

INTOSAI



Fundamental Principles of Compliance Auditing

Proposed

Endorsement Version

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Steering Committee

(Cf. Due Process - Stage 3)

INTOSAI PROFESSIONAL STANDARDS COMMITTEE

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INTRODUCTION

1. Professional standards and guidelines are essential for the credibility, quality and professionalism of public sector auditing. The International Standards of Supreme Audit Institutions (ISSAIs) developed by the International Organization of Supreme Audit Institutions (INTOSAI) aim to promote independent and effective auditing and support the members of INTOSAI in the development of their own professional approach in accordance with their national laws and regulations and mandate.
2. ISSAI 400 should be read and understood in conjunction with ISSAI 100, which includes the fundamental principles for public sector auditing in general. The principles in ISSAI 100, including specifically those relating to ethics, independence and quality control, also apply to compliance auditing. ISSAI 400 builds on the fundamental audit principles in ISSAI 100 and develops some of them further within the specific context of compliance auditing.
3. ISSAI 400 constitutes the basis for auditing standards in compliance auditing in accordance with the ISSAIs. ISSAI 400 provides detailed information on the following:
 - The purpose and authority of the ISSAIs on compliance auditing
 - The framework of compliance auditing and different ways in which it is performed
 - The elements of compliance auditing
 - The principles for compliance auditing

For the purpose of clarity ISSAI 400 distinguishes between *compliance auditing* as a type of public sector auditing and a *compliance audit*, which is the conducting of a specific audit.

PURPOSE AND AUTHORITY OF THE FUNDAMENTAL PRINCIPLES OF COMPLIANCE AUDITING

4. The purpose of the ISSAIs¹ on compliance auditing is to provide a comprehensive set of principles, standards and guidelines for compliance auditing of a wide range of subject matters, both in terms of audit scope and of qualitative and quantitative nature, being performed by applying various audit approaches and reporting formats.
5. ISSAI 400 Fundamental Principles of Compliance Auditing provides the SAI with a fundamental basis for the adoption or development of standards and guidelines relevant for compliance auditing. The principles in ISSAI 400 can be used in three ways:
 - To form the basis on which standards are developed,
 - To form the basis on which consistent national standards are adopted.
 - To form the basis for adoption of the Compliance Auditing Guidelines as the authoritative standards.
6. SAIs should only make reference to the Fundamental Principles of Compliance Auditing (ISSAI 400) in audit reports or Auditor's Reports if the standards they have developed or adopted fully comply with all relevant principles of ISSAI 400. The principles do not override national laws, regulations or mandates.

¹ ISSAI 400 and ISSAI 4000 series.

7. As the Compliance Audit Guidelines have been developed to reflect best practice, SAIs are encouraged to strive towards full adoption of them as their authoritative standards. INTOSAI recognizes that in some environments this might not be possible due to lack of basic requirements in government structure or due to laws or regulations that do not provide the premises attached to a compliance audit in accordance with level 4. SAIs in such environments have the option to develop standards based on or adopt national standards consistent with the Fundamental Principles of Compliance Auditing.
8. When adopting or developing auditing standards based on or consistent with the INTOSAI Fundamental Auditing Principles, reference to these in audit reports or Auditor's Report may be done by stating:

... We conducted our audit in accordance with [national standards] based on [or consistent with] the Fundamental Auditing Principles (ISSAI 100–999) of the International Standards of Supreme Audit Institutions.

9. SAIs in some jurisdictions may choose to adopt the Compliance Audit Guidelines as the authoritative standards for their work. Reference to the use of them as standards may be done by stating:

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

The reference may be included in audit reports or Auditor's Report or it may be communicated by the SAI in a more general form covering a defined range of engagements.

SAIs may, depending on their mandate, conduct audits related to financial, compliance and/or performance auditing as combined audits. In such cases the standards developed or adopted for each of the types of audit that are combined should be complied with. The above may be combined with the similar references to the financial and performance auditing guidelines provided by ISSAI 200 and 300.

