

# ISSAI 400

## Compliance Audit Principles



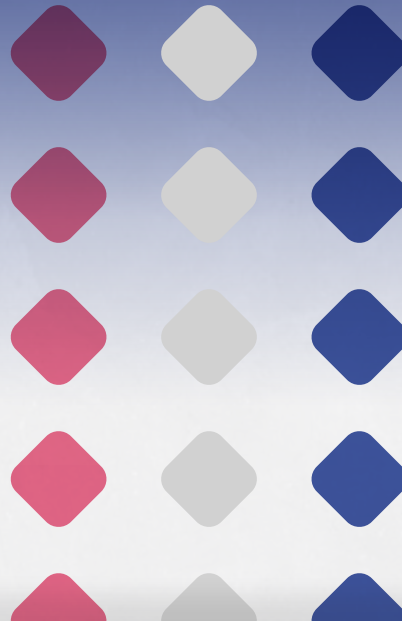
INTOSAI

INTOSAI Standards are issued  
by the International  
Organisation of Supreme Audit  
Institutions, INTOSAI, as part of  
the INTOSAI Framework of  
Professional Pronouncements.

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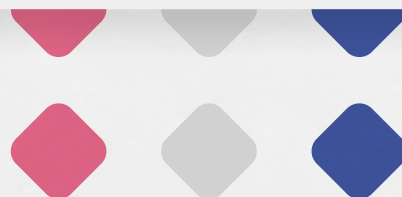
INTOSAI



#### INTOSAI, 2019

- 1) Endorsed as Reporting Standards in Government Auditing in 2001
- 2) Content reformulated and endorsed as Fundamental Principles of Compliance Auditing in 2013
- 3) With the establishment of the Intosai Framework of Professional Pronouncements (IFPP), renamed Compliance Audit Principles with editorial changes in 2019

ISSAI 400 is available in all INTOSAI official languages: Arabic, English, French, German and Spanish



# TABLE OF CONTENTS

|  |           |
|--|-----------|
| <b>1. INTRODUCTION</b>   | <b>5</b>  |
| <b>2. PURPOSE AND AUTHORITY OF THE COMPLIANCE<br/>AUDIT PRINCIPLES</b> | <b>6</b>  |
| <b>3. FRAMEWORK FOR COMPLIANCE AUDITING</b>                            | <b>8</b>  |
| The objective of compliance auditing                                   | 8         |
| Characteristics of compliance auditing                                 | 9         |
| The different perspectives of compliance auditing                      | 10        |
| Compliance auditing in relation with the audit of financial statements | 11        |
| Compliance auditing conducted separately                               | 12        |
| Compliance auditing in combination with performance auditing           | 12        |
| <b>4. ELEMENTS OF COMPLIANCE AUDITING</b>                              | <b>13</b> |
| Authorities and criteria   | 13        |
| Subject matter   | 14        |
| The three parties in compliance auditing                               | 15        |
| Assurance in compliance auditing                                       | 16        |
| <b>5. PRINCIPLES OF COMPLIANCE AUDITING</b>                            | <b>17</b> |
| <b>GENERAL PRINCIPLES</b>  | <b>17</b> |
| Professional judgement and scepticism                                  | 17        |
| Quality control  | 18        |
| Audit team management and skills                                       | 19        |
| Audit risk   | 19        |
| Materiality  | 20        |

|   |           |
|---|-----------|
| Documentation                                     | 21        |
| Communication                                     | 21        |
| <b>PRINCIPLES RELATED TO THE AUDIT PROCESS</b>    | <b>22</b> |
| Planning and designing a compliance audit         | 21        |
| Audit evidence                                    | 25        |
| Evaluating audit evidence and forming conclusions | 26        |
| Reporting   | 27        |
| Follow-up   | 28        |

- 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 Organisation 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 mandates and with national laws and regulations.
- 2) *ISSAI 100 - Fundamental Principles of Public-Sector Auditing* provides the fundamental principles for public-sector auditing in general and defines the authority of the ISSAIs. *ISSAI 400 - Compliance Audit Principles* builds on and further develops the fundamental principles of ISSAI 100 to suit the specific context of compliance auditing. ISSAI 400 should be read and understood in conjunction with ISSAI 100, which also applies to compliance auditing.
- 3) ISSAI 400 therefore constitutes the basis for compliance auditing standards in accordance with the ISSAIs. This document provides detailed information on the following:
  - The purpose and authority of the ISSAIs on compliance auditing
  - The compliance auditing framework and the different ways in which audits are conducted
  - The elements of compliance auditing
  - The principles of compliance auditing

