ISSAI Implementation Initiative (3i Programme)

Compliance Audit
ISSAI Implementation Handbook

DRAFT VERSION 0: 01.08.2018

INTOSAI Development Initiative (IDI) | www.idi.no

Compliance Audit ISSAI Implementation Handbook

Draft Version 0

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List of Acronyms

CA	Compliance Audit
CAS	Compliance Audit Subcommittee
COSO	Committee of Sponsoring Organisations
INTOSAI	International Organisation of Supreme Audit Institutions
INCOSAI	International Congress of Supreme Audit Institutions
IFPP	INTOSAI Framework of Professional Pronouncements
IDI	INTOSAI Development Initiative
ISSAI	International Standards of Supreme Audit Institutions
PSC	Professional Standards Committee
QA	Quality Assurance
RMNC	Risk of Material Non Compliance
SAI	Supreme Audit Institution

About the Handbook

In its ISSAI Implementation Initiative (3i Programme), in 2014 the IDI developed the first Compliance Audit ISSAI Implementation Handbook. At that time, it was based on the old level 4 ISSAI of compliance audit, the ISSAI 4000 series (now replaced by new CA ISSAI), and level 3 ISSAIs of ISSAI 100 and ISSAI 400. These standards then provided the basis of the audit methodology described in the first compliance audit (CA) Handbook.

At INCOSAI 2016, INTOSAI approved the new Compliance Audit ISSAI 4000. As the authoritative standard for compliance audit, the new ISSAI 4000 contains major changes from earlier ones. Subsequently, in its support for implementing the CA ISSAI in SAIs, the IDI initiated the revision of the CA ISSAI Implementation Handbook to reflect the changes in the ISSAI. This Handbook is the result of that process, as it incorporates the current ISSAI 4000-based audit methodology that is applicable to compliance audits carried out by SAIs.

A team of resource persons from different SAIs worked with the IDI to develop the first draft of this Handbook. In the process of development, the draft was shared with the experts from the Compliance Audit Subcommittee (CAS) and CA ISSAI facilitators engaged in the implementation process in SAIs. At the same time, the draft Handbook was used in IDI's cooperative compliance audit programme, in which about ten SAIs applied the methodology. Lessons learned from these practical audits helped to improve the methodology.

The intent of this Handbook is to help auditors or users understand the ISSAI 4000-based compliance audit process by referring to explanations and examples. The interpretations provided represent the compliance audit based on the ISSAI 4000 and ISSAI 100 and 400. Depending on their mandate and reporting requirements, SAIs may adapt the guidance provided in this Handbook to their specific country context and environment and customize it to suit their audits.

The Handbook has seven chapters. Chapters 1 covers the compliance audit ISSAIs and explains the concepts of compliance audit from the ISSAIs. Chapter 2 provides guidance on the SAI level considerations for a compliance audit. Chapter 3 describes the compliance audit planning at the SAI level. Chapters 4 to 6 follow the individual audit process, the engagement level planning, gathering and evaluating evidence, and reporting. Chapter 7 describes audit documentation and working papers.

All requirements of ISSAI 4000 are explained in the respective chapters, with working paper templates and guidance to apply them. It would help the auditors to prepare working papers adequate to document their work and comply with the requirements.

Chapter 1

Introduction to compliance audit

Contents

1.1 Introduction

This chapter explains the compliance audit and some essential concepts about it. It covers the intent and purpose of compliance audit ISSAIs in conducting quality audits. It describes the ways SAIs can consider adopting the ISSAIs on compliance audit; and when can the SAI refer to the compliance audit ISSAIs in its reports. It introduces the different approaches of conducting compliance audits - the type of engagement, reasonable or limited, direct reporting or attestation engagement – and guides the auditor to decide on the appropriate engagement type suitable for the SAI.

1.2 Public sector auditing and its objectives

Public sector auditing is described as a systematic process of objectively obtaining and evaluating evidence to determine whether information or actual conditions conform to established criteria.[1] Public-sector auditing is essential in that it provides – to the legislative and oversight bodies, those charged with governance and the general public – with information, and independent and objective assessments concerning the stewardship and performance of government policies, programmes or operations.

SAIs serve this aim as important pillars of their national democratic systems and governance mechanisms and play an important role in enhancing public-sector administration by emphasising the principles of transparency, accountability, governance and performance. All public-sector audits start from these objectives, which may differ depending on the type of audit being conducted.

According to ISSAI 100, SAIs usually carry out three types of audit; namely, financial audit, compliance audit and performance audit. Auditor needs to understand how the three audits are different, and what to look for in each type of audit.

Financial audit is to determine whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework[2].

In a financial audit, the auditors look for misstatements and errors that can have a material impact on the information presented in the financial statement. A material misstatement or error is one that would lead individuals with an average understanding of the subject matter to change their views of the assertions made in the financial statements.

Performance audit is an independent, objective and reliable examination of whether the government undertakings, systems, operations, programmes, activities or organizations are operating in accordance with the principles of economy, efficiency and effectiveness, and whether there is room for improvements.[3]

Auditors here review any subject matter from the perspectives of economy, efficiency and effectiveness. Is the government using resources economically while handling a subject matter? Is the ratio of inputs to output optimal in the government operations covered in the audit? Is the government entity able to deliver the intended result and impact?

Compliance audit is an independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. This is done by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities that govern the audited entity[4].

[1] ISSAI 100.18
[2] ISSAI 100.22
[3] ISSAI 300.9
[4] ISSAI 400.12

1.3 Compliance audit and its context

The definition of compliance audit mentioned above builds from the definition of public sector auditing, with a specific focus on assessing compliance with criteria derived from authorities. In compliance audit, the auditor looks for material non-compliance or departure from established criteria, which could be based on laws and regulations, principles of sound financial management, or best practice.

Context of compliance auditing

The concepts and establishment of audit are inherent in public financial management, 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 non-compliance with accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make corrective action possible in individual cases. This serves to make those accountable accept responsibility, and provides the opportunity to obtain compensation, or to take steps to prevent such breaches, or at least make them more difficult.

Public sector audit is essential to public sector administration, because the management of scarce public funds is placed in the care of public sector officials. The use of these funds is regulated by laws and regulations, principles, rules and standards, which together constitute the applicable authorities. The officials are expected to act in the best interest of the public by spending the funds for the intended purposes and in line with the authorities.

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.[5] Whether and how public sector managers fulfil their responsibilities is not a matter of absolute trust. Compliance audit plays an important role in ensuring that the principles of transparency, accountability and good governance are actually met.

Compliance auditing promotes transparency by providing reliable reports as to whether public funds have been used in line with the applicable authorities. It promotes accountability by reporting non-compliance and violations of authorities. This information makes it possible to take corrective action and to hold public officials accountable for their activities. Compliance audit promotes good governance by identifying weaknesses and non-compliance with laws and regulations and also by assessing the propriety of officials.