10. ISSAI 100 further explains the authority attached to the INTOSAI Fundamental Principles.
11. When the ISSAIs on level 4 are used as authoritative standards for a compliance audit conducted together with an audit of financial statements, auditors of public sector entities respect the authority of both the Compliance Audit Guidelines and the Financial Audit Guidelines².

FRAMEWORK FOR COMPLIANCE AUDITING

The objective of compliance auditing

² ISSAI 1000–1810.

12. Compliance auditing is the independent assessment of whether a particular subject matter is in compliance with applicable authorities³ identified as criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material respects, in compliance with the authorities which govern the audited entity.
13. The objective of compliance auditing is to enable the SAI to address whether the activities of public sector entities are in accordance with applicable authorities that govern such entities. This involves reporting on the degree to which the audited entity complies with criteria. The reporting take different forms, either as brief standardized opinions, various forms of conclusions, short or long form reporting. Compliance auditing may encompass the assessment both of compliance with formal criteria of regularity and/or with the general principles of sound public sector financial management and conduct of public sector officials of propriety. While *regularity* is the main focus of compliance auditing, *propriety* may be pertinent due to the public sector context where expectations concerning sound financial management and the conduct of public sector officials also exist. Depending on the mandate of the SAI, the scope of the audit may, due to these expectations, include aspects of propriety⁴.
14. Compliance auditing may also lead SAIs with jurisdictional powers to pronounce judgments and sanctions on those responsible for managing public funds. Some SAIs have the capacity to refer to entitled bodies facts subject to criminal prosecution. In this context, the objective of the compliance audit may be extended and the auditor should take due account of relating specific requirements in the audit strategy, planning and throughout the audit process.

Characteristics of compliance auditing

15. Compliance auditing may cover a wide range of subject matters and can be performed to provide either reasonable or limited assurance. Compliance auditing comprises several types of criteria, evidence gathering procedures and reporting formats. Compliance auditing encompasses both direct reporting and attestation engagements. The reporting may take either a long or short form and may contain various forms of conclusions. The conclusion may take the form of a clear written expression of a separate opinion on compliance or be expressed as a more elaborated answer to specific audit questions.
16. Compliance auditing is often an integral part of the audit mandate of SAIs in their audits of public sector entities. This is because legislation and other authorities are the primary means by which legislatures control income and expenditure, management and due process rights of citizens in the public sector. 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 governance** over such funds.
17. Compliance auditing promotes **transparency** by providing reliable reports as to whether funds, management and due process rights of citizens have been undertaken in accordance with applicable authorities. Compliance auditing promotes **accountability** by reporting deviations and violations from authorities, so that corrective action may be taken, and so that

³ See paragraphs 28–32 Authorities and criteria.

⁴ See paragraph 32 on criteria.

those accountable may be held responsible for their actions. Compliance auditing promotes **good governance** both by identifying weaknesses and deviations from laws and regulations and by assessing propriety where appropriate laws and regulations are insufficient or where there are obvious gaps in legislation. Fraud and corruption are by their nature elements which counteract transparency, accountability and good stewardship. Hence, compliance auditing promotes good governance in the public sector by considering the risk of fraud in relation to compliance.

18. Depending on the organizational structure of the public sector and the mandate of the SAI, compliance auditing may cover all levels of government: central, regional, as well as local. Compliance auditing may also be applied to audits of private entities. This could for revenue be tax payers and for expenditure those involved in the management of public property or services, for instance through partnership arrangements or as recipients of public grants or subsidies.
19. In certain countries, the SAI is a court, composed of judges, which has authority over state accountants and other public officials who must render accounts to it. This jurisdictional function requires the SAI to make sure that whoever is charged with governance over public funds is accountable for those funds and is in this regard subject to its jurisdiction. There exists an important complementary relationship between this jurisdictional authority and the characteristics of compliance auditing. This means that in compliance auditing there might be additional requirements for auditors operating in an environment with a judicial role, such as in court of accounts.

