels, for example:
- a) During the initial planning phase, including 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

- b) During the performance phase and throughout the audit, including gathering evidence and making inquiries of relevant persons as appropriate. Any significant difficulties encountered during the audit, as well as instances of material non-compliance are promptly communicated to the appropriate level of management, or to those charged with governance. 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. For this reason, many public sector auditors communicate all identified instances of non-compliance to management.
- c) During the reporting phase, including issuing written reports on a timely basis to the intended users, the audited entity and others as appropriate

116. Some SAIs can, according to their audit mandate, order the audited entity to correct identified instances of non-compliance. In doing so, public sector auditors determine whether their independence and objectivity will be impaired, and take appropriate action to avoid such impairment.

117. Further relevant guidance on communication may be found in:

- ISSAI 1260
- INTOSAI's Implementation Guidelines for Performance Auditing Appendix 4
- IFAC's ISAE 3000

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

118. While detecting potential unlawful acts, including fraud, is normally not the main objective of performing a compliance audit, public sector 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.

119. In performing compliance audits, if public sector 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. Public sector auditors may consider consulting with legal counsel or appropriate regulatory authorities (ISSAI 300, 3.4.7). 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 organisational structures that exist internationally, it is up to the SAI to determine the appropriate action to be taken (ISSAI 400, 4.0.7b).

120. 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 public

sector 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 organisations making such claims.

121. 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.
122. 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 conclusion.
123. If suspicion of unlawful acts arises during the audit, public sector 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. Public sector 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. Public sector auditors may also report such incidents directly to the relevant law enforcement authorities.
124. Further guidance on considerations when dealing with suspected fraud may be found in:
  - ISSAI 1240
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 3, Subsection – Compliance with laws and regulations

## **8 Evaluating Evidence and Forming Conclusions**

### **8.1 General Considerations on Evaluating Evidence and Forming Conclusions**

125. Public sector auditors evaluate whether the evidence obtained is sufficient and appropriate so as to reduce audit risk to an acceptably low level. This evaluation includes exercising professional judgement and professional skepticism, and consideration of evidence that both supports, and seems to contradict, the subject matter information.
126. Evidence obtained is evaluated in relation to identified materiality levels 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 (ISSAI 400, 4.0.19). SAIs 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.
127. Public sector auditors evaluate whether, based on the evidence obtained, there is reasonable assurance that the subject matter information is in compliance, in all material respects, with the identified criteria. Due to the inherent limitations of an audit, public sector auditors cannot be expected to detect all occurrences of non-compliance.
128. Public sector auditors' assessment of what represents a material compliance deviation is a matter of professional judgement and includes considerations of context as well as quantitative and qualitative aspects of the transactions or issues concerned.
129. 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

130. Some examples of compliance deviations and considerations related to materiality and forming conclusions are set out in Appendix 6.

131. Further guidance on forming conclusions may be found in:

- ISSAI 1700
- INTOSAI's Implementation Guidelines for Performance Auditing Section 4.5
- IFAC's ISAE 3000

## **8.2 Written Representations from Responsible Officials**

132. 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 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.

133. Further guidance on written representations may be found in ISSAI 1580.

## **8.3 Subsequent Events**

134. 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.

135. Further guidance on subsequent events may be found in:

- ISSAI 1560
- IFAC's ISAE 3000

## 9 Reporting

136. Reporting is an essential part of a public sector 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. To this end, the Fundamental Auditing Principles state that a written report, setting out findings in an appropriate form, should be prepared at the end of each audit (ISSAI 400, 4.0.7a).
137. The principles of completeness, objectivity and timeliness are important in reporting on compliance audits. Public sector 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. This involves applying the principle of contradiction which involves checking facts with the audited entity and incorporating responses from responsible officials as appropriate.

### 9.1 Form and Content of Compliance Audit Reports

138. The form of the written report may vary depending on the circumstances. However, some consistency in the auditor's report may help users of the report to understand the audit work done and conclusions reached, and to identify unusual circumstances when they arise.
139. 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.
140. 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.
141. Guidance is given below on the form and content of reports. For the practical purposes of these guidelines, the illustrative examples provided in Appendices 7-12 are short form reports. Due to the lengthy nature of long form reports, specific examples have not been included in the guidelines. Public sector auditors are however encouraged to browse websites of SAIs for suitable examples of compliance audit special reports.
142. In cases where the mandate of the SAI establishes a form of reporting that differs from that envisioned in these guidelines, the guidelines may, nonetheless, be useful

to public sector auditors and may be applied, adapted as appropriate in the particular circumstances.

### **9.1.1 Compliance Audit Reports**

143. In general, the compliance audit report itself includes the following elements (although not necessarily in the following order):

1. Title
2. Addressee
3. Objectives and scope of the audit, including the time period covered
4. Identification or description of the subject matter information (and where appropriate, the subject matter)
5. Identified criteria
6. Responsibilities of the various parties (legal basis)
7. Identification of the auditing standards applied in performing the work
8. A summary of the work performed
9. A conclusion
10. Responses from the audited entity (as appropriate)
11. Recommendations (as appropriate)
12. Report date
13. Signature

144. Guidance on elements of a compliance audit report that warrant significant consideration by public sector auditors are set out below.

#### **9.1.1.1 Identified Criteria**

145. 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 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.

146. 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.

#### 9.1.1.2 Conclusions

147. Depending on the scope and mandate of the audit, the conclusion may be expressed as a statement of assurance or as a more elaborated answer to specific audit questions. The nature of the wording may be influenced by the mandate of the SAI and the legal framework under which the audit is conducted.

148. Where no material instances of non-compliance have been identified, the conclusion is unqualified. An example of the form for an unqualified conclusion (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 information] is in compliance, in all material respects, with [the applied criteria].'*

149. Public sector auditors modify their conclusions 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 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. An adverse conclusion (*'Based on the audit work performed, we found that the subject matter information is not in compliance...'*); or

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

- i. A qualified 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...'*)

150. Public sector auditors provide information as to the reasons for the modified conclusions. 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 conclusion and that describes the basis for that conclusion.

151. Public sector auditors may conclude that there is a need to elaborate on particular matters which do not affect the compliance 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 management assertions 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 management assertions, and not affecting the conclusion on compliance, for example the need for the legislature to take action when a conflict between different sources of law has been identified).

Examples are set out in Appendix 11.

#### **9.1.1.3 Responses from the Audited Entity**

152. 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 public sector auditing. It relates to the presentation of weaknesses or critical findings in such a way as to encourage correction (ISSAI 400, 4.0.20 and 4.0.24). 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.

#### **9.1.1.4 Providing Constructive Recommendations**

153. The Fundamental Auditing Principles also emphasize the need for reports to be constructive. This means that the auditor's 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 public sector auditor's objectivity may be impaired in future audits. (ISSAI 400, 4.0.4, 4.0.20 and 4.0.25)

#### **9.1.1.5 Report Date**

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

#### **9.1.1.6 Signature**

155. 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.

#### **9.1.1.7 Limited Assurance Reports**

156. On an exceptional basis, these guidelines may be applied, adapted as appropriately, to limited assurance reviews. As explained in the scope section of these guidelines, in a limited assurance review, 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].'*
157. Limited assurance reviews require a sufficient amount of work to be done in order to express a conclusion, albeit less work than that necessary to express a conclusion with reasonable assurance. Nonetheless, public sector auditors evaluate whether sufficient, appropriate audit evidence has been obtained in order to express a limited assurance conclusion.

#### **9.1.1.8 Incidental Findings**

158. Public sector 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 public sector 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 reasonable 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.

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

159. 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 envisaged in the preceding section. In some cases, this type of report may be in addition to a compliance audit short form report.
160. 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.

161. In general, compliance audit special reports include all of the elements set out in the guidance on compliance audit reports, but are normally structured into 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, objectives and scope
- f) Observations and findings
- g) Conclusions and recommendations
- h) Responses from the audited entity
- i) Appendices (if necessary)

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

162. 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.
163. 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.
164. 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.

#### **9.1.2.2 Executive Summary**

165. 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.
166. 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).
167. 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.

### **9.1.2.3 Introduction, objectives and scope**

168. The introduction sets out the context of the audit including the objectives and scope of the audit, identification or description of the subject matter or subject matter information, the identified criteria, the responsibilities of the various parties involved and the auditing standards applied in performing the work.
169. The introduction is generally short without a lot of detail. If necessary, relevant detailed information may be included in appendices.

### **9.1.2.4 Observations and findings**

170. The observations and findings section comprises the main body of the compliance audit special report. This section describes the audit work performed and related findings. 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.
171. 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).
172. When significant amounts of data are included to support audit findings, such data may be more appropriately included in appendices.

### **9.1.2.5 Conclusions and recommendations**

173. 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.

174. 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.
175. 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.
176. 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.

#### **9.1.2.6 Responses from the audited entity**

177. As set out in the guidance above on compliance audit reports, the principle of contradiction – agreeing facts and incorporating responses - 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.
178. 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.
179. Incorporating the views of responsible officials assists in ensuring the practicality of the recommendations and in making the responsible officials accountable for their actions.

#### **9.1.2.7 Appendices**

180. 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.

181. Further guidance on reporting may be found in:

- ISSAI 1700, 1705 and 1706
- INTOSAI's Implementation Guidelines for Performance Auditing Part 5
- IFAC's ISAE 3000 and International Standard on Review Engagements 2400

## **9.2 Follow-up Processes**

182. The Fundamental Auditing Principles place emphasis on the reporting of constructive recommendations and additional follow-up as necessary in regard to correction of identified weaknesses (ISSAI 400, 4.0.26). 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.

183. Further guidance on follow-up processes may be found in:

- INTOSAI's Implementation Guidelines for Performance Auditing Part 5.5

## **10 Additional Guidance for Public Sector Auditors Operating in a Court of Accounts Environment**

184. Because of the jurisdictional status conferred on SAIs that operate in a Court of Accounts environment, such SAIs have the power to exercise judgements and decisions over the accounts and over responsible persons, including accountants and administrators (ISSAI 100, 1.0.21).

### **10.1 Performing Audits in a Court of Accounts**

185. When performing compliance audits of individual public accounts or of the general state budget, public sector auditors in a Court of Accounts environment also:

- a) Obtain reasonable assurance about whether the information presented in the individual public accounts and the underlying transactions are in compliance, in all material respects, with the authorities that govern them
- b) Determine whether the execution of the state budget has been carried out in compliance, in all material respects, with the authorities governing it and with individual public accounts, and
- c) Report the findings to the appropriate parties

186. The unique jurisdictional status described above may also give rise to the need for additional considerations by public sector auditors operating in a Court of Accounts environment when planning and performing compliance audits. Such matters may include:

- a) Identifying the person(s) who may be held responsible for acts of non-compliance due to the potential legal implications the SAI's judgement may have on such persons. Public officials may be held personally liable for the loss or waste of public funds, requiring them to repay the full amount of any such losses.
- b) Taking into consideration the applicable prescriptive period, the actions interrupting prescription of personal liability and the exact time period for which public officials may be held liable.
- c) Distinguishing personal liability for acts of non-compliance from the liability for unlawful acts (suspected fraud). For unlawful acts there may be a need to perform additional audit procedures.
- d) Liaising with prosecutors and police as appropriate in understanding the audited entity and its environment, assessing risks of non-compliance, dealing with instances of non-compliance that may indicate fraud, and reporting on such matters

- e) Considering the need for additional levels of, or more formalised procedures for quality control
- f) Performing inquiry in written form (as opposed to orally)
- g) Ensuring that audit documentation complies with relevant rules of evidence
- h) Communicating in a highly formalised manner
- i) Including in the report the explicit criteria against which public officials may be held liable, including any amounts likely to be involved
- j) Considering the most appropriate form of conclusions, including recommendations, identification of damages, or court orders that may lead to a formal discharge of responsibility or to a formal determination of liability

## **10.2 Communicating and Enforcing the Law**

187. Public sector auditors in Court SAIs also communicate compliance issues that may result in legal action, damages or prosecution for a criminal offence to the judge, attorney or section responsible for dealing with judgement issues within the Court, or to other bodies as appropriate. In addition, Court SAIs may also communicate remarks of a more general, or informative nature resulting from the audit work to appropriate officials of the audited entity.

188. When enforcing the law regarding public officials, decisions taken by Court SAIs are subject to:

- a) Due process of law and public hearing
- b) Public disclosure
- c) Communication to appropriate law enforcement authorities when there is evidence of a criminal offence

## **10.3 Processes in Various Models of Courts of Accounts**

189. For SAIs operating in a Court of Accounts environment, the work performed may involve various phases including audit, instruction and formal judgement.

190. Some SAIs operating in a Court of Accounts environment follow the audit process as it is described in these guidelines. However, following the planning, performance and evidence gathering phases, there may then be additional and specific issues that may lead to opening the process of instruction and to a final formal judgement.

191. In the event a judge or attorney decides on instructing a case, the objective of instruction is to gather enough evidence on the guilt or innocence of the public official who allegedly caused a damage, so as to allow a judgement to be made.
192. In some SAIs operating in a Court of Accounts environment, the auditors may also act in the role of judges and may be empowered to both audit and give formal judgements. In these cases, the instruction phase is an integral part of the audit planning, performance and evidence gathering phases, such that the audit is planned with a view to covering all these phases.

## Appendix 1 - Examples of Subject Matters, Subject Matter Information and Criteria in Compliance Auditing

The follow table is intended to give examples of subject matters, subject matter information and relevant criteria. The list is not intended to be an exhaustive overview. The particular subject matter, subject matter information and criteria will vary depending on a variety of matters such as the mandate of the SAI and the objective of the particular audit.

	Subject matter	Subject matter information	Criteria
1	<p>Financial performance and use of appropriated funds</p> <p>This may involve budget execution, including testing that funds have been used in accordance with the purposes and intentions as decided by the legislature. In many SAIs this type of compliance audit may be related to regularity audit, including the audit of financial statements.</p> <p>More specific guidance on this particular topic is included in ISSAI 4200 -Appendix 1-A.</p>	Financial information such as financial statements	<p>Relevant budget legislation such as an appropriations act</p> <p>Approved budget</p>
2	<p>Financial performance, for example revenues in the form of:</p> <ul style="list-style-type: none"> <li>• project funds from donor agencies</li> <li>• funds from federal governments</li> <li>• other similar types of funds</li> </ul> <p>and how they have been used</p>	Project financial information / project accounts	<p>Relevant legislation relating to use of federal government funds (eg a 'single audit act')</p> <p>The mandated activities of the audited entity</p> <p>The terms of the funding agreement</p>

	<b>Subject matter</b>	<b>Subject matter information</b>	<b>Criteria</b>
3	Financial performance, for example revenues in the form of grants, and how the revenues have been used	Financial information related to the use of the grant	The mandated activities of the audited entity  The terms of the grant agreement
4	Financial performance, for example revenues or expenditures in accordance with a contract or loan agreement, and how they have been used	Financial information related to the contract or loan agreement	The terms of the contract or loan agreement
5	Procurement	Financial information	Relevant procurement legislation and regulations (national and international)  The terms of a contract with a supplier
6	Expenditures	Financial information  Statement of compliance	Relevant budget legislation such as an appropriations act  Other relevant legislation  Relevant ministerial directives, government policy requirements and resolutions of the legislature  The terms of a contract
7	Program activities	Activity indicators or reports	Relevant agreed levels of performance such as those set out in laws and regulations, ministerial directives, goals agreed by the legislature or the entity, international treaties, protocols, conventions or agreements, a service level agreement, the terms of a contract, generally established industry standards, or reasonable public expectations.