1.4 Adopting compliance audit ISSAIs

Current ISSAI framework has two ISSAIs for compliance audit: at level 3, ISSAI 400 – Fundamental principles of compliance auditing, and at level 4, ISSAI 4000 – Compliance audit standard. These ISSAIs[6] are broad principles, standards, and guidelines that provide a common frame of reference for SAIs, and facilitate convergence toward common professional standards and practices of compliance audit. These are also based on the historical practices of SAIs. Many SAIs have taken significant steps toward adopting these ISSAIs. If the SAIs conduct their audits in compliance with the ISSAIs, it will assure the quality of their audits to the users. ISSAI 400 provides SAIs with a basis for the adoption or development of standards and guidelines in compliance auditing. SAIs can adopt the ISSAIs in different ways which may help to improve the quality of their audit:

[5] ISSAI 400.16
[6] ISSAI 400.4

As a basis for developing standards

Some SAIs may be conducting compliance audits as per their mandate but they may not have any governing auditing framework to support their work. These SAIs can review the ISSAIs and develop standards and guidelines accordingly for compliance audits. While carrying out this work, the SAIs would need to consider ISSAI 400: Fundamental principles of compliance auditing.

It is important for SAIs to note that references should be made in audit reports to the fundamental principles of compliance auditing only if the standards the SAIs have developed fully comply with all relevant principles of compliance auditing. The ISSAIs emphasize the need for SAIs to consider their respective mandate, laws, and regulations when adopting the ISSAIs. Thus, these principles do not override the existing mandates, laws, and regulations that govern SAI audit practices.

As a basis for adoption of consistent national standards

Some SAIs may already have their national standards for compliance audits. ISSAI 400 provide a frame of reference as fundamental principles for these SAIs. They can analyse their existing practices vis-à-vis the ISSAIs, identify gaps, and modify their governing auditing standards to ensure that it covers all principles of ISSAI 400. SAI can then conduct its audit based on its national standards which is consistent with ISSAI 400.

As a basis for adoption of ISSAI 4000 as the authoritative compliance audit standards

Another option for SAIs could be to consider directly adopting the ISSAI 4000, the authoritative compliance audit standards, as their compliance auditing standards. In some SAI environments, this might not be possible because of administrative structures or laws or regulations that do not support this direction. It is also important to note that SAIs may have different approaches to achieving these principles, and those approaches may be included in the SAI's policies, manuals etc.

1.5 Making reference to compliance audit ISSAIs in the report

Once the SAI adopts the ISSAIs for its compliance audit (following one of the ways mentioned above) it can refer to the ISSAIs in its audit report as the standard it followed to conduct the audit. However, compliance with ISSAIs and making reference to the ISSAIs needs rigorous internal quality assurance, and having such a mechanism in the SAI. If the SAI chooses the third option above, i.e. it has adopted ISSAI 4000 as its standard, the SAI can then make reference to ISSAI 4000. Here, it is important to note that, compliance to ISSAI 4000 refers to an SAI's compliance with all relevant[7] requirements of ISSAI 4000 in an audit [engagement] or in compliance audit practice[8] overall, as verified by an independent evidence based quality assurance (QA) function in the SAI.

This implies that to refer to the ISSAIs in its audit report, the SAI must either have an ISSAI compliant audit practice, or a specific audit must be assessed as ISSAI compliant. Both require an independent QA[9]. So, to make reference to compliance with ISSAIs in its audit report SAI should have a robust QA mechanism.

When SAI complies with ISSAIs and making reference ISSAIs in its compliance audit, an SAI has two options:

[7] In the practical application of such QA, a reviewer will find instances of non-compliance both within an audit and across an audit practice, but must form an overall judgement on ISSAI compliance based on materiality and professional judgement.

[8] As per IDI's understanding, audit practice refers to a set of audits conducted under the same organisational arrangement that follow the same standards, methodology, competency requirements for audit teams, quality control and quality assurance arrangements.

[9] For further guidance on independent QA, please refer to SAI PMF dimensions on strength of QA functions.

1) An SAI may fully comply with its own national standards, which is consistent with the fundamental auditing principles: ISSAI 400 for compliance audit.

   In this case a reference in the compliance audit report can be made (refers to Paragraph 9 of ISSAI 100) by stating:
   'We conducted our audit in accordance with [country national standards], which are based on [or consistent with] the fundamental auditing principles for compliance audit ISSAI 400 of the International Standards of Supreme Audit Institutions'

   This reference can be made only if the auditor has complied with all requirements of the national standards that are relevant to the audit.

2) For compliance audit, an SAI may fully comply with ISSAI 4000, which is at level 4 of the current ISSAI framework. In this case a reference can be made (refers to Paragraph 10 of ISSAI 100) by stating:
   'We conducted our audit[s] in accordance with the International Standards of Supreme Audit Institutions'.

   This reference can be made only if the auditor has complied with all relevant requirements of ISSAIs that are relevant to the audit[10].

An SAI can claim ISSAI compliance for individual audit engagements as well as for its audit practices. An SAI may be able to comply with all relevant ISSAI requirements in an individual audit engagement or selection of individual audit engagements. In this case, the SAI can refer to the ISSAIs in those specific audit engagements, but may not claim to have an ISSAI compliant audit practice. In order to claim that its audit practice is ISSAI complaint, as mentioned above, the SAI must have a QA function that confirms that the SAI complies with all relevant ISSAI requirements at the organisational and individual audit engagement level on a regular and consistent basis.

How this handbook helps

This handbook provides guidance - to the SAI that has adopted ISSAI 4000 as its authoritative standard - on how to conduct a compliance audit following ISSAI 4000. This will enable the SAI to make reference to standards in its audit report as mentioned in option two above.

Next sections of this chapter cover some key concepts of compliance audit that the auditor needs to understand before embarking on the audit. Chapter two explains the SAI level requirements of ISSAI 4000. These are the institutional level arrangement that the SAI must have to conduct an ISSAI compliant audit. Chapter three describes how the SAI can select audit topics, make its annual plan and decide about the SAI level issues for a compliance audit. From chapter four handbook describes the engagement level process from planning to reporting.

1.6 Concepts of compliance audit

Compliance audits are risk-based and carried out by assessing whether activities, transactions and information comply, in all material respects, with the authorities that govern the audited entity.[11] Standards also define the related parties in compliance audit, and the relationships among them. Compliance auditing is based on a three-party relationship in which *the auditor* aims to obtain sufficient appropriate audit evidence in order to make a conclusion designed to enhance the degree

[10] These references will change after migration to the INTOSAI Framework of Professional Pronouncements is completed in 2019
[11] ISSAI 400.12.

of confidence of *the intended users*, other than *the responsible party*, about the measurement or evaluation of a subject matter against criteria.[12]

1.6.1 The three parties

Public sector audits involve three separate parties: the responsible party, the auditor and the intended user(s):

- The *responsible party* refers to the public officials (and therefore to the government entity being audited) who are responsible for the subject matter.
- The *auditor* refers to the SAI.
- The *intended users* are the individuals, organizations or classes for whom the auditor prepares the audit report. In many countries, the legislature or the body that creates the legislation would be considered the main intended user. However, according to the standards it can also be oversight bodies, those charged with governance, or the general public.[13]