The different perspectives of compliance auditing

20. Compliance auditing can be carried out in combination with other audit types, but is generally performed either:
 - related to the audit of financial statements (in which case ISSAI 4200 provides additional guidance), or
 - separately from the audit of financial statements (in which case ISSAI 4100 provides additional guidance), or
 - together with performance auditing.

Compliance auditing performed related to the audit of financial statements

21. The legislature as a part of a public democratic process, establishes the priorities concerning public sector income and expenditure, and concerning calculations of and purpose of expenditure and income. The premises and decisions of the legislature are the origins of the authorities governing cash flow in the public sector. These decisions and premises of the legislature form the basis of compliance as the broader perspective of the audit of financial statements in the execution of the budget.
22. The audit of compliance with relevant authorities is often an important part of the mandate of the SAI and integrated with the audit of the financial statements to report on the execution of public budgets.
23. Laws and regulations are important both in compliance auditing and in the audit of financial statements. Which laws and regulations to apply in either field depends on the objective of the audit: Compliance auditing is the independent assessment of whether a particular subject matter is in compliance with applicable authorities identified as criteria, and focuses on obtaining sufficient and appropriate evidence regarding compliance with the identified criteria. An audit of financial statements focuses on obtaining an understanding of whether the

financial statements of the entity is prepared in accordance with an acceptable financial reporting framework and, in relation to laws and regulations, to obtain sufficient and appropriate audit evidence regarding those laws and regulations that have a direct and material effect on the financial statements.⁵ Hence, in the audit of financial statements only those laws and regulations with a direct and material effect on the financial statement are relevant. In compliance auditing any laws and regulations relevant to the subject matter may be applied.

24. **ISSAI 4200** provides guidance to compliance auditing performed related to the audit of financial statements. These guidelines should be read together with INTOSAI's Financial Audit Guidelines (ISSAI 1000–2999).

Compliance auditing performed separately

25. Compliance auditing may also be planned, performed and reported on separately from the audit of financial statements and from performance auditing. **ISSAI 4100** provides guidance on this. Compliance auditing performed as a separate task may be conducted on a regular basis or on an ad hoc basis as a separate, identifiable audit task related to a specific subject matter selected for the audit.

Compliance auditing performed together with performance auditing

26. When compliance auditing is performed as a part of a performance audit, compliance is seen as one of the aspects of economy, efficiency and effectiveness. Non-compliance may be the cause of, an explanation for, or a consequence of, the state of the activities being subject to the performance audit. When performing compliance auditing related to a performance audit, auditors make use of their professional judgment to decide whether performance or compliance is the primary purpose of the audit, and whether to apply the ISSAIs on performance auditing and/or compliance auditing.

ELEMENTS OF COMPLIANCE AUDITING

27. The elements of public sector auditing are described in ISSAI 100. This section outlines additional aspects of the elements relevant to compliance auditing. The elements should be identified by the auditor before conducting a compliance audit.

Authorities and criteria

28. The most fundamental element of compliance auditing is authorities, since the structure and contents of authorities form the basis of how and what to perform as compliance auditing within a specific constitutional arrangement. Authorities are the sources of audit criteria, and hence a prerequisite for the conducting of a compliance audit.

⁵ ISSAI 1250.