	Subject matter	Subject matter information	Criteria
			<p>For example:</p> <ul style="list-style-type: none"> <li>• number of kindergarten places related to number of eligible children</li> <li>• number of qualified nurses and doctors per number of citizens</li> <li>• number of miles of road paved</li> <li>• number of months required to process benefit payments or building permits</li> <li>• frequency and quality of accounting information to be provided by a service organisation</li> <li>• number of building inspections to be performed within a particular time period</li> <li>• measures of results related to water quality, etc.</li> </ul>
8	Service delivery	<p>A statement of service delivery</p> <p>Publicly reported information</p>	Relevant legislation or directives
9	Probity of a public administrative decision	<p>Citizen complaints register</p> <p>Publicly reported information</p>	Relevant legislation or directives
10	Corporate Social Responsibility (CSR), for example the audit of publicly funded projects in developing countries	A statement of compliance with CSR (or lack thereof)	Relevant legislation or directives in areas such as human and civil rights, gender equality, workplace, environment, etc.
11	Behaviour / Propriety	A statement of compliance, for example a statement of independence (legal competence).	<p>Relevant legislation or directives covering behaviour of public sector officials</p> <p>A code of ethics or internally</p>

	Subject matter	Subject matter information	Criteria
		In the public sector this 'statement' may sometimes be implicit and related to the concepts of probity and propriety. (see section on criteria above).	<p>developed code of conduct.</p> <p>Stated values or leadership principles</p> <p>Internal policies, manuals and guidelines</p> <p>The terms of reference of the organisation, the bylaws or similar</p> <p>The terms of a contract (eg agreed confidentiality or quarantine arrangements subsequent to certain employment situations)</p>
12	Membership obligations	A statement of compliance	Agreed terms of membership
13	Processes related to health and safety	A statement of compliance  Financial transactions	<p>Relevant occupational health and safety legislation, for example, related to handicap access</p> <p>Policies, processes, manuals, guidelines etc</p>
14	Processes related to environmental protection	A statement of compliance  Financial transactions	<p>Relevant environmental legislation, for example, related to water quality, waste disposal or carbon emissions levels</p> <p>The terms of international environmental treaties, protocols, conventions or agreements</p> <p>Policies, processes, manuals, guidelines etc</p>
15	Internal control processes	A statement of compliance	An internal control framework, for example COSO, CoCo <sup>1</sup> or

<sup>1</sup> COSO – Committee of Sponsoring Organizations of the Treadway Commission. CoCo = Criteria of Control Board, The Canadian Institute of Chartered Accountants.

	<b>Subject matter</b>	<b>Subject matter information</b>	<b>Criteria</b>
		Financial transactions	similar, or internal control requirements set out in relevant legislation or generally accepted within a jurisdiction  Policies, processes, manuals, guidelines etc
16	Processes particular to the entity's activities and operations, such as payment of pensions or social benefits, processing passport or citizenship applications, assessing fines or other forms of penal sentences	A statement of compliance  Financial transactions	Relevant legislation or directives  Policies, processes, manuals, guidelines etc
17	Physical characteristics	A specifications document or the physical object itself	A building code (size, height, purpose, density measures for a particular zoned area, etc)  The terms of a construction contract, or other type of contract
18	Tax revenues, taxpayer obligations or other obligations involving reporting to regulatory authorities	Individual or corporate tax returns  Other tax forms submitted to regulatory authorities (such as VAT forms, reporting forms for agencies operating within regulated industries such as banking and finance, pharmaceuticals, etc)	Relevant legislation or industry specific codes  A tax code, revenue code or similar

## **Appendix 2 – Examples of Sources to be used in Gaining an Understanding of the Audited Entity and Identifying Suitable Criteria**

The following is an illustrative, but not exhaustive list of sources that public sector auditors may use in identifying suitable audit criteria:

- a) Laws and regulations, including the documented intentions and premises for establishing such legislation
- b) Budgetary legislation / approved budget or appropriations
- c) Documents of the legislature related to budgetary laws or resolutions, and to the premises or particular provisions for use of approved appropriations, or for financial transactions, funds and balances
- d) Legislative or ministerial directives
- e) Information from regulatory authorities
- f) Official records of meetings of the legislature, public accounts committee or similar committee of the legislature, or other public bodies
- g) Principles of law
- h) Legal precedent
- i) Codes of practice or codes of conduct
- j) Internal descriptions of policies, strategic and operational plans and procedures
- k) Manuals or written guidelines
- l) Formal agreements, such as contracts
- m) Loan or grant agreements
- n) Industry standards
- o) Well established theory (for example theory for which there is general consensus. Such theory may be obtained, for example, from published information such as technical literature and methods, professional journals, etc, or through inquiry with knowledgeable sources such as experts in a particular field)
- p) Generally accepted standards for a particular area (such standards are normally clearly identifiable standards that have their source in some form of legislation)

and that are a result of established practice and legal precedent, for example 'generally accepted accounting principles' in a particular country)

- q) For audits of propriety: Principles for sound public sector financial management and conduct of public sector officials. Principles of conduct may arise from the legislature's or public expectations regarding the behaviour of public sector officials. In some cases, these principles may be documented in only fragmentary ways. They may, in some cases, only be defined as a result of their breach.

Additional sources which public sector auditors may use to obtain an understanding about the audited entity, its environment and relevant program areas may include:

- a) The entity's annual report
- b) Legislative propositions and speeches
- c) Websites
- d) Published reports, articles in newspapers or journals, other media sources, etc
- e) Knowledge obtained from previous audits
- f) Information gathered through meetings and other communication
- g) Minutes of Board or other management meetings
- h) Internal audit reports
- i) Official statistics

## **Appendix 3 – Examples of Factors Related to Assessing Risk in Compliance Auditing**

The following are examples of factors that may be considered in assessing risk in a compliance audit. The list is not intended to be exhaustive, and the factors will depend on the particular audit circumstances.

### **The Audited Entity's Objective and Mandate**

1. Are the audited entity's objective, mandate and legal capacity clearly stated and readily available?
2. Have there been recent changes in mandate, objectives or program areas?
3. Are program areas or relevant subject matters clearly identifiable?
4. Do program areas overlap considerably with other entities such that there is a risk of duplication or of fragmentation?

### **Organisational Structure**

1. What is the legal basis of the entity (ministry, directorate, agency etc) and from where does it derive its authority?
2. Does the audited entity have clearly defined roles and responsibilities, and related authority attaching to these?
3. Are these roles, responsibilities and authorities clearly communicated and understood throughout the entity?
4. If the entity is part of a hierarchic structure, and another entity is responsible for supervision of the audited entity, how does such supervision take place?
5. Does the organisation focus on risk assessment and risk management, including risks of non-compliance, in its operations?
6. Have there been recent organisational changes?
7. Are any activities outsourced to other entities?
8. If activities are outsourced, how is compliance and performance monitored?
9. Are there other potential risks associated with outsourcing?
10. Do personnel have adequate competence and ethical behaviour?
11. Do personnel seek relevant information and is relevant information easily accessible?
12. Is information communicated on a timely basis in the organisation?
13. Are there any aspects of organisational structure that could give rise to greater risk of fraud?

## **Political Considerations**

1. To which level of government does the particular entity belong and does it have relations to other levels of government?
2. What are the responsibilities (constitutional or other) of the relevant minister, or of entity management?
3. What is experience in dealing with the entity's political vs. administrative management?
4. Is there political consensus, or are differing views freely expressed?
5. How is the political management comprised?
6. What are program areas of political focus, visibility and sensitivity?
7. How does the working relationship between political and administrative management function?
8. Are there any areas of particular public interest?
9. What is experience in relation to one entity exercising unfavourable influence on other related entities in the public sector hierarchy?
10. Are there any political considerations that could give rise to greater risk of fraud?
11. Do laws and regulations contain requirements for political neutrality related to the use of resources and funds, and what is past experience in this area?

## **Laws, Regulations and Other Relevant Authorities**

1. Is it clear which laws, regulations and authorities apply to the audited entity and the particular subject matter?
2. Are there overlaps or inconsistencies between different sets of legislation?
3. Is the entity a lawmaking body, and if so what impact can the lawmaking process have on the rights of individuals?
4. If the entity is a lawmaking body, has it delegated any authority to other entities, such as regulatory authorities or private sector entities?
5. Is relevant legislation relatively new, or is it well established?
6. If new, is it clear in terms of form and content such that it may be clearly understood and applied?
7. If well established, has legal precedent been consistent such that the legislation is clearly understood and applied?
8. Is the relevant program area subject to significant application of judgement in its operations?
9. If a significant amount of judgement is applied, is this done in accordance with the intentions behind the laws and regulations?
10. If a significant amount of judgement is applied, is it applied consistently?
11. Are other bodies involved in interpreting or supplementing the relevant legislation?
12. Has the entity carried out its duties on a timely basis such that individual rights have not been compromised, and there have not been significant negative financial consequences due to passiveness?
13. Have channels for complaints and appeals for affected parties been used appropriately?
14. Have any individual's / organisation's rights been compromised in any way through the entity's interpretation and application of particular legislation or regulations?

15. Are there any aspects of laws, regulations or other authorities that could give rise to greater risk of fraud?

### **Significant Events and Transactions**

1. Are there any significant events or transactions that may give rise to significant risks or fraud risks (eg significant procurement contracts, long term construction contracts, dealings in financial instruments such as foreign exchange contracts, significant loans or financial speculation, privatisation etc)?
2. Does the entity possess the necessary authority and competence to enter into and carry out significant events and transactions?
3. Have experts been engaged in connection with significant events and transactions?
4. If experts have been engaged, what precautions have been taken to ensure their competence and objectivity?
5. How is the work of experts monitored?

### **Management**

1. Is there stability in the management team or have there been changes in key personnel?
2. How are members of management recruited (open and transparent processes with real competition, or token process)?
3. Is management actively involved in assessing risk on a continual basis?
4. Has management considered the consequences of changes in the entity's environment and the impact this may have on the audited entity?
5. Is management conservative in its approach or more willing to take risks (eg what is the 'risk appetite')?
6. What initiatives has management taken to identify and avoid significant risks that could have an adverse impact on the entity?
7. Are risk evaluations that are performed throughout the entity effectively communicated to management at the appropriate levels?
8. Does management actively monitor and evaluate the consequences of their decisions and actions?
9. Have previous audits identified instances of non-compliance, fraud, unlawful acts, unethical behaviour, management bias, etc?
10. How does management balance the achievement of program objectives with the need to manage risk, and ensure compliance with laws and regulations etc?

## Appendix 4 - Examples of Risk Factors Related to a Particular Subject Matter

Procurement is a typical subject matter for compliance audits. The following table gives some examples of risk factors relating to a compliance audit of procurement. The list is not intended to be exhaustive. The relevant risks and risk factors will vary depending on the subject matter and the circumstances of the particular audit.

<b>Examples of Risk Factors Related to the Audit of Procurement</b>	
<b>Inherent risk</b>	
1	Lack of relevant procurement legislation
2	Recent changes to the procurement legislation (eg to conform to international legislation)
3	Complex or unclear legislation, or legislation open for interpretation
4	Significant monetary amounts are involved such as defence procurement
5	Audit findings from the prior year revealed compliance deviations in regard to procurement legislation and directives
6	Previous suspicions or instances of fraud and corruption involving management and key staff
7	Inspections by regulatory authorities (eg competition authorities)
8	Complaints received from potential suppliers about unfair practices related to awarding tenders
9	Potential conflicts of interest
<b>Control risk</b>	
1	Lack of good internal guidelines, including lack of clear and objective criteria
2	Recent changes in general or application controls related to procurement IT systems
3	Poor quality-control or weak monitoring activities related to suppliers
4	Weak or non-existent controls regarding suppliers' compliance with ethical guidelines
5	Non-existent or poor quality monitoring activities related to compliance with relevant legislation
<b>Detection risk</b>	
1	Audit procedures are ineffectively designed (eg performing procedures that only involve checking transactions that are recorded, and not checking for completeness; or making inquiries only of staff in the procurement department and not of others such as administration or facilities management staff, suppliers or agencies that register complaints)
2	Incentives may lead management to intentionally withhold or conceal evidence (for example, suppliers may make bribes or give kickbacks)

3	Possible management collusion or override of controls
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## Appendix 5 - Examples of Compliance Audit Procedures for Selected Subject Matters

This table shows illustrative examples of possible compliance audit procedures in the areas of environmental legislation and project funds from donor organisations. It is not intended to be an exhaustive list of procedures. Audit procedures must be designed for the particular audit circumstances and objectives.

<b>Sample audit procedures</b>	
<b>Subject matter: Environmental legislation</b>	
1	Obtain an overview of relevant environmental legislation to which the entity is required to adhere.
2	Inquire with management, and internal audit as applicable, as to the processes and routines in place to ensure compliance with relevant environmental legislation.
3	Review manuals and systems descriptions to understand the processes and relevant controls. Document the process and identify key controls. Test key controls as necessary.
4	Perform a media search, and other databases as applicable, to identify previous instances of non-compliance by the entity.
5	Review any inspection reports, including those of internal audit as applicable. Follow up any areas that may indicate significant risks of non-compliance with environmental legislation.
6	Confirm that the audited entity has necessary permits and registration certificates as appropriate. Evaluate procedures to ensure that these remain valid and up to date.
7	Review minutes of meetings of environmental, or health and safety committees. Follow up as necessary.
8	Interview selected staff as to their understanding of relevant policies and procedures in place, including training, and how these procedures operate in practice.
9	Inquire with management, and legal counsel as appropriate, as to any previous, existing or potential environmental liability claims. Consider the causes and effects/impacts of any such claims.
10	Observe processes and routines in practice (eg waste disposal – properly stored and disposed of, etc) and document appropriately (eg photo or video evidence may be relevant)

## Sample audit procedures

### Subject matter: Project funds received from a donor organisation

1	Obtain an overview of the funding agreement and any relevant legislation, directives, mandates, etc to which the entity is required to adhere.
2	Inquire with management, and internal audit as applicable, as to the processes and routines in place to ensure compliance with the terms of the funding agreement and relevant legislation, directives, mandates, etc. Inquire as to routines to ensure appropriate accounting and disclosure.
3	Review manuals and systems descriptions to understand the processes and relevant controls related to compliance with such funding agreements. Document the process and identify key controls. Test key controls as necessary.
4	Perform analytical procedures for assessing risks, and substantive procedures as considered necessary. For example, compare any financial information, including project accounts, with budget and prior year(s). Follow up suspected deviations as necessary in the circumstances. Review project accounts for unusual or significant transactions. Follow up as necessary.
5	Select a sample of transactions related to project funds. For each transaction selected, test compliance with the terms of the funding agreement and any relevant legislation, for example: <ul style="list-style-type: none"><li>• requirements related to use of funds</li><li>• proper approval and authorization</li><li>• reporting requirements</li><li>• proper accounting and disclosure, including appropriate accounting policies and recording transactions in the appropriate periods, etc.</li></ul>
6	Where project funds have been used for specific purposes, assess the need to perform physical inspections. Follow up as appropriate.
7	Review related correspondence, minutes of meetings etc to identify any relevant matters. Follow up as necessary.
8	Consider the need to obtain any written confirmations from third parties and follow up as appropriate.
9	Consider the need to obtain specific written representations from management in regard to the funding agreement.
10	Perform cut-off testing and review after the period end as necessary to ensure funds are accounted for in the appropriate period.

## Appendix 6 - Examples of Compliance Deviations

The following table provides some examples of compliance deviations and includes considerations related to materiality and forming conclusions. The comments related to materiality and forming conclusions are not intended to be definitive assessments of whether the particular example constitutes a material compliance deviation or not, but rather to highlight relevant considerations. The determination of materiality will depend on the particular circumstances and the professional judgement of the public sector auditor.