# 2

## PURPOSE AND AUTHORITY OF THE COMPLIANCE AUDIT PRINCIPLES

- 4) The purpose of the ISSAIs on compliance auditing<sup>1</sup> is to provide a comprehensive set of principles, requirements and application material for the compliance auditing of subject matter, both qualitative and quantitative, that varies widely in scope and can be addressed through a range of audit approaches and reporting formats.
- 5) ISSAI 400 provides SAIs with a basis for the adoption or development of standards on compliance auditing. The principles in ISSAI 400 can be used in three ways:
  - as a basis for the development of standards;
  - as a basis for the adoption of consistent national standards;
  - as a basis for adoption of the ISSAIs as the authoritative standards on compliance auditing.
- 6) SAIs should only make reference to the Compliance Audit Principles in audit reports – whether in the Auditor’s Report or other reporting formats – if the standards they have developed or adopted fully comply with all relevant principles of ISSAI 400. The principles in no way override national laws, regulations or mandates.
- 7) As the Compliance Audit Standards (ISSAIs 4000-4899) have been developed to reflect best practice, SAIs are encouraged to strive towards adopting them in full as their authoritative standards. INTOSAI recognizes that, in some environments, this might not be possible due to the absence of basic

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1 ISSAI 400 and ISSAIs 4000-4899

administrative structures or because laws or regulations do not establish the premises for carrying out audits in accordance with the Compliance Audit Standards. Where this is the case, SAIs have the option of developing standards based on, or adopting national standards consistent with, the Compliance Audit Principles.

- 8) Where an SAI's auditing standards are based on or consistent with the Compliance Audit Principles, these may be referred to by stating:

*... We conducted our audit[s] in accordance with [standards], which are based on [or consistent with] ISSAI 100 Fundamental Principles of Public-Sector Auditing and ISSAI 400 Compliance Audit Principles of the International Standards of Supreme Audit Institutions.*

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

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

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

Depending on their mandate, SAIs may conduct combined audits incorporating financial, compliance and/or performance aspects. In such cases the standards relevant to each audit type should be complied with. The statement of standards applied in the audit (paragraph 8 or 9 above) may need to be adjusted in accordance with ISSAI 100, paragraph 9 or 10.

- 10) *ISSAI 100 - Fundamental Principles of Public-Sector Auditing* gives further information on the authority attached to the INTOSAI Fundamental Principles.
- 11) When the ISSAIs are used as the authoritative standards for a compliance audit conducted together with an audit of financial statements, the public-sector auditors should respect the authority of the compliance audit standards (ISSAIs 4000-4899) as well as the financial audit standards (ISSAIs 2000-2899)

## THE OBJECTIVE OF COMPLIANCE AUDITING

- 12) Compliance auditing is the independent assessment of whether a given subject matter is in compliance with applicable authorities<sup>2</sup> identified as criteria. Compliance audits are carried out by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities which govern the audited entity.
- 13) The objective of public-sector compliance auditing, therefore, is to enable the SAI to assess whether the activities of public-sector entities are in accordance with the authorities governing those entities. This involves reporting on the degree to which the audited entity complies with established criteria. Reporting may vary between brief standardised opinions and various forms of conclusions, presented in short or long form. Compliance auditing may be concerned with regularity (adherence to formal criteria such as relevant laws, regulations and agreements) or with propriety (observance of the general principles governing sound financial management and the conduct of public officials). While regularity is the main focus of compliance auditing, propriety may also be pertinent given the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials. Depending on the mandate of the SAI, the audit scope may therefore include aspects of propriety.<sup>3</sup>

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<sup>2</sup> See paragraphs 28-29 on the concept of authorities.

<sup>3</sup> See paragraph 32.



- 14) Compliance auditing may also lead SAIs with jurisdictional powers to pronounce judgments and sanctions on those responsible for managing public funds. Some SAIs are mandated to refer facts liable to criminal prosecution to the judicial authorities. In this context, the objective of the compliance audit may be extended, and the auditor should take due account of the relevant specific requirements when devising the audit strategy or planning and throughout the audit process.