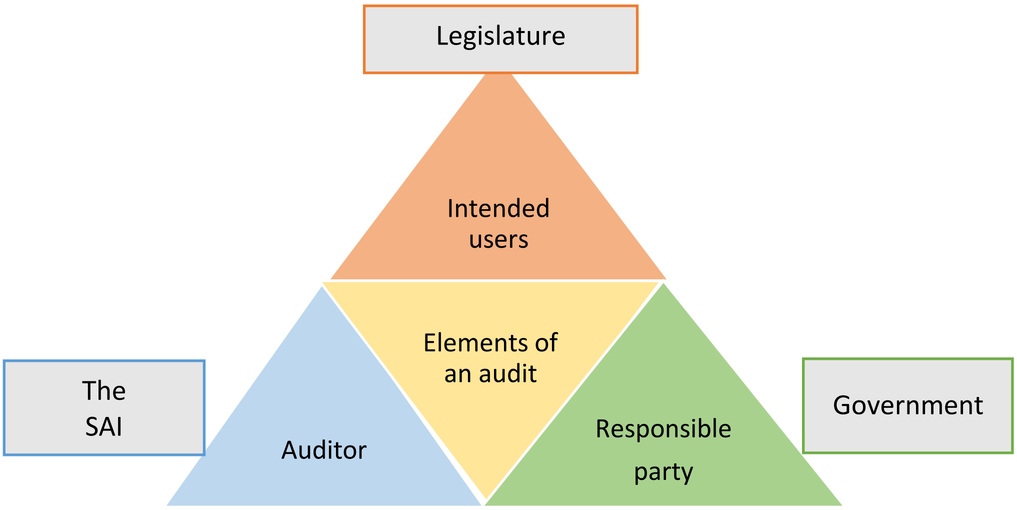

Figure 1.1: The three parties to the audit

In order to understand the three parties, it is important to consider the relationship between them, what each party expects from the others, and how these expectations are met.

Although there are different models, usually the legislature empowers the government to perform specific duties by providing budget, and by establishing a legal framework to govern the spending of these funds. The executive branch of government (public officials) is responsible for the management of public funds. In theory, public officials' exercise of authority is under the control of the legislature. However, in practice, establishing this control depends on receiving information about how the entities are fulfilling their mandate. The legislature needs information about the entities and their activities for decision-making purposes. As auditor, the SAI provides this information to the users.

As key stakeholders, SAI must have a proper understanding of the needs and expectations of the intended users. It is the stakeholders who use the audit reports. The SAI has to be aware of the

[12] ISSAI 400.35.
[13] ISSAI 100.25.

information that users need and how they use the information they receive. The auditor needs to understand the intended user and what (e.g., kind of information, results) might change a decision made by the intended user.

1.6.2 Subject matter of compliance audit

According to ISSAI, "the main objective of compliance auditing is to provide the intended user(s) with information on whether the audited public entities follow parliamentary decisions, laws, legislative acts, policy, established codes and agreed upon terms. These form the relevant authorities governing the subject matter/entity that is going to be audited."[14]

The *subject matter* depends on the mandate of the SAI, the relevant authorities and the scope of the audit. Because of this, the content and scope of compliance audit subject matter can vary widely. It can take many forms and have different characteristics depending on the audit objective and audit scope.[15] For example, subject matter can refer to the information, condition or activity that is measured or evaluated against certain criteria.

Subject matter information refers to the outcome of evaluating or measuring the subject matter against the criteria. Compliance audit is about evaluating the subject matter or subject matter information against relevant criteria.

Identifying the subject matter of compliance audit

The definition of subject matter in compliance audit standards is flexible. This flexibility responds to the diverse needs of SAIs, which may view the concept differently, and allows them to focus their resources where it matters most.

Some SAIs have mandated requirements or have to perform audits on request from the parliament, while other SAIs have discretion to select the coverage of compliance audits. How the subject matter is selected has an impact on the audit approach when it comes to audit evidence and resources[16].

For example, in some SAIs the subject matter of a compliance audit consists of an entity (or the subject matter information is taken as the "accounts" of an entity), without defining a more specific scope. Looking at the definition, it is possible to take an "entity" as the subject matter. In this case, the scope of the audit will cover all activities of the entity and all authorities governing them. Nevertheless, providing a conclusion on such a wide audit scope would be very challenging.

For this reason, standards recognize the relationship between the subject matter and the scope of compliance audits to narrow down the issue which is manageable to audit. The definition provided above states, "The subject matter depends on the mandate of the SAI, the relevant authorities and *the scope of the audit*." This means that when auditors plan a compliance audit, they usually start with a larger subject matter, such as the entity, but as they become more knowledgeable during the process, they may modify the subject matter and scope to a more focused audit, which will make the results more meaningful for users.

The scope defines the subject matter, and what is going to be audited. The scope depends on the needs of the intended user(s), the decided level of assurance, the assessed risk and the competence and resources available in the SAI[17].

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[14] ISSAI 4000.23
[15] ISSAI 100.28 and ISSAI 400.33
[16] ISSAI 4000.43
[17] ISSAI 4000.44

For example, auditors may start their audit planning considering “Ministry of Health” as the subject matter and eventually scope down to auditing “the provision of clean drinking water”.

Example: Scoping for compliance audit of a clean drinking water initiative
SAI X included the health sector of the country as subject matter in its audit plan of 2017 because the sector had received significant government and donor funding in the past few years. What prompted the audit focus on this area was a decline in key health indicators despite considerable investments. At the same time, there were media reports criticizing improper handling of public health issues by the government.
Auditors first thought of covering service delivery mechanisms in the health sector, covering all from primary to the tertiary healthcare institutions. The country had an elaborate legal framework, including constitutional provisions and other policies and procedures to provide healthcare services to all citizens. However, during the audit planning stage, auditors discovered that many indicators were linked to the consumption of unsafe drinking water. These were indicators such as child mortality rate, maternal health, and proportion of under-five children with malnutrition, all of which were declining. Further, the auditors noted that a major fraction of government and donor funding that ended up in the health sector was used in creating facilities for clean drinking water for the poor and vulnerable people in the country. Thus, the auditors decided to narrow down the audit scope to only the provision of clean drinking water. The auditors’ review for the planning process also indicated that appropriate benchmarks/criteria were available for this engagement.

In some countries the subject matter of compliance audits may be indicated in the relevant laws, and in others it can be determined by using risk assessment and professional judgment. For example, in some SAIs, auditable entities have been classified into high-, medium- or low-risk entities. SAIs will conduct compliance audits of high-risk entities every year, while medium- to low-risk entities will be audited once every three years. SAIs should work out a way to determine the subject matter for compliance audit considering their particular circumstances and the flexibility available in the ISSAI framework. Chapter 3 of this Handbook covers the process of determining possible subject matter as part of SAI-level planning.

1.6.3 Authorities and criteria in compliance audit

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. Authorities may include rules, laws and regulations, budgetary resolutions, policies, established codes, agreed terms or the general principles governing sound public sector financial management and the conduct of public officials.[18]

The extent of the auditor's work to obtain a sufficient understanding of the legal and regulatory framework will depend on the nature and complexity of the laws and regulations. However, the auditor needs to understand only the parts of the legislation that are relevant to the particular audit task. In all cases, the audited entity retains the responsibility for ensuring compliance with applicable laws and regulations.