Example of Compliance Deviation		Considerations Related to Materiality and Forming Conclusions
1	During the year, a government agency received budget appropriations through the Ministry of Education for national educational purposes. The agency's grant expenditure for the year included \$10 million to overseas high tech manufacturers.	Based on the legislation governing the government agency, the agency did not have the power to make grants to overseas bodies. The non-compliance may be material because the grant expenditure was paid out to overseas bodies and was therefore not in compliance with relevant authorities, nor was it applied to the purposes intended by the legislature.
2	During the year, a government agency incurred expenditures of \$100 in excess of the total expenditure of \$5000 authorised by the budget approved by the legislature.	In this case, actual expenditures were in excess of amounts authorised through the approved budget. This non-compliance may be material because it was a clear violation of clearly established authorities. Depending on the circumstances, including the type of expenditures, it may also be very sensitive in nature.
3	A citizen is entitled to a monthly pension of \$1000. The government agency has only been paying out \$900 per month. The payments were also made after the dates stipulated in the legislation.	Although the monetary amounts involved may not be material to the financial statements of the government agency, the consequences of the non-compliance are likely to be very significant to the individual pensioner living on a fixed income. If the non-compliance is due to a system weakness, the non-compliance may also affect many other citizens. The non-compliance may therefore be material in terms of the impact on citizens and society in general.
4	A single mother is entitled to monthly child benefits for each child under age 18. The government agency has paid out	While this compliance deviation may have been positive for the recipient, it is not in accordance with the legislation and its intentions, and may therefore be unfair to other beneficiaries. If the

<b>Example of Compliance Deviation</b>	<b>Considerations Related to Materiality and Forming Conclusions</b>
	<p>child benefits for a 19 year old child.</p> <p>non-compliance is due to a system weakness, the non-compliance may also affect many other citizens. The non-compliance may therefore be material in terms of the impact on citizens and society in general.</p>
<p>5</p> <p>The terms of a building code require annual inspections to be performed. The government agency has not performed inspections for the past five years.</p>	<p>The non-compliance may be significant due to qualitative aspects such as safety implications. Although no particular monetary amounts are involved, the non-compliance may be material due to the potential consequences it may have on the safety of the building occupants. In the event of a disaster, there is also a risk that the non-compliance may result in significant liability claims which could have material financial implications for the government agency as well.</p>
<p>6</p> <p>The terms of a funding agreement state that the recipient of the funds must prepare financial statements and send them to the donor organisation by a certain date. The financial statements have not been prepared and sent by this date.</p>	<p>The non-compliance may or may not be material depending on whether or not the financial statements were subsequently prepared and sent, the extent of the delay, the reasons for the delay, any consequences that may arise as a result of the non-compliance, etc.</p>
<p>7</p> <p>Significant system weaknesses were identified in relation to revenues collected in accordance with a tax code. The weaknesses were due to incorrect interpretation of the tax code by the audited entity. Numerous instances of taxpayers being assessed more than they were obligated to pay were identified.</p>	<p>This type of compliance deviation relates to the due process rights of individual citizens. Certain citizens were being assessed too much tax, while others were not being assessed at all. Depending on the circumstances, and because it involves a system weakness, the deviation may be material.</p>

## **Appendix 7 - Example of a Compliance Audit 'Short Form' Report**

As explained in the body of this document, the format of compliance audit reports may vary depending on a number of factors, such as the mandate of the SAI, relevant legislation, customary reporting practices or the complexity of issues being reported. However, some consistency in the reporting format may help users of the auditor's report to understand the work performed and the conclusions reached, as well as to identify unusual circumstances when they arise.

The following short form report example is for illustrative purposes only. Some SAIs may use a long form report where findings are described in more detail in the body of the report.

### **Compliance Audit Report by the SAI of XXX**

[Appropriate Addressee, eg Donor Organisation XYZ]

#### **Report on [Government Agency ABC's Compliance with the Terms of the Funding Agreement with Donor Organisation XYZ dated xx.xx.20XX]**

We have audited [government agency ABC's compliance with the terms of the funding agreement with donor organisation XYZ dated xx.xx.20XX as set out the project accounts for the year ended 31.12.20XX showing total expenditures of \$ xxxxxx.xx].

#### *Management's Responsibility*

According to [the terms of the funding agreement with donor organisation XYZ dated xx.xx.20XX], management of government agency ABC is responsible for [preparing complete project accounts in compliance with the terms of the funding agreement].

#### *Auditor's Responsibility*

Our responsibility is to independently express a conclusion on [the project accounts] based on our audit. Our work was conducted in accordance with the [INTOSAI Fundamental Auditing Principles and Guidelines for Compliance Audit]. Those principles require that we comply with ethical requirements and plan and perform the audit so as to obtain reasonable assurance as to whether [the use of the project funds are in compliance, in all material respects, with the terms of the funding agreement dated xx.xx.20XX].

An audit involves performing procedures to obtain sufficient appropriate evidence to support our conclusion. The procedures performed depend on the auditor's professional judgement, including assessing the risk of material non-compliance, whether due to fraud or error. The audit procedures performed are those we believe are appropriate in the circumstances. We believe that the audit evidence gathered is sufficient and appropriate to provide the basis for our conclusion.

### *Conclusion*

Based on the audit work performed, we found that [government agency ABC's use of project funds received from donor organisation XYZ] is in compliance, in all material respects, with [the terms of the funding agreement dated xx.xx.20XX].

[Responses from the audited entity as appropriate, for example in summary under a heading 'Responses from the Audited Entity,' or as an appendix]

[Recommendations as appropriate, for example under a heading 'Recommendations' or as an appendix]

[Date of auditor's report]

[Auditor's signature]

## **Appendix 8 - Example of a Qualified Compliance Audit Conclusion**

In this example, the compliance subject matter relates to the terms of a rental agreement, and the audit revealed an instance of non-compliance which resulted in additional charges and penalties to the audited entity. The compliance deviation is not so material so as to warrant an adverse conclusion. The introductory sections on management's and the auditor's responsibilities, and final sections of the report are similar to those set out in the example in Appendix 7.

The following short form report example is for illustrative purposes only. Some SAIs may use a long form report where findings are described in more detail in the body of the report.

..... *[appropriate introductory sections of the report]*.....

[We have audited government agency ABC's compliance with the terms of the rental agreement with landlord DEF dated xx.xx.20XX.

### *Basis for the Qualified Conclusion*

The terms of the rental agreement state that monthly rent for premises BBB in the amount of \$xxxxx.xx is payable in advance on the first day of the month. During 20XX, one of the rental payments was made after the due date. This has resulted in government agency ABC being assessed late payment charges and penalties for the year amounting to \$xx.xx.

### *Qualified Conclusion*

Based on the audit work performed, we found that, except for the instance of non-compliance noted in the Basis for the Qualified Conclusion paragraph above, government agency ABC is in compliance, in all material respects, with the terms of the rental agreement with landlord DEF dated xx.xx.20XX].

..... *[appropriate concluding sections of the report]*.....

# Appendix 9 - Example of an Adverse Compliance Audit Conclusion

In this example, the compliance subject matter relates to the terms of a rental agreement, and the audit revealed that none of the monthly rental payments were made by the due date. This resulted in additional charges and penalties to the audited entity. The compliance deviation is considered to be material. The introductory sections on management's and the auditor's responsibilities, and final sections of the report are similar to those set out in the example in Appendix 7.

The following short form report example is for illustrative purposes only. Some SAIs may use a long form report where findings are described in more detail in the body of the report.

..... *[appropriate introductory sections of the report]*.....

[We have audited government agency ABC's compliance with the terms of the rental agreement with landlord DEF dated xx.xx.20XX.

### *Basis for the Adverse Conclusion*

The terms of the rental agreement state that monthly rent for premises BBB in the amount of \$xxxxx.xx is payable in advance the first day of the month. During 20XX, none of the rental payments were made by the due date. This has resulted in government agency ABC being assessed late payment charges and penalties for the year amounting to \$xxxx.xx.

### *Adverse Conclusion*

Based on the audit work performed, we found that, because of the significance of the matter noted in the Basis for the Adverse Conclusion paragraph above, government agency ABC is not in compliance, in all material respects, with the terms of the rental agreement with landlord DEF dated xx.xx.20XX].

..... *[appropriate concluding sections of the report]*.....

## Appendix 10 - Example of a Compliance Audit Disclaimer

A disclaimer is issued when the public sector auditor has not been able to reach a conclusion.

In this example, a compliance audit was to be conducted on government agency ABC's compliance with terms of building code CCC. Building BBB comprises 95% of ABC's building mass. Building BBB was recently damaged by an earthquake such that it is not safe to enter. The introductory sections on management's and the auditor's responsibilities, and final sections of the report are similar to those set out in the example in Appendix 7.

The following short form report example is for illustrative purposes only. Some SAIs may use a long form report where findings are described in more detail in the body of the report.

..... *[appropriate introductory sections of the report]*.....

[We have audited government agency ABC's compliance with the terms of building code CCC dated xx.xx.20XX.

### *Basis for the Disclaimer*

The evidence available to us for determination of whether government agency ABC was in compliance with the terms of building code CCC was limited because we were unable to obtain access to building BBB, located at address XYZ, due to earthquake damage. Building BBB comprises 95% of the building mass for which government agency ABC is responsible. There were no other satisfactory procedures we could carry out to determine if government agency ABC was in compliance with the terms of building code CCC.

### *Disclaimer*

Based on the audit work performed, because of the significance of the matter noted in the Basis for the Disclaimer paragraph above, we are unable to, and therefore do not express a conclusion on government agency ABC's compliance with the terms of building code CCC dated xx.xx.20XX].

..... *[appropriate concluding sections of the report]*.....

(Note that in situations where management is responsible for the scope limitation, this may give rise to a fundamental question as to management's integrity. In such situations, careful consideration must be given as to how, and to whom, this should be reported).

## **Appendix 11 - Example of an Emphasis of Matter and Other Matter(s) Paragraph**

In some situations there may be a need to elaborate on particular matters which do not affect the compliance conclusion. An Emphasis of Matters or Other Matters paragraph is used in such circumstances as illustrated by the following examples. The introductory sections on management's and the auditor's responsibilities, and final sections of the report are similar to those set out in the example in Appendix 7.

..... *[appropriate introductory sections of the report]*.....

### *Conclusion*

Based on the audit work performed, we found that [government agency ABC's use of project funds received from donor organisation XYZ] is in compliance, in all material respects with [the terms of the funding agreement dated xx.xx.20XX].

### *Emphasis of Matter*

We draw attention to Note xx to the project accounts which details total administrative costs of \$xxxx.xx related to the agency's reporting on compliance with the terms of the funding agreement. Our conclusion has not been qualified in respect of this matter.

### *Other Matter*

We draw attention to the fact that this report has been prepared for the use of Donor Organisation XYZ and may therefore not be suitable for another purpose.

..... *[appropriate concluding sections of the report]*.....

## **Appendix 12 - Example of a Compliance Review Report Expressing Limited Assurance**

As explained in the body of this document, the mandate of the SAI may influence the work performed and the type of conclusion expressed. The mandate of some SAIs may limit the work performed on compliance to stating that no instances of non-compliance with authorities have come to the auditors' attention during the audit that would result in the subject matter not being in compliance, in all material respects, with the applied criteria.

The following short form limited assurance report example is for illustrative purposes only. Some SAIs may use a long form report where findings are described in more detail in the body of the report.

### **Compliance Review Report by the SAI of XXX**

[Appropriate Addressee, eg Donor Organisation XYZ]

#### **Report on [Government Agency ABC's Compliance with the Terms of the Funding Agreement with Donor Organisation XYZ dated xx.xx.20XX]**

We have reviewed [government agency ABC's compliance with the terms of the funding agreement with donor organisation XYZ dated xx.xx.20XX as set out the project accounts for the year ended 31.12.20XX showing total expenditures of \$ xxxxxx.xx].

#### *Management's Responsibility*

According to [the terms of the funding agreement with donor organisation XYZ dated xx.xx.20XX], management of [government agency ABC] is responsible for [preparing complete project accounts in compliance with the terms of the funding agreement].

#### *Auditor's Responsibility*

Our responsibility is to independently express a conclusion on the project accounts based on our review. Our work was conducted in accordance with the [INTOSAI Fundamental Auditing Principles and Guidelines for Compliance Audit]. Those principles require that we comply with ethical requirements and plan and perform the review so as to obtain limited assurance as to whether [the use of the project funds are in compliance, in all material respects, with the terms of the funding agreement dated xx.xx.20XX].

A review is limited primarily to analytical procedures and to inquiries applied to the project accounts, and therefore provides less assurance than an audit. We have not performed an

audit, and, accordingly, express our conclusion in the form of limited assurance, which is consistent with the more limited work we have performed under this compliance review.

### *Conclusion*

Based on the work performed, nothing has come to our attention that would indicate that [the project accounts prepared by government agency ABC] are not in compliance, in all material respects, with [the terms of the funding agreement with donor organisation XYZ dated xx.xx.20XX].

[Responses from the audited entity as appropriate, for example in summary under a heading 'Responses from the Audited Entity,' or as an appendix]

[Recommendations as appropriate, for example under a heading 'Recommendations' or as an appendix]

[Date of auditor's report]

[Auditor's signature]

INTOSAI



# *Compliance Audit*

## *Guidelines*

### *Compliance Audit Related to the Audit of Financial Statements*

INTOSAI PROFESSIONAL STANDARDS COMMITTEE

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## Preface

The suite of compliance audit guidelines comprises the following:

- ISSAI 4000: A general introduction to guidelines on compliance audit
- ISSAI 4100: Compliance audit guidelines for audits performed separately from the audit of financial statements. Such work may be carried out as part of a performance audit or as a separate audit type.
- ISSAI 4200: Compliance audit guidelines related to the audit of financial statements

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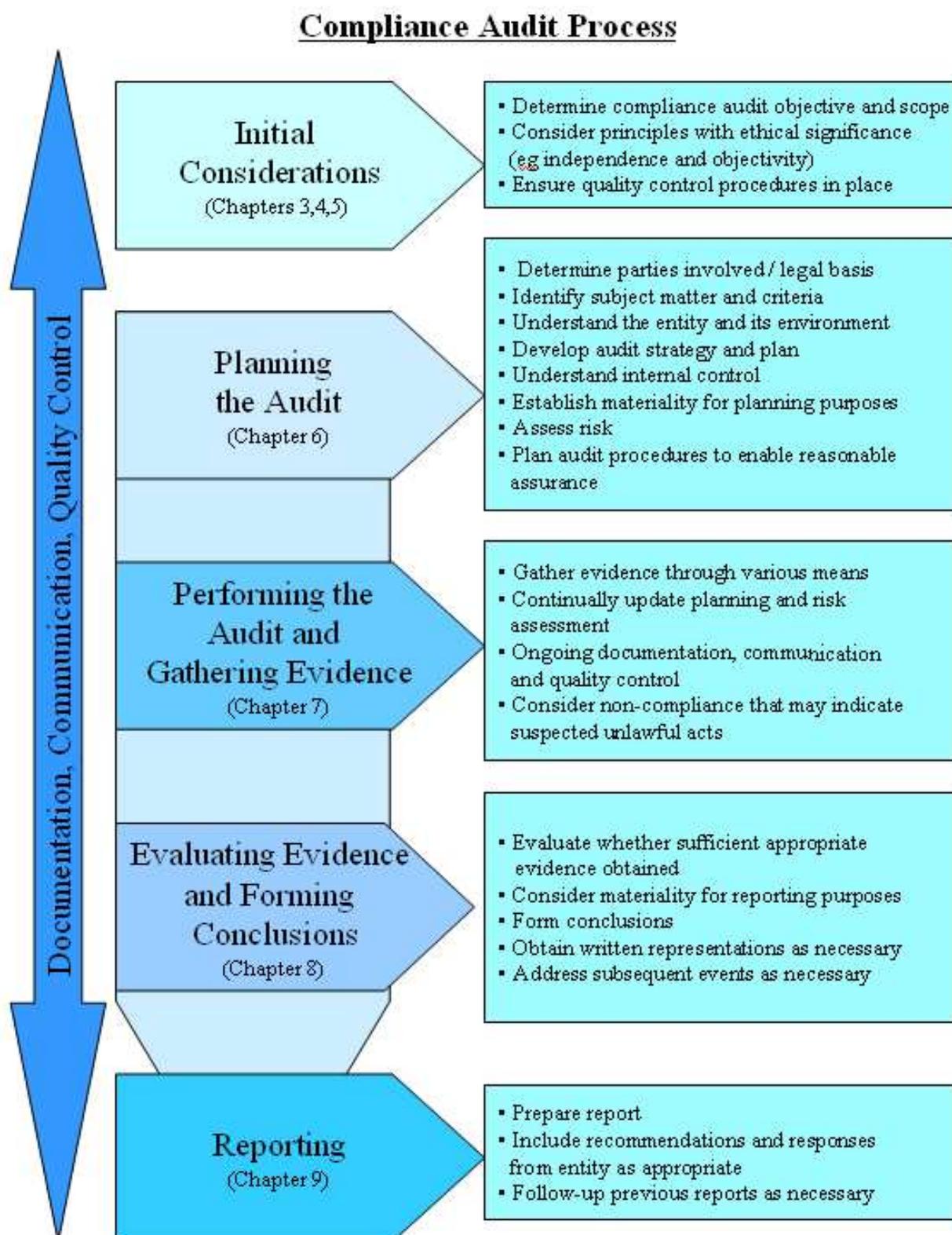
# 1 Introduction