## CHARACTERISTICS OF COMPLIANCE AUDITING

- 15) Compliance auditing may cover a wide range of subject matter and can be performed to provide either reasonable or limited assurance, using several types of criteria, evidence-gathering procedures and reporting formats. Compliance audits may be attestation or direct reporting engagements, or both at once. The audit report may be either long- or short-form, and conclusions may be expressed in various ways: as a single clear written statement of opinion on compliance or as a more elaborate answer to specific audit questions.
- 16) Compliance auditing is often an integral part of an SAI's mandate for the audit of public-sector entities. This is because legislation and other authorities are the primary means by which legislatures exercise control of income and expenditure, management and the rights of citizens to due process in their relations with the public sector. Public-sector entities are entrusted with the sound management of public funds. It is the responsibility of public-sector bodies and their appointed officials to be **transparent** about their actions and **accountable** to citizens for the funds with which they are entrusted, and to exercise **good governance** over those funds.
- 17) Compliance auditing promotes **transparency** by providing reliable reports as to whether funds have been administered, management exercised and citizens' rights to due process honoured as required by the applicable authorities. It promotes **accountability** by reporting deviations from and violations of authorities, so that corrective action may be taken and those accountable may be held responsible for their actions. It promotes good governance both

by identifying weaknesses and deviations from laws and regulations and by assessing propriety where there are insufficient or inadequate laws and regulations. Fraud and corruption are, by their very nature, elements which counteract transparency, accountability and good stewardship. Compliance auditing therefore promotes good governance in the public sector by considering the risk of fraud in relation to compliance.

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

## THE DIFFERENT PERSPECTIVES OF COMPLIANCE AUDITING

- 20) Compliance auditing can be part of a combined audit that may also include other aspects. Though other possibilities exist, compliance auditing is generally conducted either:
  - in relation with the audit of financial statements or
  - separately or
  - in combination with performance auditing.

## » COMPLIANCE AUDITING IN RELATION WITH THE AUDIT OF FINANCIAL STATEMENTS

- 21) The legislature, as an element of public democratic process, establishes the priorities for public-sector income and expenditure and for the calculation and attribution of expenditure and income. The underlying premises of legislative bodies, and the decisions they take, are the source of the authorities governing cash flow in the public sector. Compliance with those authorities constitutes a broader perspective alongside the audit of financial statements in budgetary execution.
- 22) The audit of compliance with relevant authorities is often an important part of the mandate of an SAI, where it is combined with the audit of financial statements as part of reporting 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 apply in each field will depend on the audit objective. Compliance auditing is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria; it focuses on obtaining sufficient and appropriate evidence regarding compliance with those criteria. The audit of financial statements seeks to ascertain whether the financial statements of the entity concerned were prepared in accordance with an acceptable financial reporting framework and to obtain sufficient and appropriate audit evidence regarding the laws and regulations that have a direct and material effect on the financial statements.<sup>4</sup> Whereas, 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 relevant for the audit.
- 24) *(This paragraph has been deleted)*

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4 Cf. ISSAI 2250.

» **COMPLIANCE AUDITING CONDUCTED SEPARATELY**

- 25) Compliance audits may also be planned, performed and reported on separately from the audit of financial statements and from performance audits. Compliance audits may be conducted separately on a regular or an *ad hoc* basis, as distinct and clearly-defined audits each related to a specific subject matter.

» **COMPLIANCE AUDITING IN COMBINATION WITH PERFORMANCE AUDITING**

- 26) When compliance auditing is 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 that are the subject of the performance audit. In combined audits of this kind, auditors should use their professional judgement to decide whether performance or compliance is the primary focus of the audit, and whether to apply the ISSAIs on performance auditing, compliance auditing or both.

# 4

## 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, which should be identified by the auditor before commencing the audit.

### AUTHORITIES AND CRITERIA

- 28) Authorities are the most fundamental element of compliance auditing, since the structure and content of authorities furnish the audit criteria and therefore form the basis of how the audit is to proceed under a specific constitutional arrangement.
- 29) Authorities may include rules, laws and regulations, budgetary resolutions, policy, established codes, agreed terms or the general principles governing sound public-sector financial management and the conduct of public officials. Most authorities originate in the basic premises and decisions of the national legislature, but they may be issued at a lower level in the organisational structure of the public sector.
- 30) Because of the variety of possible authorities, they may have mutually conflicting provisions and be subject to differing interpretations. In addition, subordinate authorities may not be consistent with the requirements or limits of the enabling legislation, and there may be legislative gaps. As a result, to assess compliance with authorities in the public sector it is necessary to have sufficient knowledge of the structure and content of the authorities themselves. This is of particular importance when it comes to identifying

the audit criteria, as the sources of the criteria may themselves feature in the audit, both when determining the audit scope and when drawing up the audit findings.