29. Authorities include rules, laws and regulations, budgetary resolutions, policy, established codes, agreed upon terms or general principles of sound public sector financial management and conduct of public sector officials. Most authorities originate from the premises and decisions of the legislature, but may be issued at a lower level of the organizational structure of the public sector.
30. 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, and there might be gaps in legislation. As a result, an assessment of compliance with authorities in the public sector requires considerable and sufficient knowledge of the structure and contents of authorities themselves. This is of particular importance when the auditor needs to identify the criteria, as the sources of the audit criteria can themselves become a part of the audit, both in terms of scoping the audit and in terms of being a part of the audit findings.
31. Criteria are the benchmarks used to evaluate or measure consistently and reasonably a subject matter. The auditor identifies relevant criteria on the basis of authorities. Criteria should be suitable and have the following characteristics: relevant, reliable, complete, objective, understandable, comparable, acceptable and available. Criteria should be suitable both in the audit of regularity and of propriety. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding.
32. Compliance auditing generally comprises the assessment of compliance with formal criteria, such as authorizing legislation, regulations issued under governing legislation and other relevant laws, regulations and agreements, including budgetary laws (*regularity*). Where formal criteria are absent or there are obvious gaps in legislation due to a complete or partial absence of rules and regulations on whose basis could be decided a question of their application, compliance auditing may also encompass compliance with the general principles of sound public sector financial management and conduct of public sector officials (*propriety*). A compliance audit of propriety is based on suitable criteria, either generally accepted or national or international best practice. In some cases such criteria may be uncodified, implicit or based on overriding principles of law.

Subject matter

33. The subject matter of a compliance audit is defined in the scope of the audit. The subject matter of compliance audits can be activities, financial transactions and information. For attestation engagements on compliance it is more relevant to identify the subject matter information. The subject matter information may be a statement of compliance in accordance with an established and standardized reporting framework.
34. The subject matter of a compliance audit depends on the mandate of the SAI, the relevant authorities and the scope of the audit. Hence, the content and scope of compliance audit subject matters vary widely. Compliance audit subject matters may either be general or specific in nature. Some subject matters are quantitative and can often be easily measured (for example; payments which do not fulfill certain conditions), while others are qualitative and more subjective in nature (for example; behavior or adherence to procedural requirements).

The three parties of compliance auditing

35. Compliance auditing is based on a three party relationship, where **an auditor** aims to obtain sufficient, appropriate audit evidence in order to express a conclusion designed to enhance

the degree of confidence of **the intended users**, other than **the responsible party**, about the measurement or evaluation of a subject matter against criteria.

36. In compliance auditing the responsibility of *the auditor* is to identify the elements of the audit, assess whether a particular subject matter is in compliance with the identified criteria and issue a compliance audit report.
37. *The responsible party* is the executive branch of government and/or its underlying hierarchy of public sector officials and entities responsible for the management of public funds and the exercise of authority under the control of the legislature. Their responsibility is to manage funds and exercise authority in accordance with the authorities. The responsible party in compliance auditing is responsible for the subject matter of the audit.
38. *The intended users* are the individuals, organizations or classes thereof for whom the auditor prepares the audit report. In compliance auditing the users usually include the legislature as representatives of the citizens, who are the ultimate users of compliance audit reports. The legislature makes decisions and fixes priorities concerning calculations of and purpose of public sector expenditure and income. The primary user in compliance auditing is often the entity issuing the authorities identified as criteria of the audit.
39. The relationship between the three parties needs to be viewed within the context of the specific audit and may differ between direct reporting and attestation engagements. Who to define as the three parties may also differ between different public sector entities.

Assurance in compliance auditing

40. An auditor performs procedures to reduce or manage the risk of providing incorrect conclusions, recognizing that there are inherent limitations in all audits. These limitations mean that an audit can never provide absolute assurance of the condition of the subject matter. This should be communicated in a transparent way. A compliance audit will in most cases not cover all elements within a subject matter, which means that an approach for sampling in qualitative and/or quantitative terms needs to be applied.
41. Compliance auditing performed by obtaining assurance enhances the confidence of the intended users in the information provided by the auditor or a party other than the auditor. In compliance auditing there are **two levels of assurance**: either *reasonable assurance* conveying that in the auditor's opinion the subject matter is / is not in compliance, in all material respects, with the stated criteria or *limited assurance* conveying that nothing has come to the auditor's attention to cause the auditor to believe the subject matter is not in compliance with the relevant criteria. Reasonable and limited assurance can be applied both in direct reporting and attestation engagements in compliance auditing.