1. The concept of compliance audit is encompassed by the description of the purpose of a public sector audit as set out in INTOSAI's Lima Declaration: '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 audit deals with the degree to which the audited entity follows rules, laws and regulation, policy, established codes, or agreed upon terms, such as the terms of a contract or the terms of a funding agreement. The concept of compliance audit is introduced in INTOSAI's Fundamental Auditing Principles (ISSAI 100.38 and 39). The concept is further described in ISSAI 4000 – Introduction to the Compliance Audit Guidelines.
3. In the public sector, the concepts of transparency, accountability, stewardship and good governance are basic and important principles. Laws and regulations may set out what activities public sector entities are charged with carrying out for the citizens, any limits or restrictions on such activities, the overall objectives to be achieved and how due process rights of individual citizens are protected. Furthermore, public funds are entrusted to public sector entities for their proper management. It is the responsibility of these public sector bodies and their appointed officials to be transparent about their actions, accountable to the citizens for the funds with which they are entrusted, and to exercise good stewardship over such funds.
4. The need to monitor that the activities of public sector entities are in accordance with the relevant authorities that govern them, and that the due process rights of citizens are protected are important public sector control functions. Through public sector auditing in general, and compliance auditing specifically, public sector auditors help to monitor that the basic principles set out above are being followed and put into operation. In the context of compliance auditing, this responsibility includes determining whether information related to a particular subject matter is in compliance, in all material respects, with relevant criteria such as relevant laws, regulations, directives, terms of contracts and agreements, etc. The result of such auditing is reported to the audited entity and the legislature. In addition, the result is normally made available to the general public. This is done to support accountability and transparency in the public sector.
5. These guidelines address aspects of compliance audit in the public sector which, in many countries, is subject to very different mandates and objectives. In a democratic

system of government, accountability to the public, and particularly to its designated representatives, is an overriding aspect of the management of a public sector entity and an essential element of good public governance. Public sector entities are usually established by legislation and their operations governed by various authorities derived from legislation. Management of public sector entities is accountable for operating in accordance with the provisions of the relevant laws, regulations and other authorities governing them. Since legislation and other authorities are the primary means by which legislators control the raising and spending of money by the public sector, auditing for compliance with relevant authorities is usually an important and integral part of the audit mandate, or terms of engagement, for most audits of public sector entities. Because of the variety of authorities, their provisions may be conflicting with one another and may be subject to differing interpretations. Also, subordinate authorities may not be consistent with the directions or limits prescribed by the enabling legislation. As a result, an assessment of compliance with authority in the public sector requires considerable professional judgment and is of particular importance.

6. These guidelines (ISSAI 4200 on Compliance Audit related to the Audit of Financial Statements), concern situations where compliance audit is performed together with an audit of financial statements. They build upon INTOSAI's Fundamental Auditing Principles (referenced within this document as ISSAI 100 – ISSAI 400, previously referred to as the 'INTOSAI Auditing Standards') and have been designed to assist public sector auditors and SAIs in applying these principles. These guidelines supplement, and should be read together with, INTOSAI's Financial Audit Guidelines (ISSAI 1000-2999, referred to in this document as the 'Financial Audit Guidelines').
7. These guidelines, when applied together with the Financial Audit Guidelines, are intended to provide public sector auditors with a comprehensive set of guidance for audits of financial statements in the public sector.

8. The process generally followed in carrying out compliance audits is shown in the figure below and is described in the subsequent sections of the guidelines.



## 2 Scope of the guidelines

### 2.1 Scope and Nature of a Compliance Audit

9. In general, the mandate of the SAI determines whether the SAI carries out compliance audit activities or not. When the SAI carries out compliance audits, it is the SAI itself that is normally responsible for determining the scope and nature of the work to be performed and the appropriate audit approach. In some cases, the legislative body, such as a parliament, may request the SAI to perform a certain type of audit. Such requests may be accepted as long as the auditor's independence is not compromised. (ISSAI 200, 2.2.16) Nonetheless, it should be up to the SAI to determine the appropriate audit approach and methodology to be employed.
10. The subject matters of compliance audits are wide ranging and may vary significantly from one audit to the next. A subject matter may be general in nature or may be very specific. More guidance on compliance audit subject matters is set out in section 6.2 below.
11. The Fundamental Auditing Principles explain that compliance audit is important because government agencies, programs and activities are often the result of particular laws and regulations. Decision makers need to know whether relevant laws and regulations are being followed, whether they have the desired results, and if not, what revisions are necessary (ISSAI 300, 3.4.2). Laws, regulations, and other compliance requirements pertaining to the audited entity may be significant to the particular audit objectives, whether it is performed as a separate audit type, or related to performance audit or to an audit of financial statements. Public sector auditors therefore plan and perform work of a scope and nature that will allow them to provide a constructive report to the appropriate parties.
12. In some cases, the audit mandate may set out the audit subject matter and scope of a particular compliance audit. In other cases, the subject matter and scope of the compliance audit may be based on the professional judgement of the public sector auditor. Factors that may influence public sector auditors' determination of the audit subject matter and scope may include:
  - a) Requirements set out in the audit mandate or relevant laws and regulations, such as an appropriations act or procurement act
  - b) Previous instances of non-compliance by the entity, for example compliance deviations identified in previous audits
  - c) Findings and recommendations in audits performed by auditors outside the SAI
  - d) Risk assessments performed in connection with financial or performance audits indicating specific areas where there is risk of non-compliance (for example across sectors such as procurement, or large sector-specific program areas such as revenue collection, defence, welfare benefits, etc)

- e) Public interest or expectations (for example suspected fraud, mismanagement or areas of non-compliance identified by the media etc)
  - f) Specific areas that are the subject of significant legislative focus (for example environmental issues and compliance with international environmental agreements)
  - g) Requests by legislative bodies, funding agencies or donor organisations (for example compliance with the terms of funding agreements)
  - h) Significant funding is received by the entity from donor organisations and the continued provision of such funding is subject to compliance with the terms of a contract or agreement
13. In situations where the scope and nature of the compliance audit do not follow directly from the audit mandate or relevant legislation, but are based on the public sector auditor's professional judgement, it may be useful to inform the audited entity of the scope and nature of the audit in writing. This may assist in clarifying the understanding of the roles and responsibilities of the various parties, including what is to be covered by the audit and any particular limitations, information to be provided, the type of report to be issued and to whom, timetables, etc.
14. References to 'compliance audit' throughout this document are understood to be in the context of work carried out by SAIs, or for which the SAI is responsible.
15. For the purposes of these guidelines, compliance audit and compliance reporting are regarded as related to the audit of the financial statements if:
- a) The audit opinion on compliance forms part of the auditor's report on the audit of the financial statements, or
  - b) The financial statements have been prepared in accordance with a financial reporting framework that requires the financial statements to reflect compliance with laws and regulations.
16. Due to the extended mandate of SAIs, in performing an audit of financial statements in the public sector, the scope and objective of the auditor is generally broader than that set out in ISA 200 (Revised and Redrafted) Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing. In conducting an audit of financial statements, the overall objectives of the auditor as set out in ISA 200 are:
- a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
  - b) To report on the financial statements, or otherwise and communicate as required by the ISAs, in accordance with the auditor's findings.

17. Compliance audit in the public sector normally has a broader scope than that set out in Redrafted ISA 250 Consideration of Laws and Regulations in an Audit of Financial Statements. The objective of the auditor as set out in ISA 250 is three-part:
- a) To obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognized to have a direct effect on the determination of material amounts and disclosures in the financial statements;
  - b) To perform specified audit procedures to help identify instances of non-compliance with other laws and regulations that may have a material effect on the financial statements; and
  - c) To respond appropriately to non-compliance or suspected non-compliance with laws and regulations identified during the audit.
18. Additional guidance on informing the entity about the scope and nature of the audit may be found in:
- ISSAI 1210 and 1300
  - INTOSAI's Implementation Guidelines for Performance Auditing section 2.3 – The institutions concerned should be properly informed
  - IFAC's International Standard for Assurance Engagements (ISAE) 3000

## **2.2 Reasonable vs. Limited Assurance**

19. The Fundamental Auditing Principles related to compliance state that the audit should be designed to provide reasonable assurance of detecting errors, irregularities and illegal acts that may significantly affect the audit objectives (ISSAI 300, 3.4.1).
20. In most types of engagements there are two types of assurance levels: reasonable (positive) assurance and limited (negative) assurance. Reasonable assurance is high, but not absolute assurance. Due to the inherent limitations of an audit (see section on risk assessment below), an audit does not normally provide 100% assurance. In general, reasonable assurance audits are designed to result in a positive form of expressing an opinion/conclusion, such as 'in our opinion the subject matter is / is not in compliance, in all material respects, with the stated criteria...' Limited assurance work is not considered an audit, but rather a review-level engagement. It provides a lower level of assurance than an audit, and is designed to result in a negative form of expressing a conclusion, 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...'
21. Both reasonable assurance audits and limited assurance reviews involve understanding the subject matter and obtaining sufficient appropriate evidence to support the public sector auditor's opinion. 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. In

performing a limited assurance review, procedures are usually limited to analytical procedures and inquiries. The nature, timing and extent of procedures performed in both reasonable assurance audits and limited assurance reviews are determined by public sector auditors applying professional judgement. A limited assurance review may be appropriate for subject matters across entities, which may involve more complex issues than subject matters within a specific entity.

22. These guidelines are written in the context of reasonable assurance audits. For compliance audit performed together with the audit of financial statements, these guidelines provide guidance for public sector auditors reporting in the form of reasonable assurance opinions on an entity's compliance with authorities.
23. When a limited assurance review on compliance is combined with a reasonable assurance audit of the financial statements, the different responsibilities of the auditor should be clearly described.

### **2.3 Assertion Based Reporting vs. Direct Reporting**

24. In some cases, management at the audited entity may prepare a specific assertion or a statement of compliance. In other instances the assertion may be implicit.
25. For example, when issuing financial statements, management makes implicit financial reporting assertions that having prepared those financial statements in accordance with the applicable financial reporting framework, such as International Public Sector Accounting Standards (IPSAS) or generally accepted government accounting standards in the particular country, the financial statements are prepared in accordance with the applicable framework, assets exist, and are owned by the entity and properly valued, etc. Similarly, management may make implicit assertions related to compliance with authorities.
26. In many public sector audits, there are no specific assertions or statements of compliance that the audited entity makes available to users. Rather, the subject matter information is embedded in the auditor's report – either in the form of data/information or as an explicit statement in the form of an opinion. These types of audits are referred to as direct reporting audits. Audit findings are reported in an appropriate manner to relevant parties such as the audited entity and the legislature. Reports are usually made available to the general public.
27. The form of reporting may vary depending on the auditor's professional judgement as to how to communicate most effectively with the intended users. Reports may be either short-form or long-form reports. More guidance on reporting is set out in the reporting section of this document.
28. These guidelines are developed based on direct reporting audits, but may be applied to assertion based reporting as appropriate.

### **3 Objectives to be Achieved**

29. As noted above, ISA 200.11 (Revised and Redrafted) explains that in performing an audit of financial statements, the objective of the auditor is to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework and to report and communicate in accordance with the auditor's findings.
30. Depending on the mandate and constitutional role of the SAI, the overall objectives of public sector auditors in performing compliance audit in connection with the audit of financial statements are to:
  - a) Obtain reasonable assurance about whether the activities, financial transactions and information reflected in the financial statements are, in all material respects, in compliance with the authorities which govern them, and
  - b) Report the findings and conclusions to the legislature and/or other bodies as appropriate.
31. For SAIs representing the Court of Accounts system, the objective is also to communicate compliance deviations to the appropriate bodies or open the process leading to a formal judgement in aspects related to the judicial function of the courts such as identification of the responsible authority/agent and determination of any potential offence.

## 4 Definitions

32. For purposes of these guidelines the following terms have the meanings set out below:
1. **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.
  2. **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.
  3. **Compliance audit** – compliance audit 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. 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.

In performing compliance audits in the context of the INTOSAI Fundamental Auditing Principles, there are two concepts of significant relevance:

- a) **Regularity** – the concept that activities, transactions and information which are reflected in the financial statements of an audited entity are in accordance with authorising legislation, regulations issued under governing legislation and other relevant, laws, regulations and agreements, including budgetary laws and are properly sanctioned.
- b) **Propriety** – general principles of sound public sector financial management and conduct of public sector officials.

Depending on the mandate of the SAI, a compliance audit may be an audit of regularity, or propriety, or both.

Because propriety is not readily susceptible to objective verification, it may be difficult, and in some cases impossible to audit propriety to a level of reasonable

assurance. There are often no clear and objective benchmarks against which to measure propriety – what may be acceptable in one part of the public sector may not be acceptable elsewhere.

Where SAIs have a mandate to audit propriety, criteria may not be clearly defined at the outset. The issue of suitable criteria is addressed in more detail in the following sections of this document. Where the audit mandate requires an audit of propriety, the principles outlined in these guidelines may be applied as appropriate in the circumstances. The form and content of reports on propriety may vary depending on the mandate of the SAI and the particular circumstances.

4. **Compliance deviation** – the audited entity's failure to comply with:
  - a) Authorities – for compliance audits of regularity; or
  - b) General principles for sound public sector financial management and conduct of public sector officials – for compliance audits of propriety.
  
5. **Conclusion** – The auditor's report on compliance subject matters normally contains a conclusion based on the audit work performed. When compliance audit is performed together with the audit of financial statements, the conclusion may take the form of an opinion (see Opinion). The conclusion may also be expressed as a more elaborated answer to specific audit questions.
  
6. **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.
  
7. **Opinion** – The auditor's report on the financial statements may contain a clear written expression of opinion on compliance in addition to the opinion on the financial statements. An unqualified opinion may be expressed when the auditor concludes that, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.
  