- 31) Criteria are the benchmarks used to evaluate or measure the subject matter consistently and reasonably. The auditor identifies criteria on the basis of the relevant authorities. To be suitable, compliance audit criteria must be relevant, reliable, complete, objective, understandable, comparable, acceptable and available. 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 authorising legislation, regulations issued under framework legislation and other relevant laws, regulations and agreements, including budgetary laws (*regularity*). Where formal criteria are absent or there are obvious shortcomings in the legislation concerning their application, audits may also examine compliance with the general principles governing sound financial management and the conduct of public officials (*propriety*). Suitable criteria are needed both in audits focusing on regularity and in audits focusing on propriety. Suitable criteria for a compliance audit of propriety will be either generally-accepted principles or national or international best practice. In some cases they 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. It may take the form of activities, financial transactions or information. For attestation engagements on compliance it is more relevant to identify the subject matter information, which may be a statement of compliance prepared in accordance with an established and standardised reporting framework.
- 34) The subject matter 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 matter can vary widely. The subject matter of an audit may be either general or specific. Some types of subject matter are quantitative and,

often, easily measured (for example payments which do not satisfy certain conditions), while others are qualitative and more subjective in nature (for example behaviour or adherence to procedural requirements).

## THE THREE PARTIES IN COMPLIANCE AUDITING

- 35) Compliance auditing is based on a three-party relationship in which **the 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 compliant with the established criteria and issue a compliance audit report.
- 37) *The responsible party* is the executive branch of government and/or its underlying hierarchy of public officials and entities responsible for the management of public funds and the exercise of authority under the control of the legislature. 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 generally include the legislature as representatives of the people, who are the ultimate users of compliance audit reports. The legislature makes decisions and sets priorities concerning the calculation and purpose of public-sector expenditure and income. The primary user in compliance auditing is often the entity that issued the authorities identified as audit criteria.
- 39) The relationship between the three parties should be viewed in the context of each audit and may be different in direct reporting as opposed to attestation engagements. The definition of the three parties may also vary according to the public-sector entities involved.

## ASSURANCE IN COMPLIANCE AUDITING

- 40) An auditor performs procedures to reduce or manage the risk of providing incorrect conclusions, recognising that, owing to the inherent limitations in all audits, no audit can ever provide absolute assurance of the condition of the subject matter. This should be communicated in a transparent way. In most cases, a compliance audit will not cover all elements of the subject matter but will rely on a degree of qualitative or quantitative sampling.
- 41) Compliance auditing carried out by obtaining assurance enhances the confidence of the intended users in the information provided by the auditor or another party.

In compliance auditing there are **two levels of assurance**: *reasonable assurance*, conveying that, in the auditor's opinion, the subject matter is or is not in compliance, in all material respects, with the stated criteria; and *limited assurance*, conveying that nothing has come to the auditor's attention to cause him/her to believe that the subject matter is not compliant with the criteria. Both reasonable and limited assurance are possible in both direct reporting and attestation engagements in compliance auditing.



# 5

## PRINCIPLES OF COMPLIANCE AUDITING

- 42) A compliance audit is a systematic process of objectively obtaining and evaluating evidence as to whether a given subject matter is in compliance with applicable authorities identified as criteria. The principles below are fundamental to the conduct of a compliance audit. The nature of the audit is iterative and cumulative, but for the purposes of presentation this section is divided into principles that the auditor should consider prior to commencement and at more than one point during the audit process (general principles) and those related to steps in the audit process itself.

### GENERAL PRINCIPLES

#### » PROFESSIONAL JUDGEMENT AND SCEPTICISM

- 43) Auditors should plan and conduct the audit with professional scepticism and exercise professional judgement throughout the audit process.**

The terms “professional scepticism” and “professional judgement” are relevant when formulating requirements regarding the auditor’s decisions about the appropriate course of action. They express the attitude of the auditor, which must include a questioning mind.