PRINCIPLES FOR COMPLIANCE AUDITING

42. A compliance audit is a systematic process of objectively obtaining and evaluating evidence of whether a particular subject matter is in compliance with identified criteria. The principles below are fundamental to the conducting of a compliance audit. The nature of the audit is iterative and cumulative, but for the purposes of presentation in this ISSAI the principles have been grouped into principles that the auditor should consider prior to commencement and at more than one point throughout the audit process (general principles) and those principles related to steps in the audit process itself (principles related to the audit process).

General principles

Professional judgment and skepticism

43. Auditors should plan and conduct the audit with professional skepticism. Auditors should exercise professional judgment throughout the audit process.

The terms "professional skepticism" and "professional judgment" are to be used when formulating requirements relating to the auditor's decisions about the appropriate course of action and to express the attitude of the auditor that includes a questioning mind.

The concept of professional judgment is applied by the auditor in all stages of the audit process. The term "professional judgment" means: the application of relevant training, knowledge and experience, within the context provided by auditing standards, in making informed decisions about the courses of action that are appropriate in the circumstances of the audit.

The concept of "professional skepticism" is fundamental to all audits. The auditor plans and conducts an audit with an attitude of professional skepticism recognizing that circumstances may exist that cause the subject matter to be in non-compliance with the criteria. An attitude of professional skepticism means that the auditor makes a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit.

Professional judgment and skepticism is used throughout the compliance audit process to assess the elements of the audit, the subject matter, suitable criteria, the audit scope, risk, materiality and the audit procedures as a response to the defined risks. Professional judgment and skepticism is also used in the evaluation of evidence and instances of non-compliance, in reporting and in determining form, content and frequency of communication throughout the audit. Specific requirements for maintaining professional judgment and skepticism in compliance auditing are the competence in analyzing the structure and contents of public authorities as a basis for identifying suitable criteria or gaps in legislation, in case of complete or partial absence of laws and regulations, and applying professional audit concepts in the approach to known and unknown subject matters. The auditor should be able to judge the relevance and source of a variety of types of audit evidence related to the audit scope and subject matter and evaluate the sufficiency and appropriateness of evidence obtained by the end of the audit.

Quality control

44. Auditors should take responsibility for the overall quality of the compliance audit.

The auditor is responsible for the performance of the compliance audit and should implement quality control procedures during the audit. The quality control procedures are aimed at ensuring that the audit complies with the applicable standards and that the audit report, conclusion or opinion is issued in the appropriate circumstances.

Audit team management and skills

45. Auditors should have access to the necessary skills.

The individuals in the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the compliance audit. This includes an understanding and practical experience of the type of audit being undertaken; an understanding of the applicable standards and authorities; an understanding of the audited entity's operations; and the ability and experience to exercise professional judgment.

Consistent for all compliance audits are the needs for recruiting personnel with suitable qualifications, developing and training employees, the preparation of manuals and other written guidance and instructions concerning the conduct of audits, and the assignment of sufficient resources for the audit. Auditors should maintain professional competence through continuing professional development.

Audits may require specialized techniques, methods or skills from disciplines not available within the SAI. External experts may be used in different ways e.g. to provide knowledge or conduct specific work. Auditors should evaluate whether the expert have the necessary competence, capabilities and objectivity and determine whether the work of the expert is adequate for the purpose of the audit.