8. **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

## 5 Initial Considerations

### 5.1 Ethical Considerations

33. The Fundamental Auditing Principles set out principles with ethical significance that are taken into consideration prior to commencing the audit (ISSAI 200, 2.2.1). These principles relate to:
- a) The independence of the SAI and the auditor, including political neutrality
  - b) Avoidance of conflict of interest between the auditor and the audited entity
  - c) The need for the auditor and the SAI to possess the necessary competence
  - d) Exercise of due care and concern by the SAI and the auditor in complying with the Fundamental Auditing Principles
34. If for some reason, the SAI or the auditor is not in a position to comply with the Fundamental Auditing Principles that have ethical significance, appropriate actions are taken to ensure that the threats to non-compliance are eliminated before commencing the audit. This may, for example, involve re-allocating staff assigned to the audit, additional training or involvement of experts.
35. Additional guidance may also be found in:
- INTOSAI's Code of Ethics
  - INTOSAI's Implementation Guidelines for Performance Auditing Section 2.2 and 2.3
  - IFAC's ISAE 3000

### 5.2 Quality Control

36. As with other types of auditing, it is important in performing compliance audits that the SAI have processes and procedures in place to ensure that the work carried out is of sufficient quality, that the public sector auditors performing such audits collectively have the necessary competence and skills, and that the work of the team is appropriately directed, supervised and reviewed. INTOSAI's Fundamental Auditing Principles establish benchmarks and provide guidance for ensuring the quality of work (ISSAI 200, 2.1.26 and 2.2.36).
37. Further guidance on quality control may be found in:
- INTOSAI's [proposed] Code of Quality and ISSAI 1220
  - INTOSAI's Implementation Guidelines for Performance Auditing Appendix 4
  - IFAC's International Standard on Quality Control (ISQC)1
  - IFAC's ISAE 3000

## **6 Planning and Designing a Compliance Audit**

38. The Fundamental Auditing Principles state that the auditor should plan the audit in a manner which ensures that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner (ISSAI 300 3.1.1). Furthermore, those planning the audit need to be knowledgeable of the compliance requirements that apply to the entity being audited (ISSAI 300, 3.4.3).
39. Public sector auditors plan and perform audits while maintaining an attitude of professional skepticism.

### **6.1 Identification of the Parties Involved / Legal Basis**

40. Public sector auditors ensure that the necessary preconditions exist in order to effectively perform the audit. In planning compliance audits, this may involve identifying at the outset the relevant parties involved. This is important in order to establish the legal basis for performing the audit, such as the mandate of the SAI, including the responsibilities of public sector auditors, and the constitutional status and responsibilities of the audited entity.
41. In addition, it is important to identify the users of the audit report. The form and content of the report are influenced by the auditor's professional judgement as to how to communicate most effectively with the intended users. The needs of users may vary depending upon whether the users are the legislature, a funding agency, a donor organisation, the citizens or other relevant stakeholders.

### **6.2 Subject Matter and Subject Matter Information**

42. 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.
43. 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 behaviour). 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 information sufficient to support reporting in the form of a reasonable assurance opinion.
44. 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.

45. When compliance audit encompasses budgetary laws, or other relevant budgetary resolutions, the entity's revenue and financing are included, as well as its expenditure.
46. 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.
47. 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.
48. Some examples of subject matters and subject matter information in relation to compliance auditing are set out in Appendix 1.

### 6.3 Criteria

49. The criteria, or the benchmarks against which the subject matter will be compared, must also be identified. In performing compliance audits, the identification of the criteria is an essential step in the audit planning process. Some examples of criteria in relation to compliance auditing are set out in Appendix 1 and 1-A.
50. 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 behaviour, 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.
51. The criteria should be suitable. This means that the criteria should have the following characteristics:
  - a) **Relevant** – relevant criteria provide meaningful contributions to the information and decision making needs of the intended users of the audit report

- b) **Reliable** – reliable criteria result in reasonably consistent conclusions when used by another auditor in the same circumstances
  - c) **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.
  - d) **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.
  - e) **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.
  - f) **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
52. 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 objectives 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.
53. 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. Some examples of such sources are set out in Appendix 2.
54. 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.

55. 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.
56. However, when propriety is the subject matter of 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 behaviour 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 behaviour by public officials, if circumstances so warrant.
57. 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).
58. 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.
59. 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.
60. 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.
61. 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
62. The audit approach may also be broken down into parts, or the scope narrowed, such that clearly identifiable criteria may be applied.
63. 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.
64. 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.

#### **6.4 Understanding the Audited Entity and its Environment**

65. 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 auditing 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. Some examples of sources that may be used in gaining this understanding are set out in Appendix 2.
66. According to ISSAI 4000, paragraph 5, the Compliance Audit Guidelines cover compliance audit at all levels of government. As a consequence, the guidelines 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.

#### **6.5 Audit Strategy and Plan**

67. Planning the audit so that it will be performed effectively involves discussions with relevant members of the audit team, and developing an overall audit strategy and an audit plan. Both the audit strategy and the audit plan should be documented in writing. Planning is not a distinct phase of the audit, but is a continual 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 engagement team.

68. In establishing the overall audit strategy for the compliance audit, public sector auditors consider:
- a) The objectives, 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 objectives, 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 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
69. 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.
70. 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) For audits of propriety – obtaining an understanding of relevant principles of sound public sector financial management and expectations regarding the conduct of public sector officials

71. Further guidance on audit planning and on audit criteria may be found in:
- ISSAIs 1210 and 1300
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 3 and Appendix 2
  - IFAC's Assurance Framework and ISAE 3000

## **6.6 Understanding Internal Control at the Audited Entity**

72. Understanding internal control is normally an integral part of understanding the entity and the relevant subject matter. The Fundamental Auditing Principles explain that in performing an audit, public sector auditors understand and evaluate the reliability of internal control (ISSAI 300, 3.3.1). In compliance audit, this includes understanding and evaluating controls that assist management in complying with laws and regulations (ISSAI 300, 3.3.2).
73. The particular type of controls evaluated depends on the subject matter, and the nature and scope of the particular compliance audit. In evaluating internal control, public sector auditors assess the risk that the control structure may not prevent or detect material non-compliance (ISSAI 300, 3.4.6). 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.
74. Further guidance on understanding the audited entity may be found in:
- ISSAI 1315
  - INTOSAI's Implementation Guidelines for Performance Auditing Section 3.3, Subsection - Understanding the program and Appendix 1, Subsection 2- Formulating the audit question or defining the audit problem
  - INTOSAI Guidelines for Internal Control Standards for the Public Sector
  - IFAC's ISAE 3000

## **6.7 Materiality**

75. Materiality consists of both quantitative and qualitative factors. In performing compliance audits, materiality is determined for:

- a) Planning purposes
  - b) Purposes of evaluating the evidence obtained and the effects of identified instances of non-compliance, and
  - c) Purposes of reporting the results of the audit work.
76. Public sector auditors plan and perform the audit to determine whether the subject matter information, in all material respects, is in compliance with the stated criteria.
77. As stated in the Fundamental Auditing Principles, 'Materiality is often considered in terms of value but the inherent nature or characteristics of an item or group of items may also render a matter material--for example, where the law or regulation requires it to be disclosed separately regardless of the amount involved.' (ISSAI 100, 1.0.10)
78. 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.
79. The determination of materiality for planning purposes may be straight forward. This might be the case in situations where a law or regulation, or agreed-upon terms establish an unconditional requirement for compliance, for example if the constitution prohibits overspending in relation to the approved budget.
80. 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
81. In other cases the determination of materiality is normally a matter for professional judgement.
82. 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.

83. 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.
84. Further guidance on materiality in relation to identified non-compliance is discussed in the section on Evaluating Evidence and Forming Conclusions below.
85. Further guidance on materiality may be found in:
  - ISSAIs 1320 and 1450
  - INTOSAI's Implementation Guidelines for Performance Auditing Section 5.3, Subsection – Materiality, relevance and objectivity, and Appendix 3 part 1.2, Subsection - Sufficiency of evidence
  - IFAC's ISAE 3000

## **6.8 Risk Assessment**

86. Risk assessment is an essential part of performing a reasonable assurance audit. 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:
  - a) Judgement may be applied by management in interpreting laws and regulations
  - b) Human errors occur
  - c) Systems may be improperly designed or function ineffectively
  - d) Controls may be circumvented
  - e) Evidence may be concealed or withheld
87. In performing compliance audits, public sector auditors assess 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 assurance as the basis for the auditor's conclusion.
88. The risks and the factors that may give rise to such risks will vary depending on the particular subject matter and circumstances of the audit. In general, public sector

auditors consider the three elements of audit risk - inherent risk, control risk and detection 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.

### **6.8.1 Risk Assessment Considerations in regard to Fraud**

89. 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.
90. Fraud risks and assessments of materiality in relation to fraud are considered in the context of the broader scope of public sector 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.

### **6.8.2 Risk Assessment Considerations in regard to Relationships between Public Sector Entities**

91. Relationships between various public sector entities are considered when assessing audit risk, 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.
92. Examples of factors related to assessing risk in compliance audits are set out in Appendix 3. In addition, an illustrative example of risk factors related to a compliance audit of procurement is set out in Appendix 4.
93. Further guidance on risk assessment, and fraud risk may be found in:

- ISSAIs 1240, 1315 and 1550
- INTOSAI's Implementation Guidelines for Performance Auditing Part 3.2, Subsection - Risks or uncertainties
- IFAC's Assurance Framework and ISAE 3000

## **6.9 Planning Audit Procedures**

94. Planning audit procedures involves designing procedures to respond to the identified risks of non-compliance. The exact nature, timing and extent of the audit procedures to be performed may vary widely from one audit to the next. Nonetheless, compliance audit procedures in general involve establishing the relevant criteria, ie the authorities which govern the entity, and then measuring the relevant subject matter information against such authorities. More information on audit procedures is provided in the section on performing compliance audits and gathering evidence below.

## **7 Performing Compliance Audits and Gathering Evidence**

95. The Fundamental Auditing Principles state that public sector auditors choose and perform audit steps and procedures that, in their professional judgement, are appropriate in the circumstances. (ISSAI 300, 3.4.5). The Fundamental Auditing Principles also state that the steps and procedures are designed to obtain sufficient, competent, and relevant evidence that will provide a reasonable basis for the auditor's judgements and conclusions (ISSAI 300, 3.5.1). Evaluating the entity's internal control systems and assessing the risks that the control systems may not prevent or detect instances of non-compliance are a normal part of performing compliance audits (ISSAI 300 3.4.6).
96. The audit procedures to be performed will depend on the particular subject matter and criteria identified, as well as the auditor's professional judgement. The procedures should be clearly linked to the identified risks. When the risks of non-compliance are significant and public sector auditors plan to rely on the controls in place, such controls must be tested. When controls are not considered reliable, public sector auditors plan and perform substantive procedures to respond to the identified risks. Furthermore, additional substantive procedures are performed when there are significant risks of non-compliance. If the audit approach consists only of substantive procedures, tests of details (not only analytical tests) are performed.
97. 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 objectives 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.
98. Some examples of compliance audit procedures for selected subject matters are set out in Appendix 5.

### **7.1 Gathering and Evaluating Evidence**

99. In performing a reasonable assurance audit, public sector auditors gather sufficient appropriate audit evidence to provide a basis for the auditors' conclusions. The Fundamental Auditing Principles state that 'competent, relevant and reasonable evidence should be obtained to support the auditor's judgement and conclusions regarding the organisation, program, activity or function under audit' (ISSAI 300, 3.5.1)

100. The sufficiency of evidence relates to the quantity of the evidence. The competence, relevance, reliability and appropriateness of evidence relates to the quality of the evidence. Public sector auditors exercise professional judgement in making the determination of sufficiency and appropriateness throughout the evidence gathering process.
101. 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
102. The evidence gathering process continues until the public sector auditor is satisfied that sufficient, appropriate evidence exists to provide a basis for the auditor's conclusion.
103. In many cases, audit sampling may be used as a means of testing to detect instances of non-compliance with authorities. The use of IT audit techniques is often helpful and in many cases is an integrated part of a compliance audit.
104. 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
105. 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

### **7.1.1 Observation**

106. 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.

### **7.1.2 Inspection**

107. 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.

108. 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.

### **7.1.3 Inquiry**

109. 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.

110. 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.

111. 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.

112. 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 authorised to speak or give opinions on behalf of the entity.

#### **7.1.4 Confirmation**

113. 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.
114. 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.

#### **7.1.5 Re-performance**

115. 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.

#### **7.1.6 Analytical Procedures**

116. 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.

117. Regression analysis techniques or other mathematical methods may assist public sector auditors in comparing actual to expected results.
118. Further guidance related to evidence and evidence gathering procedures may be found in:
  - ISSAIs 1330, 1450, 1500, 1505, 1520, 1530, 1610 and 1620
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 4 and Appendix 3
  - IFAC's Assurance Framework and ISAE 3000

## **7.2 Documentation**

119. The Fundamental Auditing Principles state that audit evidence gathered must be adequately documented (ISSAI 300, 3.5.5 and 3.5.6). Documentation in regard to compliance audits includes documenting sufficiently matters that are significant in providing evidence to support the conclusions drawn and the report issued. The audit documentation should be sufficiently complete and detailed to enable an experienced auditor, having no previous connection with the audit, to understand what work was performed in support of the conclusions (ISSAI 300, 3.5.7).
120. Documentation takes place throughout the entire audit process. Public sector auditors prepare compliance audit documentation on a timely basis, and maintain such documentation which records the criteria used, the work done, evidence obtained, judgements made and review performed. Public sector auditors prepare relevant audit documentation before the auditor's report is issued. Audit documentation is retained for an appropriate period of time.
121. Further relevant guidance for documenting compliance audits may be found in:
  - ISSAI 1230
  - INTOSAI's Implementation Guidelines for Performance Auditing Appendix 3
  - IFAC's ISAE 3000

### **7.3 Communications**

122. Good communication with the audited entity throughout the audit process may help make the process more effective and constructive. Communication takes place at various phases and at various levels, for example:

- a) During the initial planning phase, including 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
- b) During the performance phase and throughout the audit, including gathering evidence and making inquiries of relevant persons as appropriate. Any significant difficulties encountered during the audit, as well as instances of material non-compliance are promptly communicated to the appropriate level of management, or to those charged with governance. 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. For this reason, many public sector auditors communicate all identified instances of non-compliance to management.
- c) During the reporting phase, including issuing written reports on a timely basis to the intended users, the audited entity and others as appropriate

123. Some SAIs can, according to their audit mandate, order the audited entity to correct identified instances of non-compliance. In doing so, public sector auditors determine whether their independence and objectivity will be impaired, and take appropriate action to avoid such impairment.

124. Further relevant guidance on communication may be found in:

- ISSAI 1260
- INTOSAI's Implementation Guidelines for Performance Auditing Appendix 4
- IFAC's ISAE 3000

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

125. While detecting potential unlawful acts, including fraud, is normally not the main objective of performing a compliance audit, public sector 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.

126. In performing compliance audits, if public sector 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. Public sector auditors may consider consulting with legal counsel or appropriate regulatory authorities (ISSAI 300, 3.4.7). 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 organisational structures that exist internationally, it is up to the SAI to determine the appropriate action to be taken (ISSAI 400, 4.0.7b).

127. 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 public sector 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 organisations making such claims.
128. 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.
129. 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.
130. If suspicion of unlawful acts arises during the audit, public sector 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. Public sector 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. Public sector auditors may also report such incidents directly to the relevant law enforcement authorities.
131. Further guidance on considerations when dealing with suspected fraud may be found in:
  - ISSAI 1240
  - INTOSAI's Implementation Guidelines for Performance Auditing Part 3, Subsection – Compliance with laws and regulations

## **8 Evaluating Evidence and Forming Conclusions**

### **8.1 General Considerations on Evaluating Evidence and Forming Conclusions**

132. Public sector auditors evaluate whether the evidence obtained is sufficient and appropriate so as to reduce audit risk to an acceptably low level. This evaluation includes exercising professional judgement and professional skepticism, and consideration of evidence that both supports, and seems to contradict, the subject matter information.
133. Evidence obtained is evaluated in relation to identified materiality levels 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 (ISSAI 400, 4.0.19). SAIs 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.
134. Public sector auditors evaluate whether, based on the evidence obtained, there is reasonable assurance that the subject matter information is in compliance, in all material respects, with the identified criteria. Due to the inherent limitations of an audit, public sector auditors cannot be expected to detect all occurrences of non-compliance.
135. Public sector auditors' assessment of what represents a material compliance deviation is a matter of professional judgement and includes considerations of context as well as quantitative and qualitative aspects of the transactions or issues concerned.
136. 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

137. Some examples of compliance deviations and considerations related to materiality and forming conclusions are set out in Appendix 6.