[18] ISSAI 400.28 and 29.

Hierarchy of authorities

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. 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.[19]

If the auditor identifies conflicting authorities, it is important to consider the hierarchy of the authorities; the higher level of authority will prevail over subordinate authorities. For example, if something has been defined in the law about a subject matter, the internal regulations of an entity must be in line with this law. If they are not, auditors should point out the contradiction and, if their mandate allows, recommend a change in the subordinate regulation. This could also be audit evidence if following the internal regulation has caused non-compliance with the higher authority.

Similarly, when auditors are in doubt about the correct interpretation of an authority, they should review background information to understand the intent and premises of the law before using the authority as benchmark. When faced with such a situation, auditors may bring it to the attention of their seniors so the appropriate course of action can be followed during the audit.

Criteria

Criteria are the benchmarks derived from authorities that are used to evaluate the subject matter consistently and reasonably. Criteria can be specific or more general, and may be drawn from various sources, including laws, regulations, standards, sound principles and best practices.

In conducting compliance audits, the criteria may differ greatly from audit to audit. 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 are otherwise available from a readily accessible and reliable source. Whichever of these options are chosen, it is important to clearly identify the criteria in the compliance audit report, so that the users of the report can understand the basis for the auditors' work and conclusions.

Criteria should be made available to the intended users to enable them to understand how the subject matter has been evaluated or measured. Without the frame of reference provided by suitable criteria, any conclusion is open to individual interpretation and misunderstanding. Users should be able to comment on the audit criteria before the audit is started, to make sure that the audit will have the desired effect. Especially for propriety criteria, communication with intended users can prevent the audit results from being neglected in a discussion about criteria when the conclusions are reported.

The ISSAIs frequently stress the need for applying suitable criteria when assessing regularity and propriety aspects of an entity. The reason is that the quality of the audit opinion and conclusion in compliance audits largely depends on how auditors establish and apply audit criteria in their work. Auditors are expected to carry out proper risk assessment to determine which compliance requirements are likely to be violated and, based on that assessment, design and perform procedures to detect such instances. Auditors use professional judgment in determining and applying criteria.

Two types of criteria are required in compliance standards as per the ISSAI framework: those based on established authorities as regularity, and those that capture aspects of propriety.

[19] ISSAI 400.30.

Propriety is defined as “observance of the general principles governing sound financial management and the conduct of public officials”[20]. The use of propriety as a basis for the audit may be common in some SAIs, but there are others that lack the relevant authorities and mandate to assess propriety. Some SAIs use this approach in “management audits” conducted at the request of a legislative body.

Criteria based on established authorities are relatively easy to develop and apply, since auditors look into these authorities while developing an understanding of an audited entity. They know which authorities are significant and use them as benchmarks accordingly. However, establishing suitable criteria for propriety is challenging, as these criteria may be less formal and may require that auditors consider public expectations regarding the actions and behaviour of government officials.

If criteria have not been defined by authorities, it is important to identify criteria that carry the qualities described in the standards. Criteria must be relevant, complete, reliable, neutral, understandable, useful, comparable, acceptable and available.[21]

Suitable audit 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. This would provide sufficient flexibility to the Supreme Audit Institutions to adopt criteria for an audit of propriety that are relevant to their country.

Suitable propriety criteria may derive from:

- Public financial management expectations such as compliance with an effective and efficient internal control system.
- Beneficiaries' expectations regarding the utility of goods or the quality of the services and works.
- Requirements for a transparent and unbiased allocation of public funds and human resources.

1.7 Compliance audit as an assurance engagement

Public officials are responsible for running public entities in compliance with the authorities governing their activities and for achieving a level of performance expected of them. If, for some reason, the entity fails to comply with authorities, officials responsible will be held accountable.

The auditor audits the issue or the subject matter to provide the intended user with correct information. If the audit conclusion is that the information provided is correct in all material respects, the auditor must have sufficient audit evidence to support that conclusion. There can also be cases where the responsible party does not provide the users with required information and users request an independent assessment by the SAI of the actual conditions. The SAI conducts an audit and provide the ‘assurance’ on the condition to the users.

As such, audit conducted by the SAI is an assurance engagement. Compliance audit - as an assurance engagement - enhances the credibility of information provided by the auditor. This assurance can either be provided through opinions and conclusions that explicitly convey the level of assurance, or it can be provided in other forms.[22] The compliance auditor will check whether the information provided by the government entities or actual conditions in these entities comply with authorities

[20] ISSAI 400.13.
[21] ISSAI 4000.118
[22] ISSAI 100.32.

(the relevant laws and regulations, etc.). Following the audit, the SAI will prepare a report for the users, which includes a conclusion on the subject matter. Thus the auditor will be providing an 'assurance' that reduces the risk to the users of using the specific information, and help them to make informed decision.

In the standards, this is referred to as "enhancing the degree of confidence of the intended users". So assurance is linked to how the auditor can gather audit evidence and how much work he/she has to do to be sure of the conclusions. To provide a conclusion with reasonable assurance, the auditor must decide which audit techniques to use, combine them, and then be able to conclude that "the information provided is, in all material respects, correct."

ISSAIs state that the intended users will wish to be confident about the reliability and relevance of the information they use as the basis for making decisions. Audits therefore provide information based on sufficient and appropriate evidence, and auditors should perform procedures to reduce or manage the risk of reaching inappropriate conclusions.[23]

An auditor performs procedures to reduce or manage the risk of providing incorrect conclusions, recognising that due 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.[24]

Reasonable assurance and limited assurance

ISSAIs state that compliance auditing can be performed to provide either *reasonable assurance* or *limited* assurance. These two types are different in using the types of criteria, sampling, evidence gathering procedures and reporting formats. Again, each assurance engagement is either an attestation engagement or a direct reporting engagement. These two types of engagement differ (explained in next section) based on who prepares and measures the subject matter.[25]

Two levels of assurance in compliance auditing convey the message differently to the users. In reasonable assurance engagement, audit conveys that, in the auditor's opinion, the subject matter is or is not in compliance, in all material respects, with the stated criteria. In limited assurance engagements, it conveys that, nothing has come to the auditor's attention to cause him/her to believe that the subject matter is not in compliance with the criteria. Reasonable or limited assurance can be provided both for direct reporting and attestation engagements in compliance auditing.[26]

Next section of this chapter describes the different ways to conduct a compliance audit. It analyses the situation on when to provide limited or reasonable assurance concerning direct reporting and attestation engagement and design the audit accordingly.

1.8 Different ways to conduct compliance audit

The ISSAI 4000 explains key considerations that apply when SAIs conduct compliance audits as stand-alone engagements. This Handbook covers – the compliance audit process as explained in ISSAI 4000 – the different ways to conduct a compliance audit.

[23] ISSAI 100.31.
[24] ISSAI 400.40.
[25] ISSAI 4000.31.
[26] ISSAI 400.41.