The auditor must apply professional judgement at all stages of the audit process. The concept refers to the application of relevant training, knowledge and experience, within the context provided by auditing standards, so

that informed decisions can be made about the courses of action that are appropriate given the circumstances of the audit.

The concept of professional scepticism is fundamental to all audits. The auditor should plan and conduct the audit with an attitude of professional scepticism, recognising that certain circumstances may cause the subject matter to diverge from the criteria. An attitude of professional scepticism means the auditor making a critical assessment, with a questioning mind, of the sufficiency and appropriateness of evidence obtained throughout the audit.

Professional judgement and scepticism are 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 to be used in response to the defined risks. The two concepts are also used in the evaluation of evidence and instances of non-compliance, in reporting and in determining the form, content and frequency of communication throughout the audit. Specific requirements for maintaining professional judgement and scepticism in compliance auditing are the ability to analyse the structure and content of public authorities as a basis for identifying suitable criteria or gaps in legislation, in the event that laws and regulations are entirely or partially lacking, and to apply professional audit concepts in the approach to known and unknown subject matter. The auditor should be capable of appraising a variety of types of audit evidence by their source and relevance to the audit scope and subject matter, and of evaluating the sufficiency and appropriateness of all evidence obtained during the audit.

## » QUALITY CONTROL

### **44) Auditors should take responsibility for the overall quality of the audit.**

The auditor is responsible for the performance of the audit and should implement quality control procedures throughout the audit process. Such procedures should be aimed at ensuring that the audit complies with the applicable standards and that the audit report, conclusion or opinion is appropriate given the circumstances.

## » 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 audit. This includes an understanding and practical experience of the type of audit being undertaken, familiarity with the applicable standards and authorities, an understanding of the audited entity's operations and the ability and experience to exercise professional judgement. Common to all audits is the need to recruit personnel with suitable qualifications, offer staff development and training, prepare manuals and other written guidance and instructions concerning the conduct of audits, and assign sufficient audit resources. Auditors should maintain their professional competence through ongoing professional development.

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

## » AUDIT RISK

### **46) Auditors should consider audit risk throughout the audit process.**

Audits should be conducted in such a way as to manage, or reduce the audit risk to an acceptable level. The audit risk is the risk that the audit report – or more specifically the auditor's conclusion or opinion -will be inappropriate in the circumstances of the audit.

Consideration of audit risk is relevant in both attestation and direct engagements. 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 is to include an

opinion or a conclusion. The relative significance of these dimensions of audit risk depends on the nature of the subject matter, whether the audit is to provide reasonable or limited assurance and whether it is a direct reporting or an attestation engagement.

## » MATERIALITY

### **47) Auditors should consider materiality throughout the audit process.**

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

As stated above, materiality in compliance auditing has both quantitative and qualitative aspects, although the qualitative aspects generally play a greater role in the public sector. Materiality should be considered for the purposes of planning, evaluating the evidence obtained and reporting. An essential part of determining materiality is to consider whether reported cases of compliance or non-compliance (potential or confirmed) could reasonably be expected to influence decisions by the intended users. Factors to be considered within this judgment assessment are mandated requirements, public interest or expectations, specific areas of legislative focus, requests and significant funding. Issues at a lower level of value or incidence than the general determination of materiality, such as fraud, may also be considered material. The assessment of materiality requires comprehensive professional judgement on the part of the auditor and is related to the audit scope.

» **DOCUMENTATION**

**48) Auditors should prepare sufficient audit documentation.**

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

» **COMMUNICATION**

**49) Auditors should maintain effective communication throughout the audit process.**

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

## PRINCIPLES RELATED TO THE AUDIT PROCESS

### » PLANNING AND DESIGNING A COMPLIANCE AUDIT

#### *Audit scope*

#### **50) Auditors should determine the audit scope.**

Where the SAI's mandate or the applicable legislation does not prescribe the scope of the audit, this should be decided by the auditor. The audit scope is a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. The scoping of an audit is influenced by materiality and risk, and it determines which authorities and parts thereof will be covered. The audit process as a whole should be designed to cover the entire audit scope.

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

The subject matter may take many forms and have a variety of characteristics. When identifying the subject matter, the auditor should employ professional judgement and scepticism to analyse the audited entity and assess materiality and risk.