138. Further guidance on forming conclusions may be found in:

- ISSAI 1700
- INTOSAI's Implementation Guidelines for Performance Auditing Section 4.5
- IFAC's ISAE 3000

## **8.2 Written Representations from Responsible Officials**

139. 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.

140. Further guidance on written representations may be found in ISSAI 1580.

## **8.3 Subsequent Events**

141. 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.

142. Further guidance on subsequent events may be found in:

- ISSAI 1560
- IFAC's ISAE 3000

## **9 Reporting**

143. Reporting is an essential part of a public sector 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. To this end, the Fundamental Auditing Principles state that a written report, setting out findings in an appropriate form, should be prepared at the end of each audit (ISSAI 400, 4.0.7a).
144. The principles of completeness, objectivity and timeliness are important in reporting on compliance audits. Public sector 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. This involves applying the principle of contradiction which involves checking facts with the audited entity and incorporating responses from responsible officials as appropriate.

### **9.1 Form and Content of Compliance Audit Reports**

145. The form of the written report may vary depending on the circumstances. However, some consistency in the auditor's report may help users of the report to understand the audit work done and conclusions reached, and to identify unusual circumstances when they arise.
146. 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.
147. 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 ISA 700.
148. Guidance is given below on the form and content of reports. For the practical purposes of these guidelines, the illustrative examples provided in Appendices 7-12 are short form reports. Due to the lengthy nature of long form reports, specific examples have not been included in the guidelines.

149. In cases where the mandate of the SAI establishes a form of reporting that differs from that envisioned in these guidelines, the guidelines may, nonetheless, be useful to public sector auditors and may be applied, adapted as appropriate in the particular circumstances.

### **9.1.1 Compliance Audit Reports**

150. In general, the compliance audit report itself includes the following elements (although not necessarily in the following order):

1. Title
2. Addressee
3. Objectives and scope of the audit, including the time period covered
4. Identification or description of the subject matter information (and where appropriate, the subject matter)
5. Identified criteria
6. Responsibilities of the various parties (legal basis)
7. Identification of the auditing standards applied in performing the work
8. A summary of the work performed
9. An opinion
10. Responses from the audited entity (as appropriate)
11. Recommendations (as appropriate)
12. Report date
13. Signature

151. Guidance on elements of a compliance audit report that warrant significant consideration by public sector auditors are set out below.

#### **9.1.1.1 Identified Criteria**

152. 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 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.

153. 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.

#### 9.1.1.2 Opinions and Conclusions

154. For items tested for compliance based on a reasonable assurance audit, the conclusion is expressed clearly as a statement of positive assurance. When compliance audit is performed together with the audit of financial statements, the conclusion may take the form of an opinion (see section below on reporting on compliance audit related to the audit of financial statements). The nature of the wording may be influenced by the mandate of the SAI and the legal framework under which the audit is conducted.
155. Where no material instances of non-compliance have been identified, the conclusion is unqualified. An example of the form for an unqualified opinion or conclusion (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 information] is in compliance, in all material respects, with [the applied criteria].'*
156. Public sector auditors modify their conclusions 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 information 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 information is not in compliance...'*);  
or
  - b) 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...'*)

157. Public sector auditors provide information as to the reasons for the modified conclusions. 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 conclusion and that describes the basis for that conclusion.
158. 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).

Examples are set out in Appendix 11.

#### **9.1.1.3 Responses from the Audited Entity**

159. 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 public sector auditing. It relates to the presentation of weaknesses or critical findings in such a way as to encourage correction (ISSAI 400, 4.0.20 and 4.0.24). 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.

#### **9.1.1.4 Providing Constructive Recommendations**

160. The Fundamental Auditing Principles also emphasize the need for reports to be constructive. This means that the auditor's 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 public sector auditor's objectivity may be impaired in future audits. (ISSAI 400, 4.0.4, 4.0.20 and 4.0.25)

#### **9.1.1.5 Report Date**

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

#### **9.1.1.6 Signature**

162. 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.

#### **9.1.1.7 Limited Assurance Reports**

163. These guidelines are written from the perspective of reasonable assurance audits. However, on an exceptional basis, they may be applied, adapted as appropriately, to limited assurance reviews. As explained in the scope section of these guidelines, in a limited assurance review, 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].'*

164. Limited assurance reviews require a sufficient amount of work to be done in order to express a conclusion, albeit less work than that necessary to express a conclusion with reasonable assurance. Nonetheless, public sector auditors evaluate whether sufficient, appropriate audit evidence has been obtained in order to express a limited assurance conclusion.

165. 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. An example of an auditor's report with a reasonable assurance opinion on the financial statements and a limited assurance conclusion on compliance is set out in Appendix 12.

#### **9.1.1.8 Incidental Findings**

166. Public sector 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 public sector 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 reasonable 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.

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

167. 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. Further guidance on separate compliance audit reports is provided in ISSAI 4100. Sample reports including compliance opinions are set out in Appendices 7-11.

### **9.1.2.1 Unmodified Compliance Opinions**

168. 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.

### **9.1.2.2 Modified Compliance Opinions**

169. 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).

170. 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.

171. When the compliance opinion is modified, the reasons for the modification are explained in an appropriate 'Basis for the Modified Opinion' paragraph. Some examples of modified compliance opinions are provided in Appendices 8-10.

172. 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.

### **9.1.2.3 Additional Reporting Considerations**

173. 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. Further guidance on compliance audit special reports is set out in ISSAI 4100.

174. 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.

175. Further guidance on reporting may be found in:

- ISSAI 1700, 1705 and 1706
- INTOSAI's Implementation Guidelines for Performance Auditing Part 5
- IFAC's ISAE 3000 and International Standard on Review Engagements 2400

## **9.2 Follow-up Processes**

176. The Fundamental Auditing Principles place emphasis on the reporting of constructive recommendations and additional follow-up as necessary in regard to correction of identified weaknesses (ISSAI 400, 4.0.26). 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.

177. Further guidance on follow-up processes may be found in:

- INTOSAI's Implementation Guidelines for Performance Auditing Part 5.5

## **10 Additional Guidance for Public Sector Auditors Operating in a Court of Accounts Environment**

178. Because of the jurisdictional status conferred on SAIs that operate in a Court of Accounts environment, such SAIs have the power to exercise judgements and decisions over the accounts and over responsible persons, including accountants and administrators (ISSAI 100, 1.0.21).

### **10.1 Performing Audits in a Court of Accounts**

179. When performing compliance audits of individual public accounts or of the general state budget, public sector auditors in a Court of Accounts environment also:

- a) Obtain reasonable assurance about whether the information presented in the individual public accounts and the underlying transactions are in compliance, in all material respects, with the authorities that govern them
- b) Determine whether the execution of the state budget has been carried out in compliance, in all material respects, with the authorities governing it and with individual public accounts, and
- c) Report the findings to the appropriate parties

180. The unique jurisdictional status described above may also give rise to the need for additional considerations by public sector auditors operating in a Court of Accounts environment when planning and performing compliance audits. Such matters may include:

- a) Identifying the person(s) who may be held responsible for acts of non-compliance due to the potential legal implications the SAI's judgement may have on such persons. Public officials may be held personally liable for the loss or waste of public funds, requiring them to repay the full amount of any such losses.
- b) Taking into consideration the applicable prescriptive period, the actions interrupting prescription of personal liability and the exact time period for which public officials may be held liable.
- c) Distinguishing personal liability for acts of non-compliance from the liability for unlawful acts (suspected fraud). For unlawful acts there may be a need to perform additional audit procedures.
- d) Liaising with prosecutors and police as appropriate in understanding the audited entity and its environment, assessing risks of non-compliance, dealing with instances of non-compliance that may indicate fraud, and reporting on such matters

- e) Considering the need for additional levels of, or more formalised procedures for quality control
- f) Performing inquiry in written form (as opposed to orally)
- g) Ensuring that audit documentation complies with relevant rules of evidence
- h) Communicating in a highly formalised manner
- i) Including in the report the explicit criteria against which public officials may be held liable, including any amounts likely to be involved
- j) Considering the most appropriate form of conclusions, including recommendations, identification of damages, or court orders that may lead to a formal discharge of responsibility or to a formal determination of liability

## **10.2 Communicating and Enforcing the Law**

181. Public sector auditors in Court SAIs also communicate compliance issues that may result in legal action, damages or prosecution for a criminal offence to the judge, attorney or section responsible for dealing with judgement issues within the Court, or to other bodies as appropriate. In addition, Court SAIs may also communicate remarks of a more general, or informative nature resulting from the audit work to appropriate officials of the audited entity.

182. When enforcing the law regarding public officials, decisions taken by Court SAIs are subject to:

- a) Due process of law and public hearing
- b) Public disclosure
- c) Communication to appropriate law enforcement authorities when there is evidence of a criminal offence

## **10.3 Processes in Various Models of Courts of Accounts**

183. For SAIs operating in a Court of Accounts environment, the work performed may involve various phases including audit, instruction and formal judgement.

184. Some SAIs operating in a Court of Accounts environment follow the audit process as it is described in these guidelines. However, following the planning, performance and evidence gathering phases, there may then be additional and specific issues that may lead to opening the process of instruction and to a final formal judgement.

185. In the event a judge or attorney decides on instructing a case, the objective of instruction is to gather enough evidence on the guilt or innocence of the public official who allegedly caused a damage, so as to allow a judgement to be made.
186. In some SAIs operating in a Court of Accounts environment, the auditors may also act in the role of judges and may be empowered to both audit and give formal judgements. In these cases, the instruction phase is an integral part of the audit planning, performance and evidence gathering phases, such that the audit is planned with a view to covering all these phases.

## Appendix 1 - Examples of Subject Matters, Subject Matter Information and Criteria in Compliance Auditing

The follow table is intended to give examples of subject matters, subject matter information and relevant criteria. The list is not intended to be an exhaustive overview. The particular subject matter, subject matter information and criteria will vary depending on a variety of matters such as the mandate of the SAI and the objective of the particular audit.

	Subject matter	Subject matter information	Criteria
1	<p>Financial performance and use of appropriated funds</p> <p>This may involve budget execution, including testing that funds have been used in accordance with the purposes and intentions as decided by the legislature. In many SAIs this type of compliance audit may be related to regularity audit, including the audit of financial statements.</p> <p>More specific guidance on this particular topic is included in Appendix 1-A.</p>	Financial information such as financial statements	<p>Relevant budget legislation such as an appropriations act</p> <p>Approved budget</p>
2	<p>Financial performance, for example revenues in the form of:</p> <ul style="list-style-type: none"> <li>• project funds from donor agencies</li> <li>• funds from federal governments</li> <li>• other similar types of funds</li> </ul> <p>and how they have been used</p>	Project financial information / project accounts	<p>Relevant legislation relating to use of federal government funds (eg a 'single audit act')</p> <p>The mandated activities of the audited entity</p> <p>The terms of the funding agreement</p>

	<b>Subject matter</b>	<b>Subject matter information</b>	<b>Criteria</b>
3	Financial performance, for example revenues in the form of grants, and how the revenues have been used	Financial information related to the use of the grant	The mandated activities of the audited entity  The terms of the grant agreement
4	Financial performance, for example revenues or expenditures in accordance with a contract or loan agreement, and how they have been used	Financial information related to the contract or loan agreement	The terms of the contract or loan agreement
5	Procurement	Financial information	Relevant procurement legislation and regulations (national and international)  The terms of a contract with a supplier
6	Expenditures	Financial information  Statement of compliance	Relevant budget legislation such as an appropriations act  Other relevant legislation  Relevant ministerial directives, government policy requirements and resolutions of the legislature  The terms of a contract
7	Program activities	Activity indicators or reports	Relevant agreed levels of performance such as those set out in laws and regulations, ministerial directives, goals agreed by the legislature or the entity, international treaties, protocols, conventions or agreements, a service level agreement, the terms of a contract, generally established industry standards, or reasonable public expectations.

	Subject matter	Subject matter information	Criteria
			<p>For example:</p> <ul style="list-style-type: none"> <li>• number of kindergarten places related to number of eligible children</li> <li>• number of qualified nurses and doctors per number of citizens</li> <li>• number of miles of road paved</li> <li>• number of months required to process benefit payments or building permits</li> <li>• frequency and quality of accounting information to be provided by a service organisation</li> <li>• number of building inspections to be performed within a particular time period</li> <li>• measures of results related to water quality, etc.</li> </ul>
8	Service delivery	<p>A statement of service delivery</p> <p>Publicly reported information</p>	Relevant legislation or directives
9	Probity of a public administrative decision	<p>Citizen complaints register</p> <p>Publicly reported information</p>	Relevant legislation or directives
10	Corporate Social Responsibility (CSR), for example the audit of publicly funded projects in developing countries	A statement of compliance with CSR (or lack thereof)	Relevant legislation or directives in areas such as human and civil rights, gender equality, workplace, environment, etc.
11	Behaviour / Propriety	A statement of compliance, for example a statement of independence (legal competence).	<p>Relevant legislation or directives covering behaviour of public sector officials</p> <p>A code of ethics or internally</p>

	Subject matter	Subject matter information	Criteria
		In the public sector this 'statement' may sometimes be implicit and related to the concepts of probity and propriety. (see section on criteria above).	<p>developed code of conduct.</p> <p>Stated values or leadership principles</p> <p>Internal policies, manuals and guidelines</p> <p>The terms of reference of the organisation, the bylaws or similar</p> <p>The terms of a contract (eg agreed confidentiality or quarantine arrangements subsequent to certain employment situations)</p>
12	Membership obligations	A statement of compliance	Agreed terms of membership
13	Processes related to health and safety	A statement of compliance  Financial transactions	<p>Relevant occupational health and safety legislation, for example, related to handicap access</p> <p>Policies, processes, manuals, guidelines etc</p>
14	Processes related to environmental protection	A statement of compliance  Financial transactions	<p>Relevant environmental legislation, for example, related to water quality, waste disposal or carbon emissions levels</p> <p>The terms of international environmental treaties, protocols, conventions or agreements</p> <p>Policies, processes, manuals, guidelines etc</p>
15	Internal control processes	A statement of compliance	An internal control framework, for example COSO, CoCo <sup>1</sup> or

<sup>1</sup> COSO – Committee of Sponsoring Organizations of the Treadway Commission. CoCo = Criteria of Control Board, The Canadian Institute of Chartered Accountants.

	Subject matter	Subject matter information	Criteria
		Financial transactions	similar, or internal control requirements set out in relevant legislation or generally accepted within a jurisdiction  Policies, processes, manuals, guidelines etc
16	Processes particular to the entity's activities and operations, such as payment of pensions or social benefits, processing passport or citizenship applications, assessing fines or other forms of penal sentences	A statement of compliance  Financial transactions	Relevant legislation or directives  Policies, processes, manuals, guidelines etc
17	Physical characteristics	A specifications document or the physical object itself	A building code (size, height, purpose, density measures for a particular zoned area, etc)  The terms of a construction contract, or other type of contract
18	Tax revenues, taxpayer obligations or other obligations involving reporting to regulatory authorities	Individual or corporate tax returns  Other tax forms submitted to regulatory authorities (such as VAT forms, reporting forms for agencies operating within regulated industries such as banking and finance, pharmaceuticals, etc)	Relevant legislation or industry specific codes  A tax code, revenue code or similar

## **Appendix 1-A – Examples of Audit Criteria when Compliance Audit is Performed together with the Audit of Financial Statements**

The following are illustrative examples of audit criteria that may be applied when examining whether the income and expenditures of the audited entity are in compliance with authorities, including budget legislation.