As mentioned before, compliance audit can be categorised as two different types of audit engagements: attestation engagements and direct reporting engagements:[27]

- In *attestation engagements* the responsible party, i.e., the entity measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for expressing a conclusion. Attestation engagements can be both reasonable and limited assurance engagements.

- In *direct reporting engagements* it is the auditor who measures or evaluates the subject matter against the criteria. The auditor selects the subject matter and criteria, taking into consideration risk and materiality.

  The outcome of measuring the subject matter against the criteria is presented in the audit report in the form of findings, conclusions, recommendations or an opinion. The audit of the subject matter may also provide new information, analysis or insights.[28] The conclusion may also be expressed as a more elaborate answer to specific audit questions.[29]

Each assurance engagement (either reasonable or limited) is either an attestation engagement or a direct reporting engagement. Direct reporting engagements and attestation engagements differ based on who prepares and measures/evaluates the subject matter. The subject matter could be either set out in the mandate or selected by the SAI[30].

The difference between the two types of audit is linked to subject matter and subject matter information, and refers to the definition of audit.

The subject matter of a compliance audit can be activities, financial transactions or information. In attestation engagements, auditor attests the subject matter information, which may be a statement of compliance in accordance with an established and standardised reporting framework[31]. Here the audit criteria are implicitly given by the presentation of the subject matter information. In these cases, the auditor needs to identify relevant audit criteria to draw conclusions on correctness of criteria implicitly given in the subject matter information by the responsible party.[32]

According to ISSAIs, 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. This can be shown with an example that builds on the same subject matter and scope, in different environments.

	Country X	**Country Y**
Responsible party	National Tax Office (NTO) of Country X	National Tax Office (NTO) of Country Y
Subject matter of audit	Tax revenues of Value Added Tax (VAT)	Tax revenues of Value Added Tax (VAT)
Subject matter	Financial information related to	Financial information related to VAT

[27] ISSAI 100.24.
[28] ISSAI 100.29.
[29] ISSAI 400.59.
[30] ISSAI 4000.31
[31] ISSAI 100.30.
[32] ISSAI 4000.113

information	VAT revenues	revenues
Criteria	VAT law and other laws and regulations governing collection of taxes	VAT law and other laws and regulations governing collection of taxes
User	Parliament	Parliament

Now let's look at who creates the subject matter information, and how this influences the audit. There are two possible scenarios, which lead either to an attestation engagement or to a direct reporting engagement.

1.7.1 Attestation engagements

Scenario 1: Country X
National Tax Office of Country X presented a report to the parliament regarding tax collection. Subject matter information has been produced by the responsible party and presented to the users in the form of a report (this information could also be in the form of a statement, statistics, etc.). When officials were producing the subject matter information, they were obliged to follow relevant legislation and other laws and regulations governing these taxes.

Standards make reference to producing subject matter information as "evaluation of subject matter against criteria". In this situation, the National Tax Office has already provided the subject matter information (evaluation) to the Parliament, in the form of a report. With their report, the officials of the responsible party are making explicit or implicit claims (assertions) that the information (evaluation) on the VAT revenue (subject matter) is true and fair in the light of the laws and regulations (criteria).

The auditor's role in this scenario is to attest the assertion - expressed in the form of conclusion or opinion - on whether the assertion made by the responsible party about the evaluation it provided is correct or not; and whether the officials have indeed followed the laws and regulations as they have claimed (explicitly or implicitly). This conclusion enhances the confidence of the parliament about the report (subject matter information) it has received.

1.7.2 Direct reporting engagements

Scenario 2: Country Y
National Tax Office (NTO) of Country Y does not publish reports on tax collection. Some statistics are provided on its website, but these are usually outdated and not detailed. NTO is a part of the general budget system, and due to the financial management framework does not produce a separate set of financial statements. Due to the way final accounts are prepared, it is not possible to isolate tax revenues collected by NTO from tax revenues from other sources. Recently, the Parliament of Country Y has been discussing a reform initiative that aims to improve tax collection from VAT. SAI management decided to prepare an audit report on VAT revenues and submit it to Parliament.

In the scenario given above, no subject matter information (and therefore no assertion) has been made available by the responsible party, despite the need for this information. Therefore, the SAI through its audit decided to provide the information to the users. The audit will directly evaluate the VAT revenues (subject matter) based on criteria and will provide a conclusion. Based on the evaluation of the subject matter by the auditor the SAI prepares the audit report and submit it to Parliament.

This form of audit is called "direct reporting". In a direct reporting engagement, the audit is conducted directly on the subject matter, rather than on the subject matter information.

1.7.3 Levels of assurance and types of audit

To understand the wide scope of compliance audit, it is necessary to understand the link between assurance levels and types of audit. The following table will help in understanding how these concepts work together in practice.

		Engagement type	
		Direct Reporting (DR)	Attestation Engagement (AE)
Assurance level	Reasonable Assurance (RA)	RA-DR	RA-AE
	Limited Assurance (LA)	LA-DR	LA-AE

Table 1: Levels of assurance and types of audit in compliance auditing

Each audit conducted by the SAI will fall into one of the four cells shown in the table.

1.7.4 Regularity and propriety compliance audit

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 about financial management and the conduct of officials. Depending on the mandate of the SAI and the nature of laws and regulations in the public sector context of the SAI, the audit scope may therefore include aspects of propriety.

If the SAI has the mandate, auditors are also required to consider propriety aspects in compliance audits. Usually, this requires auditors to ascertain that the audited entity has followed the principles of sound financial management and its officials have acted transparently and equitably in making critical decisions for the entity. Auditors establish their compliance audit scope and audit criteria on the basis of this review.

Regardless of the source of criteria, the auditor performs the audit and forms a conclusion at the selected level of assurance (reasonable or limited), in accordance with the requirements in ISSAI 4000. Also, irrespective of the characteristics of the engagement, i.e. attestation or direct reporting, the audit criteria can include both regularity and propriety.

1.9 Conclusion

This chapter introduces the different ways to conduct compliance audit following ISSAI 4000. It shows that there are options on conducting reasonable or limited assurance, attestation or direct reporting, and regularity or propriety engagements. This handbook describes the compliance audit as reasonable assurance direct reporting engagement which is regularity in nature. Next chapter will describe the SAI level requirement for compliance audit as general principles. Subsequent chapters will explain the compliance audit phases: planning and designing the audit, gathering evidence, evaluating the evidence and forming conclusions, and reporting.

Chapter 2

SAI level considerations for compliance audit

Contents

2.1 Introduction

This chapter builds on from the concepts of compliance audit covered in Chapter one. It describes the pre-engagement issues that the SAI management needs to address first at SAI level before its starts conducting a compliance audit. These issues are included in the general requirements for compliance auditing in ISSAI 4000. This chapter also illustrates the compliance audit process, subsequent chapters of this handbook explain the process.