The subject matter should be identifiable, and it should be possible to assess it against suitable criteria. It should be of such a nature that it enables sufficient and appropriate audit evidence to be gathered in support of the audit report, conclusion or opinion.

The auditor should identify suitable criteria to provide a basis for evaluating the audit evidence and 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 the light of the relevant authorities.**

Compliance auditing may cover all levels of the executive and can include various administrative levels, types of entities and combinations of entities. The auditor should therefore be familiar with the structure and operations of the audited entity and its procedures for achieving compliance. The auditor will use this knowledge to determine materiality and assess the risk of non-compliance.

*Understanding internal controls and the control environment*

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

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

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

environment so as to ensure compliance with the authorities in all material respects.

*Risk assessment*

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

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

*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 any future legal proceedings or investigations.

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



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

#### *Audit strategy and audit plan*

#### **56) Auditors should develop an audit strategy and an audit plan.**

Audit planning should involve discussion between members of the audit team with a view to developing an overall audit strategy and an audit plan. The purpose of the audit strategy is to devise an effective response to the risk of non-compliance. It should include consideration of the planned audit responses to specific risks through the development of an audit plan. Both the audit strategy and the audit plan 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 appropriate audit evidence to cover the audit scope.**

The auditor should gather sufficient and appropriate audit evidence to provide the basis for the conclusion or opinion. Sufficiency is a measure of the quantity of evidence, while appropriateness relates to the quality of evidence – its relevance, validity and reliability. The quantity of evidence required depends on the audit risk (the greater the risk, the more evidence is likely to be required) and on the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence does not compensate for its poor quality. The reliability of evidence is influenced by its source and nature, and is dependent on the specific circumstances in which it was obtained. The auditor should consider both the relevance and the reliability of the information to be used as audit evidence, and must respect the confidentiality of all audit evidence and information received.

The audit procedures should be appropriate in the circumstances of the audit and suited to the purpose of obtaining sufficient and appropriate

audit evidence. The nature and sources of the necessary audit evidence are determined by the criteria, the subject matter and the scope of the audit. As the subject matter may be qualitative or quantitative, the auditor will focus on quantitative or qualitative audit evidence, or a combination thereof, according to the audit scope. Compliance auditing thus includes a variety of procedures for gathering evidence of both a quantitative and a qualitative nature.

The compliance auditor will often need to combine and compare evidence from different sources in order to meet the requirements for sufficiency and appropriateness.

## » EVALUATING AUDIT EVIDENCE AND FORMING CONCLUSIONS

### **58) Auditors should evaluate whether sufficient and appropriate audit evidence has been obtained and form relevant conclusions.**

After completing the audit proper the auditor will review the audit evidence in order to reach a conclusion or issue an opinion. The auditor should evaluate whether the evidence obtained is sufficient and appropriate so as to reduce the audit risk to an acceptably low level. The evaluation process entails considering evidence that both supports and seems to contradict the audit report, conclusion or opinion on compliance or non-compliance. It also includes considerations of materiality. After evaluating whether the evidence is sufficient and appropriate given the assurance level of the audit, the auditor should consider how best to conclude in the light of the evidence.

If audit evidence obtained from one source is inconsistent with that obtained from another, or if there are any doubts about the reliability of the information to be used as evidence, the auditor should determine what modifications or additions to the audit procedures would resolve the matter and consider the implications, if any, for other aspects of the audit.

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

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

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

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

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

The conclusion may take the form of a clear written statement of opinion on compliance, often in addition to the opinion on the financial statements. It may also be expressed as a more elaborate answer to specific audit questions. While an opinion is common in attestation engagements, the answering of specific audit questions is more often used in direct reporting engagements. Where an opinion is provided the auditor should state whether it is unmodified or has been modified on the basis of the evaluation of materiality and pervasiveness. Delivering an opinion would normally require a more elaborate audit strategy and approach.

Compliance audit reports should include the following elements (although not necessarily in this 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. Replies 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 action and provides useful feedback to the audited entity, the users of the audit report and the auditor (for future audit planning). The need to follow up previously reported instances of non-compliance will vary with the nature of the subject matter, the non-compliance identified and the particular circumstances of the audit. At some SAIs, including courts of accounts, the follow-up may include issuing legally binding reports or judicial decisions. In audits carried out on a regular basis the follow-up procedures may form part of the subsequent year's risk assessment.