### **Income and revenues**

1. constitutional provisions or other basic principles concerning the government's authority to impose taxes, demand fees or sell goods and services or real estate
2. provisions of tax law determining the object of taxation
3. provisions on the calculation of taxes, custom duties and other levies
4. provisions on the systems and procedures to withhold and collect taxes
5. provisions on tax control
6. provisions and principles of budgetary, competition or other law regulating sales of goods and services or real estate by public authorities
7. provisions and principles on the proper calculation of prices and fees
8. budget appropriations to obtain income
9. provisions or common practice that serves to prevent corruption and ensure that sales of goods, services and real estate are processed through transparent procedures in accordance with principles of legality and equality
10. principles that serve to maximize revenue and prevent loss of payments
11. provisions and principles regarding the terms of payment, the access to give credit, demand guarantees and on the collection of debts

### **Operational expenditures**

1. principles that serve to ensure economy and efficiency by optimizing the number and composition of the staff
2. provisions regulating the salaries, pension and other remuneration of staff
3. provisions regulating the number and categories of staff that may be employed
4. provisions and principles on reimbursement of personal expenses of staff
5. provisions and principles of budgetary, competition or other law on the procedures of public procurements
6. provisions and principles for acquiring goods and services
7. principles on rights and obligations in contracts and provisions of agreements with suppliers of goods and services
8. provisions, principles and common practice limiting the use of funds for external representation or internal staff purposes
9. provisions and principles regarding housing rents, and rental and leasing of goods
10. provisions and common practice regarding the procedures for processing of payments and internal controls

**Expenditure on construction, infrastructure, IT-systems and other large scale investments (in addition to operational expenditure)**

1. provisions in regard to feasibility studies, projecting and budgeting
2. provisions and principles of sound management of public funds concerning public tenders and the choice of suppliers
3. industry standards and standard contracts
4. principles concerning contracting provisions, sound project management and budget control
5. provisions and principles of adequate quality management in the construction/development phase and at deliverance
6. measures against corruption and uncompetitive behaviour

**Grants, entitlements, guarantees and other financial contributions to enterprises, organisations or individuals**

1. provisions on the purpose of the scheme and limits on how the funds may be used
2. principles of equality, objectivity and transparency in the process of inviting applications and allocating grants
3. criteria of eligibility
4. provisions regarding accounting, control and audit of recipients
5. conditions imposed by the administration's decisions or agreements with beneficiaries
6. provisions on the coverage of guarantees and the conditions under which they should be paid
7. provisions on calculation of amounts
8. provisions on the process of payment including conditions concerning advance payments, subsequent reimbursements and/or the final settlement

## **Appendix 2 – Examples of Sources to be used in Gaining an Understanding of the Audited Entity and Identifying Suitable Criteria**

The following is an illustrative, but not exhaustive list of sources that public sector auditors may use in identifying suitable audit criteria:

- a) Laws and regulations, including the documented intentions and premises for establishing such legislation
- b) Budgetary legislation / approved budget or appropriations
- c) Documents of the legislature related to budgetary laws or resolutions, and to the premises or particular provisions for use of approved appropriations, or for financial transactions, funds and balances
- d) Legislative or ministerial directives
- e) Information from regulatory authorities
- f) Official records of meetings of the legislature, public accounts committee or similar committee of the legislature, or other public bodies
- g) Principles of law
- h) Legal precedent
- i) Codes of practice or codes of conduct
- j) Internal descriptions of policies, strategic and operational plans and procedures
- k) Manuals or written guidelines
- l) Formal agreements, such as contracts
- m) Loan or grant agreements
- n) Industry standards
- o) Well established theory (for example theory for which there is general consensus. Such theory may be obtained, for example, from published information such as technical literature and methods, professional journals, etc, or through inquiry with knowledgeable sources such as experts in a particular field)
- p) Generally accepted standards for a particular area (such standards are normally clearly identifiable standards that have their source in some form of legislation)

and that are a result of established practice and legal precedent, for example 'generally accepted accounting principles' in a particular country)

- q) For audits of propriety: Principles for sound public sector financial management and conduct of public sector officials. Principles of conduct may arise from the legislature's or public expectations regarding the behaviour of public sector officials. In some cases, these principles may be documented in only fragmentary ways. They may, in some cases, only be defined as a result of their breach.

Additional sources which public sector auditors may use to obtain an understanding about the audited entity, its environment and relevant program areas may include:

- a) The entity's annual report
- b) Legislative propositions and speeches
- c) Websites
- d) Published reports, articles in newspapers or journals, other media sources, etc
- e) Knowledge obtained from previous audits
- f) Information gathered through meetings and other communication
- g) Minutes of Board or other management meetings
- h) Internal audit reports
- i) Official statistics

## **Appendix 3 – Examples of Factors Related to Assessing Risk in Compliance Auditing**

The following are examples of factors that may be considered in assessing risk in a compliance audit. The list is not intended to be exhaustive, and the factors will depend on the particular audit circumstances.

### **The Audited Entity's Objective and Mandate**

1. Are the audited entity's objective, mandate and legal capacity clearly stated and readily available?
2. Have there been recent changes in mandate, objectives or program areas?
3. Are program areas or relevant subject matters clearly identifiable?
4. Do program areas overlap considerably with other entities such that there is a risk of duplication or of fragmentation?

### **Organisational Structure**

1. What is the legal basis of the entity (ministry, directorate, agency etc) and from where does it derive its authority?
2. Does the audited entity have clearly defined roles and responsibilities, and related authority attaching to these?
3. Are these roles, responsibilities and authorities clearly communicated and understood throughout the entity?
4. If the entity is part of a hierarchic structure, and another entity is responsible for supervision of the audited entity, how does such supervision take place?
5. Does the organisation focus on risk assessment and risk management, including risks of non-compliance, in its operations?
6. Have there been recent organisational changes?
7. Are any activities outsourced to other entities?
8. If activities are outsourced, how is compliance and performance monitored?
9. Are there other potential risks associated with outsourcing?
10. Do personnel have adequate competence and ethical behaviour?
11. Do personnel seek relevant information and is relevant information easily accessible?
12. Is information communicated on a timely basis in the organisation?
13. Are there any aspects of organisational structure that could give rise to greater risk of fraud?

## **Political Considerations**

1. To which level of government does the particular entity belong and does it have relations to other levels of government?
2. What are the responsibilities (constitutional or other) of the relevant minister, or of entity management?
3. What is experience in dealing with the entity's political vs. administrative management?
4. Is there political consensus, or are differing views freely expressed?
5. How is the political management comprised?
6. What are program areas of political focus, visibility and sensitivity?
7. How does the working relationship between political and administrative management function?
8. Are there any areas of particular public interest?
9. What is experience in relation to one entity exercising unfavourable influence on other related entities in the public sector hierarchy?
10. Are there any political considerations that could give rise to greater risk of fraud?
11. Do laws and regulations contain requirements for political neutrality related to the use of resources and funds, and what is past experience in this area?

## **Laws, Regulations and Other Relevant Authorities**

1. Is it clear which laws, regulations and authorities apply to the audited entity and the particular subject matter?
2. Are there overlaps or inconsistencies between different sets of legislation?
3. Is the entity a lawmaking body, and if so what impact can the lawmaking process have on the rights of individuals?
4. If the entity is a lawmaking body, has it delegated any authority to other entities, such as regulatory authorities or private sector entities?
5. Is relevant legislation relatively new, or is it well established?
6. If new, is it clear in terms of form and content such that it may be clearly understood and applied?
7. If well established, has legal precedent been consistent such that the legislation is clearly understood and applied?
8. Is the relevant program area subject to significant application of judgement in its operations?
9. If a significant amount of judgement is applied, is this done in accordance with the intentions behind the laws and regulations?
10. If a significant amount of judgement is applied, is it applied consistently?
11. Are other bodies involved in interpreting or supplementing the relevant legislation?
12. Has the entity carried out its duties on a timely basis such that individual rights have not been compromised, and there have not been significant negative financial consequences due to passiveness?
13. Have channels for complaints and appeals for affected parties been used appropriately?
14. Have any individual's / organisation's rights been compromised in any way through the entity's interpretation and application of particular legislation or regulations?

15. Are there any aspects of laws, regulations or other authorities that could give rise to greater risk of fraud?

### **Significant Events and Transactions**

1. Are there any significant events or transactions that may give rise to significant risks or fraud risks (eg significant procurement contracts, long term construction contracts, dealings in financial instruments such as foreign exchange contracts, significant loans or financial speculation, privatisation etc)?
2. Does the entity possess the necessary authority and competence to enter into and carry out significant events and transactions?
3. Have experts been engaged in connection with significant events and transactions?
4. If experts have been engaged, what precautions have been taken to ensure their competence and objectivity?
5. How is the work of experts monitored?

### **Management**

1. Is there stability in the management team or have there been changes in key personnel?
2. How are members of management recruited (open and transparent processes with real competition, or token process)?
3. Is management actively involved in assessing risk on a continual basis?
4. Has management considered the consequences of changes in the entity's environment and the impact this may have on the audited entity?
5. Is management conservative in its approach or more willing to take risks (eg what is the 'risk appetite')?
6. What initiatives has management taken to identify and avoid significant risks that could have an adverse impact on the entity?
7. Are risk evaluations that are performed throughout the entity effectively communicated to management at the appropriate levels?
8. Does management actively monitor and evaluate the consequences of their decisions and actions?
9. Have previous audits identified instances of non-compliance, fraud, unlawful acts, unethical behaviour, management bias, etc?
10. How does management balance the achievement of program objectives with the need to manage risk, and ensure compliance with laws and regulations etc?

## Appendix 4 - Examples of Risk Factors Related to a Particular Subject Matter

Procurement is a typical subject matter for compliance audits. The following table gives some examples of risk factors relating to a compliance audit of procurement. The list is not intended to be exhaustive. The relevant risks and risk factors will vary depending on the subject matter and the circumstances of the particular audit.

<b>Examples of Risk Factors Related to the Audit of Procurement</b>	
<b>Inherent risk</b>	
1	Lack of relevant procurement legislation
2	Recent changes to the procurement legislation (eg to conform to international legislation)
3	Complex or unclear legislation, or legislation open for interpretation
4	Significant monetary amounts are involved such as defence procurement
5	Audit findings from the prior year revealed compliance deviations in regard to procurement legislation and directives
6	Previous suspicions or instances of fraud and corruption involving management and key staff
7	Inspections by regulatory authorities (eg competition authorities)
8	Complaints received from potential suppliers about unfair practices related to awarding tenders
9	Potential conflicts of interest
<b>Control risk</b>	
1	Lack of good internal guidelines, including lack of clear and objective criteria
2	Recent changes in general or application controls related to procurement IT systems
3	Poor quality-control or weak monitoring activities related to suppliers
4	Weak or non-existent controls regarding suppliers' compliance with ethical guidelines
5	Non-existent or poor quality monitoring activities related to compliance with relevant legislation
<b>Detection risk</b>	
1	Audit procedures are ineffectively designed (eg performing procedures that only involve checking transactions that are recorded, and not checking for completeness; or making inquiries only of staff in the procurement department and not of others such as administration or facilities management staff, suppliers or agencies that register complaints)
2	Incentives may lead management to intentionally withhold or conceal evidence (for example, suppliers may make bribes or give kickbacks)

3	Possible management collusion or override of controls
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## Appendix 5 - Examples of Compliance Audit Procedures for Selected Subject Matters

This table shows illustrative examples of possible compliance audit procedures in the areas of environmental legislation and project funds from donor organisations. It is not intended to be an exhaustive list of procedures. Audit procedures must be designed for the particular audit circumstances and objectives.

<b>Sample audit procedures</b>	
<b>Subject matter: Environmental legislation</b>	
1	Obtain an overview of relevant environmental legislation to which the entity is required to adhere.
2	Inquire with management, and internal audit as applicable, as to the processes and routines in place to ensure compliance with relevant environmental legislation.
3	Review manuals and systems descriptions to understand the processes and relevant controls. Document the process and identify key controls. Test key controls as necessary.
4	Perform a media search, and other databases as applicable, to identify previous instances of non-compliance by the entity.
5	Review any inspection reports, including those of internal audit as applicable. Follow up any areas that may indicate significant risks of non-compliance with environmental legislation.
6	Confirm that the audited entity has necessary permits and registration certificates as appropriate. Evaluate procedures to ensure that these remain valid and up to date.
7	Review minutes of meetings of environmental, or health and safety committees. Follow up as necessary.
8	Interview selected staff as to their understanding of relevant policies and procedures in place, including training, and how these procedures operate in practice.
9	Inquire with management, and legal counsel as appropriate, as to any previous, existing or potential environmental liability claims. Consider the causes and effects/impacts of any such claims.
10	Observe processes and routines in practice (eg waste disposal – properly stored and disposed of, etc) and document appropriately (eg photo or video evidence may be relevant)

## Sample audit procedures

### Subject matter: Project funds received from a donor organisation

1	Obtain an overview of the funding agreement and any relevant legislation, directives, mandates, etc to which the entity is required to adhere.
2	Inquire with management, and internal audit as applicable, as to the processes and routines in place to ensure compliance with the terms of the funding agreement and relevant legislation, directives, mandates, etc. Inquire as to routines to ensure appropriate accounting and disclosure.
3	Review manuals and systems descriptions to understand the processes and relevant controls related to compliance with such funding agreements. Document the process and identify key controls. Test key controls as necessary.
4	Perform analytical procedures for assessing risks, and substantive procedures as considered necessary. For example, compare any financial information, including project accounts, with budget and prior year(s). Follow up suspected deviations as necessary in the circumstances. Review project accounts for unusual or significant transactions. Follow up as necessary.
5	Select a sample of transactions related to project funds. For each transaction selected, test compliance with the terms of the funding agreement and any relevant legislation, for example: <ul style="list-style-type: none"><li>• requirements related to use of funds</li><li>• proper approval and authorization</li><li>• reporting requirements</li><li>• proper accounting and disclosure, including appropriate accounting policies and recording transactions in the appropriate periods, etc.</li></ul>
6	Where project funds have been used for specific purposes, assess the need to perform physical inspections. Follow up as appropriate.
7	Review related correspondence, minutes of meetings etc to identify any relevant matters. Follow up as necessary.
8	Consider the need to obtain any written confirmations from third parties and follow up as appropriate.
9	Consider the need to obtain specific written representations from management in regard to the funding agreement.
10	Perform cut-off testing and review after the period end as necessary to ensure funds are accounted for in the appropriate period.

## Appendix 6 - Examples of Compliance Deviations

The following table provides some examples of compliance deviations and includes considerations related to materiality and forming conclusions. The comments related to materiality and forming conclusions are not intended to be definitive assessments of whether the particular example constitutes a material compliance deviation or not, but rather to highlight relevant considerations. The determination of materiality will depend on the particular circumstances and the professional judgement of the public sector auditor.