2.1 SAI level considerations for compliance audit

SAI level considerations for compliance audit should happen prior to commencement of audit and throughout the audit process. SAI needs to make sure that before the start of the audit SAI has established the systems, mechanisms in the SAI and prepared its staff to conduct the audit with requirements of these elements. Following are the SAI level considerations that are fundamental to the conduct of a compliance audit:

1. Selection of audit coverage
2. Risk assessment
3. Objectivity and ethics of auditors
4. Audit team competence
5. Professional scepticim and judgment of auditor
6. Quality control mechanism
7. Documentation of audit work
8. Communication

As the nature of the audit is iterative and cumulative, the SAI should consider these prior to commencing any audit and also at more than one point during the audit process.

2.1.1 Selection of audit coverage

ISSAI 4000.64: Where the SAI has discretion to select the coverage of compliance audits it shall identify areas that are of significance for the intended user(s).

Some SAIs perform audits on request from the Parliament, while other SAIs have discretion to select the coverage of compliance audits. This requirement is not relevant for SAIs have mandated requirements for compliance audits. Where the SAI has discretion to select the coverage of compliance audits, it performs the procedures necessary (explained in the chapter three) to identify significant areas and/or areas with potential risk of non-compliance. In performing these procedures, the auditor may take into consideration any of the following:

a. Public or legislative interests or expectations.
b. Impact on citizens.
c. Projects with significant public funding.
d. Beneficiaries of public funds.
e. Significance of certain provisions of the law.
f. Principles of good governance.
g. Roles of different public sector bodies.
h. Rights of citizens and of public sector bodies.
i. Potential breaches of applicable laws and other regulations which govern the public entity's activity, or the public debt, public deficit and external obligations.

j. Non-compliance with internal controls, or the absence of an adequate internal control system.
k. Findings identified in previous audits.
l. Risks of non-compliance signalled by third parties.

When selecting areas, SAI team may find it valuable to analyse budget proposals, publications, evaluation reports etc. Taking part in conferences and discussion fora may also give the team valuable information to form the basis for selecting subject matters by the SAI and reduce the risk of auditing low risk areas. The auditor may often come across examples of non-compliance in connection with other types of audit work being performed. It can be important to report the findings to the risk assessing process work in the SAI for the coming year.

After selecting the significant audit areas, the auditor needs to determine materiality. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. For example, non-compliance with the terms and conditions of a donor-funded project would be considered material if that non-compliance could lead the donor to discontinue funding for the project or impose more stringent controls as a pre-condition of continued funding.

Materiality 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. Materiality has to be determined to form a basis for the design of the audit and re-assess it throughout the audit process.

2.1.2 Risk assessment

ISSAI 4000.52: The auditor shall perform procedures to reduce the risk of producing incorrect conclusions to an acceptable low level.

ISSAI 4000.58: The auditor shall consider the risk of fraud throughout the audit process, and document the result of the assessment.

Audit risk is the risk that the auditor’s report, conclusion or opinion may be inappropriate. A compliance audit should be performed to reduce the audit risk to an acceptable low level in the circumstances of the audit.

Reducing audit risk includes, anticipating the possible or known risks of the work envisaged and consequences thereof, developing procedures to address those risks during the audit and documenting which and how those risks will be addressed. The auditor needs to evaluate whether the scope of the work performed is sufficient. In addition, when concluding, the auditor needs to evaluate whether s/he has sufficient and appropriate audit evidence when assessing subject matter against criteria to form conclusion(s), based on the level of risk involved.

In an attestation engagement the audit risk - which includes three components as inherent riks, control risk and detection risk - are considered altogether during the evaluation of the audit risk. In a direct reporting engagement, the auditor is involved in producing the subject matter information. The auditor may apply the audit risk model in forming a conclusion on the subject matter.

2.1.3 Objectivity and ethics of auditors

ISSAI 4000.45: The auditor shall comply with the relevant procedures relating to objectivity and ethics, which in turn shall comply with the related ISSAIs on objectivity and ethics.

ISSAI 4000.48: The auditor shall take care to remain objective so that findings and conclusions will be impartial and shall be seen as such by third parties.

The auditor is to demonstrate professional behaviour and integrity, be objective, possess the required professional competence, and exercise due care. S/he is also to maintain independence in fact and appearance and confidentiality regarding all audit matters.

The auditor demonstrates objectivity in selecting their audit objectives and identifying the criteria. The auditor needs to ensure that communication with stakeholders does not compromise the objectivity of the SAI.

The auditor needs to avoid undue influence from any stakeholders in formulating a balanced report, and maintains their objectivity so that their work and report will be seen as impartial by reasonable and informed third parties.

SAI can make sure that the auditor follows the requirement and complies with it. SAI can assist the auditor by providing guidance on code of ethics. SAI can refer to ISSAI 10 Mexico Declaration on SAI Independence, ISSAI 11 INTOSAI Guidelines and Good Practices related to SAI Independence and ISSAI 30 Code of Ethics. Annex 2.1 provides a suggestive template for the SAI teams to comply with the code of ethics. For objectivity of audit team members SAIs have mechanisms (e.g. templates) for declaration of no conflict of interest, and/or declaration of conflict of interest before the audit starts. All these templates are to be filled up once (or if necessary for individual audits on a case by case basis) every year before the start of each audit cycle. It is not required to fill for every engagement.

2.1.4 Audit team competence

ISSAI 4000.85: The SAI shall ensure that the audit team collectively has the necessary professional competence to perform the audit.

The audit team is assembled to collectively have the necessary competence, knowledge, skills and expertise to perform the audit in accordance with professional standards. Depending on the subject matter, this may include:

a. Auditing skills and skills regarding data collection/analysis.
b. Legal competence.
c. An understanding and practical experience of the type of audit being undertaken.
d. Knowledge of the applicable standards and authorities.
e. An understanding of the audited entity’s operations and appropriate experience for the type of entity and operations being audited.
f. The ability and experience to exercise professional judgment.
g. Producing an auditor's report that is appropriate in the circumstances.

The SAI needs to assign adequately skilled resources that are available when needed in the different phases of the audit process. Where specialized techniques, methods or skills are not available within the team or the SAI, external experts may be used in different ways, e.g. to provide knowledge or conduct specific work. When in need of external expertise, the SAI evaluates whether experts have the necessary independence, competence, capabilities and objectivity. The SAI also determines whether their work is adequate for the purposes of the audit. Even if external experts perform audit work on behalf of the SAI, the SAI is still responsible for the conclusion(s).

SAI needs 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 and appropriate audit resources. SAI should arrange for the auditors to maintain their professional competence through ongoing professional development[13].

2.1.5 Professional scepticism & judgment of auditor

ISSAI 4000.71: The auditor shall exercise professional judgment throughout the audit process.

ISSAI 4000.74: Professional advice shall be sought when difficult or contentious issues are encountered to assist in exercising professional judgment.

ISSAI 4000.77: The auditor shall exercise professional scepticism and maintain an open and objective mind.

Auditors should plan and conduct the audit with professional scepticism and exercise professional judgment throughout the audit. The auditor's attitude should be characterised by professional scepticism and professional judgment, which are to be applied when forming decisions about the appropriate course of action. Auditors should exercise due care to ensure that their professional behaviour is appropriate.[33]

Both professional scepticism and professional judgment are required to conduct the compliance audit properly. They are two separate requirements, different in their meaning and also in their application. But each complements the other in the auditor's work.