Audit risk

46. Auditors should consider audit risk throughout the audit process.

A compliance audit should be performed so as to reduce or manage, to an acceptable level in the circumstances of the audit, the risk that the audit report or Auditor's Report, conclusion or opinion may be inappropriate. Consideration of audit risk is relevant in both attestation and direct engagements. The auditor should consider three different dimensions of audit risk: inherent risk, control risk and detection risk, in relation to the subject matter and the reporting format, i.e. whether the subject matter is quantitative or qualitative and whether the audit report will include an opinion or a conclusion. The significance of the dimensions of audit risk for the audit is affected by the nature of the subject matter, whether the audit is performed as a reasonable assurance or limited assurance audit and whether it is a direct reporting or an attestation engagement.

Materiality

47. Auditors should consider materiality throughout the audit process.

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

As stated above, materiality in compliance auditing consists of both quantitative and qualitative factors, and the qualitative aspects of materiality generally play a greater role in the public sector. Materiality is considered for planning purposes, for purposes of evaluating the evidence obtained and for purposes of reporting. An essential part of determining materiality is to consider whether reports of compliance or non-compliance could reasonably be expected to influence the decisions of the intended users, including the consequences of potential or identified instances of non-compliance. Factors to be considered within this judgment are mandated requirements, public interest or expectations, specific areas of legislative focus, requests and significant funding. Issues at a lower level of value or incidence other than the general determination of materiality, like fraud, may also be considered material. Assessment of materiality requires comprehensive professional judgment of the auditor and is related to the scope of the audit.

Documentation

48. Auditors should prepare sufficient audit documentation.

Documentation should be prepared on a timely basis. The documentation should provide a clear understanding of the criteria used, the scope of the audit, the judgments made, the evidence obtained and conclusions reached. Documentation should be in sufficient detail to enable an experienced auditor, having no previous connection to the audit, to understand from the audit documentation the following; the relationship between the subject matter, the criteria, the scope of the audit, the risk assessment, the audit strategy and audit plan and the nature, timing and extent and the results of procedures performed; the audit evidence obtained to support the auditor's conclusion or opinion; and to record reasoning on all significant matters that required the exercise of professional judgment and related conclusions. The auditor should prepare relevant audit documentation before the audit report or the Auditor's Report is issued, and the documentation should be retained for an appropriate period of time.

Communication

49. Auditors should establish good communication throughout the audit process.

Communication takes place in all audit phases; before the audit starts, during the initial planning phase, during the performance phase, and during the reporting phase. Any significant difficulties encountered during the audit, as well as instances of material non-compliance should be communicated to the appropriate level of management or those charged with governance. The auditor should communicate the audit criteria to the responsible party.

Principles related to the audit process

Planning and designing a compliance audit

Audit scope

50. Auditors should determine the audit scope.

In cases where the mandate of the SAI or the legislation does not prescribe the audit scope, the auditor should determine it. The audit scope is a clear statement of the focus, extent and boundary of the audit in terms of the subject matter being in compliance with the criteria. The scoping of the audit is influenced by materiality, risk and determines which authorities and which parts thereof will be covered. The audit process as a whole should be designed to cover the scope of the audit.

Subject matter and criteria

51. Auditors should identify the subject matter and suitable criteria.

Determination of the subject matter and criteria is one of the first steps in a compliance audit. The subject matter and criteria may be prescribed in the mandate of the SAI or in the legislation. The subject matter may also be identified by the auditor. For attestation engagements on compliance it may also be relevant to identify the subject matter information.

Subject matters may take many forms and have many characteristics. When identifying the subject matter, the auditor should develop an analysis of the audited entity assessing materiality and risk, whilst applying professional judgment and skepticism.

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 such a nature that it is possible to gather sufficient appropriate audit evidence about the subject matter to support the audit report, conclusion or opinion.

The auditor should identify suitable criteria. The criteria provide a basis for evaluating audit evidence, developing audit findings and conclusions. The criteria should be made available to the intended users and others as appropriate. They should also be communicated to the responsible party.