Example of Compliance Deviation		Considerations Related to Materiality and Forming Conclusions
1	During the year, a government agency received budget appropriations through the Ministry of Education for national educational purposes. The agency's grant expenditure for the year included \$10 million to overseas high tech manufacturers.	Based on the legislation governing the government agency, the agency did not have the power to make grants to overseas bodies. The non-compliance may be material because the grant expenditure was paid out to overseas bodies and was therefore not in compliance with relevant authorities, nor was it applied to the purposes intended by the legislature.
2	During the year, a government agency incurred expenditures of \$100 in excess of the total expenditure of \$5000 authorised by the budget approved by the legislature.	In this case, actual expenditures were in excess of amounts authorised through the approved budget. This non-compliance may be material because it was a clear violation of clearly established authorities. Depending on the circumstances, including the type of expenditures, it may also be very sensitive in nature.
3	A citizen is entitled to a monthly pension of \$1000. The government agency has only been paying out \$900 per month. The payments were also made after the dates stipulated in the legislation.	Although the monetary amounts involved may not be material to the financial statements of the government agency, the consequences of the non-compliance are likely to be very significant to the individual pensioner living on a fixed income. If the non-compliance is due to a system weakness, the non-compliance may also affect many other citizens. The non-compliance may therefore be material in terms of the impact on citizens and society in general.
4	A single mother is entitled to monthly child benefits for each child under age 18. The government agency has paid out	While this compliance deviation may have been positive for the recipient, it is not in accordance with the legislation and its intentions, and may therefore be unfair to other beneficiaries. If the

<b>Example of Compliance Deviation</b>	<b>Considerations Related to Materiality and Forming Conclusions</b>
	<p>child benefits for a 19 year old child.</p> <p>non-compliance is due to a system weakness, the non-compliance may also affect many other citizens. The non-compliance may therefore be material in terms of the impact on citizens and society in general.</p>
<p>5</p> <p>The terms of a building code require annual inspections to be performed. The government agency has not performed inspections for the past five years.</p>	<p>The non-compliance may be significant due to qualitative aspects such as safety implications. Although no particular monetary amounts are involved, the non-compliance may be material due to the potential consequences it may have on the safety of the building occupants. In the event of a disaster, there is also a risk that the non-compliance may result in significant liability claims which could have material financial implications for the government agency as well.</p>
<p>6</p> <p>The terms of a funding agreement state that the recipient of the funds must prepare financial statements and send them to the donor organisation by a certain date. The financial statements have not been prepared and sent by this date.</p>	<p>The non-compliance may or may not be material depending on whether or not the financial statements were subsequently prepared and sent, the extent of the delay, the reasons for the delay, any consequences that may arise as a result of the non-compliance, etc.</p>
<p>7</p> <p>Significant system weaknesses were identified in relation to revenues collected in accordance with a tax code. The weaknesses were due to incorrect interpretation of the tax code by the audited entity. Numerous instances of taxpayers being assessed more than they were obligated to pay were identified.</p>	<p>This type of compliance deviation relates to the due process rights of individual citizens. Certain citizens were being assessed too much tax, while others were not being assessed at all. Depending on the circumstances, and because it involves a system weakness, the deviation may be both material and pervasive, in which case an adverse opinion on compliance would be appropriate.</p>

## **Appendix 7 – Example of a Compliance Audit Opinion as part of the Auditor's Report on the Financial Statements**

As explained in the body of this document, the reporting format may vary depending on the mandate of the SAI, relevant legislation, customary reporting practices, the complexity of the issues to be reported, etc. However, some consistency in the reporting format may help users of the auditor's report to understand the work performed and the conclusions reached, as well as to identify unusual circumstances when they arise.

The following 'short form' report example is for illustrative purposes only. Some SAIs may use a 'long form' report where findings are described in more detail in the body of the report, before the conclusion or opinion section. The form and content of the opinion section may also vary depending on the particular mandate of the SAI.

### **Audit Report by the SAI of XXX**

[Appropriate Addressee, eg Legislature, Parliament, etc]

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of government agency ABC, which comprise the statement of financial position as at December 31, 20X1, and the statement of financial performance, statement of changes in net assets/equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

According to [*State name of legislation/regulations setting out management's responsibilities*], management is responsible for the preparation and presentation of these financial statements<sup>2</sup> in accordance with [*State the applicable accounting standards: International Public Sector Accounting Standards, generally accepted government accounting principles for country XYZ, etc*]. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

#### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with [*State the applicable auditing standards: for*

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<sup>2</sup> Wording is based on ISA 700 and compliance frameworks common in the public sector. For wording in relation to fair presentation frameworks, see ISA 700.

*example the INTOSAI Fundamental Auditing Principles and Guidelines, International Standards on Auditing<sup>3</sup>, generally accepted government auditing standards for country XYZ, etc]. Those standards require that we comply<sup>4</sup> with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.*

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, internal control relevant to the entity's preparation and presentation of financial statements is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of internal control.<sup>5</sup> An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the financial statements.

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

### *Opinion*

In our opinion, the financial statements of government agency ABC for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with *[State the applicable accounting standards: International Public Sector Accounting Standards, generally accepted government accounting principles for country XYZ, etc]*.

### **Report on Other Legal and Regulatory Requirements**

[Form and content of this section of the auditor's report will vary depending on the nature of the auditor's other reporting responsibilities.]

*[In some jurisdictions, the auditor may have additional responsibilities to report on other matters that are supplementary to the auditor's responsibility to express an opinion on the financial statements, as described in ISA 700, paragraphs 35-36 and A37-A38.]*

### **Report on Compliance**

*[Note: The form and content of this part of the audit report will vary with the circumstances and depending on the SAI's mandate and other reporting responsibilities].*

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<sup>3</sup> Auditors may not state compliance with ISAs unless auditors have complied with ISA 200 and all ISAs relevant to the audit. If stating compliance with ISAs, auditors are directed to ISA 700 for more specific wording.

<sup>4</sup> Wording to be adapted as necessary based on the standards / guidance applied

<sup>5</sup> Wording to be revised appropriately if an opinion on internal control is to be expressed

### *Management's Responsibility for Compliance*

In addition to the responsibility for the preparation and presentation of the financial statements described above, management is also responsible for ensuring that the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.

### *Auditor's Responsibility*

In addition to the responsibility to express an opinion on the financial statements described above, our responsibility includes expressing an opinion on whether the activities, financial transactions and information reflected in the financial statements are, in all material respects, in compliance with the authorities which govern them. This responsibility includes performing procedures to obtain audit evidence about whether the agency's expenditure and income have been applied to the purposes intended by the legislature. Such procedures include the assessment of the risks of material non-compliance.

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

### *Opinion on Compliance*

In our opinion, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.

[Include responses from the audited entity as appropriate, for example after the Opinion paragraph, in summary under a heading 'Responses from the Audited Entity,' or as a separate appendix]

[Include constructive recommendations as appropriate, for example after the Opinion paragraph, in summary under a heading 'Recommendations' or as a separate appendix]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]

## **Appendix 8 – Example of a Qualified Opinion on Compliance**

This example reflects the situation where there has been non-compliance with authorities, in particular the relevant legislation and the purposes and intentions of the legislature. The auditor has determined that the effects are material, but not pervasive. The introductory sections of the report, and sections following the compliance opinion, are unchanged from the example in Appendix 7.

..... *[appropriate introductory sections of the report]*.....

### **Report on Compliance**

..... *[appropriate introductory text]*.....

#### *Basis for Qualified Opinion on Compliance*

During the year, government agency ABC received budget appropriations through the Ministry of Education for national educational purposes. Our audit revealed that grant expenditure for the year included \$10 million to overseas high tech manufacturers.

Based on *[the legislation governing the audited entity]*, government agency ABC did not have the power to make grants to overseas bodies. The expenditure related to grants paid out to overseas bodies has not been applied to the purposes intended by the legislature and is therefore not in compliance with the authorities which govern it.

#### *Opinion on Compliance*

In our opinion, except for the expenditures to overseas bodies as described in the Basis for Qualified Opinion on Compliance above, in all material respects the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.

..... *[appropriate concluding sections of the report]*.....

## **Appendix 9 – Example of an Adverse Opinion on Compliance**

This example reflects the situation where there has been non-compliance with authorities, in particular the relevant legislation and the purposes and intentions of the legislature. The auditor has determined that the effects are material and pervasive. The introductory sections of the report, and sections following the compliance opinion, are unchanged from the example in Appendix 7.

..... *[appropriate introductory sections of the report]*.....

### **Report on Compliance**

..... *[appropriate introductory text]*.....

#### *Basis for Adverse Opinion on Compliance*

During the year, government agency ABC paid out social welfare benefits totaling \$500 million. Pension payments accounted for 90% of the total welfare benefits paid out. The financial statements fairly reflect the amounts paid out. However, weaknesses identified in the controls surrounding the IT systems used for making pension payments revealed that the payments were not being made on a timely basis in accordance with *[State the relevant social welfare legislation, regulations, etc]*. The consequence of this weakness may be a breach of the legal rights of eligible pensioners.

#### *Opinion on Compliance*

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion on Compliance paragraph above, the activities, financial transactions and information reflected in the financial statements are not in compliance with the authorities which govern them.

..... *[appropriate concluding sections of the report]*.....

## Appendix 10 – Example of a Disclaimer on Compliance

This example reflects the situation where the auditor has not been able to obtain sufficient, appropriate audit evidence in regard to expenditures being in compliance with authorities, in particular the relevant legislation and the purposes and intentions of the legislature. The auditor has determined that the effects are material and pervasive. The introductory sections of the report, and sections following the compliance opinion, are unchanged from the example in Appendix 7.

..... *[appropriate introductory sections of the report]*.....

### Report on Compliance

..... *[appropriate introductory text]*.....

#### *Basis for Disclaimer on Compliance*

During the year, government agency ABC received budget appropriations through the Ministry of Education for national educational purposes. Our audit revealed that grant expenditure for the year as reflected in the financial statements included \$10 million to a private research institution. This grant accounted for 90% of the total grant expenditures for the year.

The evidence available to us for determination of whether the grant expenditure was paid out in accordance with *[State the relevant legislation, regulations, etc]* was limited. Due to hurricane damage, government agency ABC was unable to provide sufficient documentation to demonstrate that the private research institution was eligible to receive such grants. There were no other satisfactory procedures we could carry out to determine if the payments were paid out in accordance with relevant legislation and therefore applied to the purposes intended by the legislature.

#### *Disclaimer on Compliance*

Because of the scope limitation described in the Basis for Disclaimer on Compliance paragraph above, we are unable to form an opinion as to whether the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.

..... *[appropriate concluding sections of the report]*.....

## **Appendix 11 - Example of an Emphasis of Matter and Other Matter(s) Paragraph**

In some situations there may be a need to elaborate on particular matters which do not affect the compliance opinion. An Emphasis of Matters or Other Matters paragraph is used in such circumstances as illustrated by the following examples. The introductory sections of the report, and sections following the compliance opinion, are unchanged from the example in Appendix 7.

..... *[appropriate introductory sections of the report]*.....

### **Report on Compliance**

..... *[appropriate introductory text]*.....

#### *Opinion on Compliance*

In our opinion, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities which govern them.

#### *Emphasis of Matter*

We draw attention to Note xx to the financial statements. This note explains the uncertainty related to the pending legal decision regarding the agency's interpretation of the requirements of environmental legislation dated xx.xx.20xx. Our opinion has not been qualified in respect of this matter.

#### *Other Matter*

We draw attention to the agency's compliance with procurement legislation dated xx.xx.20xx in force for agency ABC's jurisdiction. The terms of this legislation are contradictory to the terms of procurement legislation dated yy.yy.20yy, which is being implemented for all jurisdictions that are parties to the ZZZ general trade agreement. This includes agency ABC's jurisdiction. There is a need for the legislature to give this matter further attention such that necessary conforming amendments to procurement legislation dated xx.xx.20xx may be enacted.

..... *[appropriate concluding sections of the report]*.....

## **Appendix 12 – Example of an Auditor's Report on the Financial Statements with a Reasonable Assurance Opinion on the Financial Statements and a Limited Assurance Conclusion on Compliance**

These guidelines are written to provide guidance for public sector auditors reporting in the form of reasonable assurance opinions on an entity's compliance with authorities. However, as explained in the body of this document, the mandate of some SAIs limits the compliance audit opinion to stating whether transactions that have come to public sector auditors' attention in the course of discharging other audit responsibilities were carried out in compliance with authorities, or stating that no instances of non-compliance with authorities have come to their attention during the audit.

The following 'short form' report example is for illustrative purposes only for use in the small number of special situations where limited assurance is provided. Some SAIs may use a 'long form' report where findings are described in more detail in the body of the report, before the conclusion or opinion section. The form and content of the opinion section may also vary depending on the particular mandate of the SAI.

### **Report by the SAI of XXX**

[Appropriate Addressee, eg Legislature, Parliament, etc]

#### **Report on the Financial Statements**

We have audited the accompanying financial statements of government agency ABC, which comprise the statement of financial position as at December 31, 20X1, and the statement of financial performance, statement of changes in net assets/equity and cash flow statement for the year then ended, and a summary of significant accounting policies and other explanatory notes.

#### *Management's Responsibility for the Financial Statements*

According to [*State name of legislation/regulations setting out management's responsibilities*], management is responsible for the preparation and presentation of these financial statements<sup>6</sup> in accordance with [*State the applicable accounting standards: International Public Sector Accounting Standards, generally accepted government accounting principles for country XYZ, etc*]. This responsibility includes the design, implementation and maintenance of internal control relevant to the preparation and presentation of financial statements that are free from material misstatement, whether due to fraud or error.

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<sup>6</sup> Wording is based on ISA 700 and compliance frameworks common in the public sector. For wording in relation to fair presentation frameworks, see ISA 700.

### *Auditor's Responsibility*

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with [*State the applicable auditing standards: for example the INTOSAI Fundamental Auditing Principles and Guidelines, International Standards on Auditing*<sup>7</sup>, *generally accepted government auditing standards for country XYZ, etc*]. Those standards require that we comply<sup>8</sup> with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgement, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, internal control relevant to the entity's preparation and presentation of financial statements is considered in order to design audit procedures that are appropriate in the circumstances, but not for the purposes of expressing an opinion on the effectiveness of internal control.<sup>9</sup> An audit also includes evaluating the appropriateness of accounting policies used, the reasonableness of accounting estimates made by management, as well as evaluating the presentation of the financial statements.

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

### *Opinion*

In our opinion, the financial statements of government agency ABC for the year ended December 31, 20X1 are prepared, in all material respects, in accordance with [*State the applicable accounting standards: International Public Sector Accounting Standards, generally accepted government accounting principles for country XYZ, etc*].

### **Review of Compliance**

In addition to our audit of the financial statements, a compliance review was planned and performed to express a conclusion with limited assurance as to whether, in all material respects, the activities, financial transactions and information reflected in the financial statements are in compliance with the authorities that govern them. The nature, timing and extent of the compliance work were limited compared to that designed to express an opinion with reasonable assurance on the financial statements.

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<sup>7</sup> Auditors may not state compliance with ISAs unless auditors have complied with ISA 200 and all ISAs relevant to the audit. If stating compliance with ISAs, auditors are directed to ISA 700 for more specific wording.

<sup>8</sup> Wording to be adapted as necessary based on the standards / guidance applied

<sup>9</sup> Wording to be revised appropriately if an opinion on internal control is to be expressed

### *Auditor's Responsibility*

Our responsibility is to express a conclusion based on our review. Our work was conducted in accordance with the [INTOSAI Fundamental Auditing Principles and Guidelines for Compliance Audit]. Those principles require that we comply with ethical requirements and plan and perform the review so as to obtain limited assurance as to whether the activities, financial transactions and information reflected in the financial statements are in compliance, in all material respects, with the authorities that govern them.

A review is limited primarily to analytical procedures and to inquiries, and therefore provides less assurance than an audit. We have not performed an audit, and, accordingly, express our conclusion in the form of limited assurance, which is consistent with the more limited work we have performed under this compliance review.

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

### *Conclusion on Compliance*

Based on our work described in this report, the activities, financial transactions and information reflected in the financial statements that have come to our notice during the audit, are in all material respects, in compliance with the authorities which govern them.

*[Alternatively: Furthermore, based on our work described in this report, nothing has come to our attention that causes us to believe that the activities, financial transactions and information reflected in the financial statements are not in compliance with the authorities which govern them.]*

[Include responses from the audited entity as appropriate, for example after the Opinion paragraph, in summary under a heading 'Responses from the Audited Entity,' or as a separate appendix]

[Include constructive recommendations as appropriate, for example after the Opinion paragraph, in summary under a heading 'Recommendations' or as a separate appendix]

[Auditor's signature]

[Date of the auditor's report]

[Auditor's address]