Maintaining professional judgment and scepticism in compliance auditing requires 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. It also requires the ability to apply audit concepts in the approach to known and unknown subject matter.

Professional judgment

Professional judgment is used to reach a well-reasoned conclusion that is based on the relevant facts and circumstances available at the time of the conclusion. Auditors must apply professional judgment at all stages of the compliance audit process. Professional judgment involves the identification, without bias, of reasonable alternatives. Therefore, careful and objective consideration of information that may seem contradictory to a conclusion is key to its application.

When conducting compliance audits it is important to have the ability to understand and analyse the structure and content of public authorities, the public needs, and gaps in legislation. Auditors with sufficient knowledge and experience can apply professional audit concepts in the approach to a familiar or unfamiliar subject matter.

Professional judgment is a skill the auditor acquires over time, and only after acquiring this skill can he/she can apply professional judgment. Auditors acquire this skill by obtaining relevant training and

[13] ISSAI 400.45
[33] ISSAI 100.37.

experience. That is why application of professional judgment also means the application of the auditor's training, skill and experience. And only an auditor with training, knowledge and experience specific to a given circumstance is expected to exercise a reasonable professional judgment in that circumstance. In short, professional judgment is circumstance-based and not every auditor is expected to be competent for every assignment.

Knowledgeable, experienced, and objective persons can reach different conclusions in applying professional standards, despite similar facts and circumstances. This does not necessarily mean that one conclusion is right and the other is wrong. Appropriate questioning is to be expected to understand the procedures performed and the basis for conclusions reached. Documentation of professional judgment calls is important to demonstrate that a sound process was followed and to help develop a well-reasoned conclusion. When professional judgment is challenged, documentation shows the analysis of the facts, circumstances, and alternatives considered as well as the basis for the conclusions reached.

Professional scepticism

Professional scepticism is an attitude that includes maintaining an open and objective mind by being alert to conditions which may indicate possible non-compliance due to error or fraud. Professional scepticism is essential when evaluating audit evidence contradicting other audit evidence already obtained, and information that brings into question the reliability of audit evidence, such as documents and responses to inquiries[34].

Exercising professional scepticism is necessary to ensure that the auditor avoids personal bias and to make sure that the auditor is not overgeneralizing when drawing conclusions from observations. In addition, the auditor will act rational based on a critical assessment of all the evidence collected.

The auditor maintains an attitude of professional scepticism in order to be alert to conditions, circumstances and information that may indicate the existence of material non-compliance and to critically assess the audit evidence.

When exercising professional scepticism, auditors keep an open and reasonably questioning mind without being overly suspicious. Auditor does not assume that management is dishonest, nor do they assume that it honest. Auditors always keep it in the back of their mind that fraud can exist and they should not be satisfied with less than persuasive evidence because they believe that management is honest.

Professional scepticism includes being alert to, for example:

- Audit evidence that contradicts other audit evidence obtained.
- Information that brings into question the reliability of documents and responses to inquiries to be used as audit evidence.
- Conditions that may indicate possible fraud.

Maintaining professional scepticism throughout the audit is necessary if the auditor is to reduce the risks of:

- Overlooking unusual circumstances.
- Over-generalizing when drawing conclusions from audit observations.
- Using inappropriate assumptions in determining the nature, timing and extent of the audit procedures and evaluating the results thereof.

[34] ISSAI 4000.78

2.1.6 Quality control mechanism

ISSAI 4000.80: The SAI shall take responsibility for the overall quality of the audit to ensure that the audits are carried out in accordance with relevant professional standards, laws and regulations, and that the reports are appropriate in the circumstances.

Quality control refers to ongoing processes being in place for reviewing the quality of a compliance audit at each stage to ensure that the audit is in compliance with applicable governing standards, and that the audit report, conclusion, or opinion issued is appropriate in the circumstances. SAI should establish quality control mechanism as a line function for this purpose. Audit reports are issued only after the report has gone through this assessment.

The quality control procedures can be supervision, reviews, consultation and adequate training, and cover the planning, execution and reporting stage. The overall quality of the SAI is dependent on a system where roles and responsibilities are clearly defined.

Quality control includes considering whether the audit team has sufficient and appropriate competence to conduct the audit, is capable of selecting criteria free from bias, has general access to accurate information, has considered available information, and has had sufficient time to complete the audit assignment.

Within the scope of the quality control procedures, the SAI may have a quality assurance system in place to secure the overall quality of the audit. The SAI ensures that appropriate procedures are performed and that reviews are performed throughout the audit process. The quality controls are documented in the audit file.

2.1.7 Documentation of audit work

ISSAI 4000.89: The auditor shall prepare audit documentation that is sufficiently detailed to provide a clear understanding of the work performed, evidence obtained and conclusions reached.

Sufficient audit documentation is important within all steps of the compliance audit. The purpose of documenting the audit work performed is both to enhance transparency about the work performed, and to enable an experienced auditor having no previous connection with the audit, to understand significant matters arising during the audit, the conclusion(s)/ opinion(s) reached thereon, and significant professional judgments made in reaching those conclusion(s)/ opinion(s).

The documentation includes as appropriate:

a. An explanation of the subject matter of the audit.
b. Risk assessment, audit strategy and plan, and related documents.
c. The methods applied and the scope and time period covered by the audit.
d. The nature, the time and extent of the audit procedures performed.
e. The results of the audit procedures performed, and the audit evidence obtained.
f. The evaluation of the audit evidence forming the finding(s), conclusion(s) opinion(s) and recommendation(s).
g. Judgments done in the audit process, including professional consultations and the reasoning behind them.
h. Communication with and feedback from the audited entity.
i. Supervisory reviews and other quality control safeguards undertaken.

Documentation needs to be sufficient to demonstrate how the auditor defined the audit objective, subject matter, the criteria and the scope, as well as the reasons why a specific method of analysis was chosen. For this purpose, documentation needs to be organized in order to provide a clear and direct link between the findings and the evidence that support them. Further explanation on this is included in Chapter 7 of the Handbook regarding documentation and communication in relation to compliance auditing.

2.1.8 Communication

ISSAI 4000.96: The auditor shall communicate in an effective manner with the audited entity and those charged with governance throughout the audit process.

ISSAI 4000.99: Instances of material non-compliance shall be communicated with the appropriate level of management and (if applicable) those charged with governance. Other significant matters arising from the audit that are directly relevant to the entity shall also be communicated.

Communication takes place at all audit stages: before the audit starts, during initial planning, during the gathering and evaluation of evidence, and at the reporting phase. It is essential that the audited entity together with the SAI be kept informed of all matters relating to the audit. This is key to developing a constructive working relationship between the auditor and the entity and also within the audit team. This will help keep all parties informed of the audit's progress and will assist in resolving any matters that may obstruct the audit and cause delays.

Communication should include obtaining information relevant to the audit and providing to management and those charged with governance the audit criteria and, throughout the engagement, timely observations and findings. 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[14]. This can assist in rectifying any non-compliance and any other findings the auditor may observe at an earlier stage, rather than later when the impact of the finding could be substantially material and may be more difficult to resolve. The auditor may also have a responsibility to communicate audit-related matters to other users, such as legislative and oversight bodies.