Understanding the entity

52. Auditors should understand the audited entity in light of the authorities governing it.

Compliance auditing may cover all levels of the executive and can include various administrative levels, types of entities and also combinations of entities. Hence, the auditor should understand the structure and operations of the audited entity and the approach of the entity to achieve compliance. On the basis of this, the auditor determines materiality and assesses risk of non-compliance.

Understanding internal control and control environment

53. Auditors should understand the control environment and the relevant internal controls and consider whether they are likely to ensure compliance.

In understanding the audited entity and/or subject matter relevant to the scope of the audit, the auditor should understand the control environment. A control environment is the culture of honesty and ethical behavior needed to provide the foundation for other components of internal control established to ensure compliance with authorities. In compliance auditing a control environment with focus on achieving compliance is of particular importance.

In understanding the audited entity or the subject matter, the auditor should understand internal controls. The particular type of controls which the auditor focuses on depends on the subject matter and the nature and scope of the particular compliance audit. The scope of the audit may be to assess a qualitative or quantitative subject matter, and hence the auditor will focus on quantitative or qualitative internal controls, or a combination thereof, according to the scope of the audit. In evaluating internal control, the auditor assesses the risk that the internal controls may not prevent or detect material instances of non-compliance. The auditor should consider whether the internal controls correspond with the control environment so as to ensure compliance with authorities in all material respects.

Risk assessment

54. Auditors should perform a risk assessment to identify risks of non-compliance.

In light of the criteria, scope and characteristics of the audited entity, the auditor should perform a risk assessment to determine the nature, timing and extent of audit procedures to be performed. In the risk assessment the auditor considers the risk of non-compliance in the subject matter. The risk of non-compliance may arise due to fraud, error, to the inherent nature of the subject matter and/or the circumstances of the audit. The identification of risks and their impact on the audit procedures should be considered throughout the audit process. As part of the risk assessment, the auditor should evaluate any breaches detected to determine whether they are material.

Risk of fraud

55. Auditors should consider the risk of fraud.

If the auditor comes across instances of non-compliance which may be indicative of fraud, he or she should exercise due professional care and caution so as not to interfere with potential future legal proceedings or investigations.

Fraud in compliance auditing relates mainly to the execution of public authority, but also to fraudulent reporting on compliance issues. Instances of noncompliance with authorities may constitute deliberate misuse of public authority for improper benefit. Execution of public authority includes decisions, non-decisions, preparatory work, advice, information handling and other acts in public service. The improper benefits are advantages of non-economic nature or

economic value or of an intentional act by one or more individuals among management, those charged with governance, employees or third parties.

While detecting fraud is not the main objective of performing a compliance audit, the auditor should include fraud risk factors in their risk assessments, and remain alert for indications of fraud in carrying out their work.

Audit strategy and audit plan

56. Auditors should plan the audit by developing an audit strategy and an audit plan.

The planning of the audit should involve discussions between relevant members of the audit team to develop an audit strategy and an audit plan. The purpose of the overall audit strategy is to develop an effective response to the risk of non-compliance. The overall audit strategy includes consideration of planned audit responses to the specific risks through the development of 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 a continuous and iterative process.

Audit evidence

57. Auditors should gather sufficient and appropriate audit evidence to cover the scope of the audit.

The auditor should gather sufficient appropriate audit evidence to provide the basis for the conclusion or opinion. **Sufficiency** is the measure of the quantity of evidence.

Appropriateness is the measure of the quality of evidence; that is its relevance, validity, and its reliability. The quantity of evidence needed is affected by the audit risk (the greater the risk, the more evidence is likely to be required) and also by the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence does not compensate for its poor quality. The reliability of evidence is influenced by its source and nature, and is dependent on the individual circumstances under which the evidence is obtained. The auditor should consider both the relevance and reliability of information to be used as audit evidence. The auditor has to respect the confidentiality of any audit evidence and information received.

The audit procedures to be applied should be appropriate in the circumstances, for the purpose of obtaining sufficient and appropriate audit evidence to cover the scope of the audit. The nature and sources of the audit evidence required are determined by the criteria, the subject matter and the scope of the audit. The scope of the audit may be to assess a qualitative or quantitative subject matter, and hence the auditor will focus on quantitative or qualitative audit evidence, or a combination thereof, according to the scope of the audit. Hence, audit evidence in compliance auditing includes a variety of evidence gathering procedures of both quantitative and qualitative nature.

The auditor often needs to combine and compare evidence from different sources in order to obtain sufficiency and appropriateness of evidence in compliance auditing.

Evaluating audit evidence, concluding and reporting

Evaluating audit evidence and forming conclusions

58. Auditors should evaluate whether sufficient and appropriate audit evidence is obtained and form relevant conclusions.

After completing the audit procedures the auditor reviews the audit evidence in order to draw a conclusion or issue an opinion. The auditor should evaluate whether the evidence obtained is sufficient and appropriate so as to reduce audit risk to an acceptably low level. The evaluation includes considerations of evidence that both supports and seems to contradict the audit

report, conclusion or opinion on compliance/ non-compliance. The evaluation further includes considerations of materiality. After evaluating the sufficiency and appropriateness of evidence related to the assurance level of the audit, the auditor should consider which conclusion is appropriate in light of the evidence obtained.

If audit evidence obtained from one source is inconsistent with that obtained from another source; or the auditor has doubts over the reliability of information to be used as audit evidence, the auditor is to determine what modifications or additions to audit procedures are necessary to resolve the matter, and is to consider the effect of the matter, if any, on other aspects of the audit.

After completing the audit procedures the auditor reviews the audit documentation to determine whether the subject matter has been sufficiently and appropriately audited. The auditor should also determine whether the risk assessment and determination of initial materiality were appropriate in light of the evidence collected or whether they need to be revised.

Reporting

59. Auditors should prepare a report based on the principles of completeness, objectivity, timeliness and a contradictory process.

The principle of completeness implies that the auditor has considered all relevant audit evidence to issue a report. The principle of objectivity implies that the auditor applies professional judgment and skepticism to ensure that reports presented are factually correct and findings or conclusions are presented in a proper perspective and in a balanced manner. The principle of timeliness implies preparing the report in due time. The principle of a contradictory process involves checking the accuracy of facts with the audited entity and incorporating responses from responsible officials as appropriate. The form and content of a compliance audit report should cover all these principles.

The forms of reporting may be defined by legislation or in the mandate of the SAI. Nonetheless, the audit report or Auditor's Report normally contains a conclusion based on the audit work performed. The report may also provide constructive and practical recommendations for improvement where appropriate.

The reporting take different forms, either as brief standardized opinions, various forms of conclusions, short or long form reporting. In either way, the report should be complete, accurate, objective, convincing, and as clear and concise as the subject matter permits. Any limitations of the scope of the audit should be described. The report communicates clearly the relevance of criteria used and the level of assurance provided.

The conclusion may take the form of a clear written expression of a separate opinion on compliance, often in addition to the opinion on the financial statements. The conclusion may also be expressed as a more elaborated answer to specific audit questions. The opinion is often related to attestation engagements, while the answering of specific audit questions is often used in direct engagements. Where an opinion is provided the auditor should state whether it is unmodified or modified on the basis of an evaluation of materiality and pervasiveness. Where an opinion is provided this would normally require a more elaborated audit strategy and approach.

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

- 1 Title
- 2 Addressee
- 3 Scope of the audit, including the time period covered
- 4 Identification or description of the subject matter

- 5 Identified criteria
- 6 Identification of the auditing standards applied in performing the work
- 7 A summary of the work performed
- 8 Findings
- 9 A conclusion/opinion
- 10 Responses from the audited entity (as appropriate)
- 11 Recommendations (as appropriate)
- 12 Report date
- 13 Signature

Follow up

60. Auditors should follow up instances of non-compliance when appropriate.

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