The matters that are communicated in writing to the audited entity may include: the audit subject matter, audit criteria, the level of assurance, the time period for the audit, and the government undertakings, organizations and/or programs to be included in the audit, i.e. confirming the terms of engagement. Communicating these matters can help in achieving mutual understanding of the audit process and the auditees operations.

The form of communication with those charged with governance throughout the audit process needs to be adapted to the conditions. The auditor considers the timing of communications, and whether they are conducted orally or in writing or both.

[14] ISSAI 400.49

2.3 Compliance audit process

The diagram below shows the compliance audit process.

SAI level planning *(covered in chapter 3)*

- Select compliance audit topics
- Annual compliance audit plan
- Determine attestation or direct reporting
- Determine level of assurance
- Consider principles with ethical significance
- Ensure quality control procedure

Planning inidividual audit *(covered in chapter 4)*

- Identify subject matter, scope, and criteria
- Determine audit objective
- Understand the entity and environment
- Understand internal control
- Assess risk and materiality
- Develop audit strategy and plan

Gathering evidence *(covered in chapter 5)*

- Gather evidence by performing audit procedures
- Update planning and risk assessment
- Ongoing documentation, communication and quality control

Evaluating evidence *(covered in chapter 5)*

Evaluate whether sufficient appropriate evidence obtained

- Consider materiality for reporting purpose
- Form conclusions
- Address subsequent events as necessary

Reporting *(covered in chapter 6)*

- Prepare reports
- Include recommendations and responses from entity as appropriate
- Follow-up previous reports as necessary

Documentation, communication and quality control throughout the audit process
(covered in chapter 7)

Figure 2.1: Compliance audit process

SAI level planning: At SAI level planning phase, SAI selects the topic and prepare annual plan for compliance audit. SAI decides if the engagement will be attestation or direct report, and reasonable or limited. SAI considers the principles of ethical significance—i.e. independence and objectivity of the auditor, team competency, and ensure that quality control procedures are in place. SAI also makes sure that the team is able to conduct the audit with required documentation and communication throughout. As explained in chapter one, this handbook explains compliance audit as a reasonable assurance direct reporting engagement.

Planning individual audit: In the planning phase, the auditor looks into the relationship between the subject matter, criteria, and scope of the compliance audit. Auditors are guided by professional judgment and the needs of intended users while doing this exercise. Once they decide on the subject matter, criteria, and scope of the individual compliance audit engagement, they work out the audit strategy and audit plan. They understand the internal control, establish materiality, assess risks to the entity, and plan audit procedures as part of the designing the audit.

Performing the audit and gathering evidence: In this phase, auditors primarily gather and document evidence to form a conclusion or opinion as to whether the subject matter, in all material respects, complies with established criteria. In some cases, auditors may have to change the scope of a compliance audit if they come across audit evidence suggesting a need for that change. For instance, while gathering evidence, if auditors find something that is indicative of fraud they may have to modify their procedures. When the possibility of fraud has been identified, the auditors take action to ensure that they respond appropriately and they will need to document why they have changed their audit plan. Although an audit may act as fraud prevention, it is not normally designed to detect fraud.[35]

Evaluating the evidence and forming conclusions: At the end of the audit, auditors examine the evidence for sufficiency and appropriateness in order to form a conclusion or opinion as to whether the subject matter is in compliance with the established criteria. At this stage, auditors consider materiality for reporting purposes.

Reporting: The conclusion or opinion is presented in the form of a report to the intended user. Here the auditor includes the recommendations and the entity's responses to them.

This Handbook has separate chapters on the steps of the compliance audit process. As shown in Figure 2.1, documentation, communication and quality control are significant crosscutting requirements of the ISSAIs and have to be considered at all stages of the audit.

2.4 Conclusion

This chapter elaborates the SAI level requirements of compliance audit that SAI needs to establish before team starts auditing. Next chapter will explain how the SAI can centrally plan for its compliance audit for one or more years in SAI level planning. Based on the SAI level planning audit teams start individual audit planning which is explained in chapter four.

[35] ISSAI 4000.63

Annex 2.1: Audit team declaration to comply with the SAI Code of Ethics

ISSAI requirement covered: ISSAI 4000.45, ISSAI 4000.48

(This template is to be filled up once every year before the start of each audit cycle, not for every engagement)

Entity Name	
Audit Period	

Assessed by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Aspects of Code of Ethics	Declaration I declare that:	Affirmation by audit team member (Yes/No)	Reasons if indicated that he or she cannot comply with code of ethics
			Refer to Annex 1.4
Integrity	The audit will be conducted adhering to high standards of behaviour (honesty and candidness).		
	I will conduct myself in a manner that befits public confidence and is above suspicion and reproach.		
	I will observe the form and the spirit of auditing and ethical standards, principles of independence and objectivity.		
	I will maintain irreproachable standards of professional conduct and make decisions with public interest in mind.		
	I will apply absolute honesty in carrying out work and handling the resources of the SAI		
Independence Objectivity and Impartiality	I will behave in a way that increases, or in no way diminishes, my impartiality and independence from the audited entity and other outside interest groups.		
	I will maintain objectivity in dealing and disposing off any audit issues, topics and subject matters.		
	The audit work that I will perform will be according to the ISSAI and not based on ulterior motive or undue influence. The issues that arise will be based on audit evidence gathered and not influenced by any preconceived beliefs or other influence.		

Aspects of Code of Ethics	Declaration I declare that:	Affirmation by audit team member (Yes/No)	Reasons if indicated that he or she cannot comply with code of ethics
	I will maintain objectivity, accuracy and impartiality in expressing opinions based on evidence obtained and assessed in accordance with the ISSAIs.		
Political neutrality	I will maintain political neutrality and not let my personal, political affiliations influence my audit work and my conclusions, opinions reached during the audit influence the quality of the audit work.		
	I will not partake in any political activity that will influence my judgement		
	I will not express my political views during the audit and maintain a behaviour that keeps my appearance and work free from influence.		
Conflicts of interest	I will not provide any professional service or advice to the entity relating to the financial information being audited or related to management responsibilities or power.		
	I will not accept any gifts or gratuities or beyond the value customary to accept.		
	I will avoid any kind of relationships with managers and staff and other related parties that might influence or threaten my ability to act independently.		
	I will not use my status or official position for private gain and will avoid any relationship that involves the risk of corruption.		
	I will not use information obtained during the audit of securing any personal benefit nor divulge information, which would provide unfair or unreasonable advantage to other parties.		
Professional Secrecy	I will not disclose any information that I come across during the course of audit to any third party, unless the law requires me to do so.		
Competence	I will conduct myself in a professional manner and apply ISSAIs in all my work performed during the audit.		
	I will seek professional views and guidance in the work where I am not competent to discharge the work.		

Aspects of Code of Ethics	Declaration I declare that:	Affirmation by audit team member (Yes/No)	Reasons if indicated that he or she cannot comply with code of ethics
	I will keep abreast of and apply applicable auditing, accounting, and financial reporting standards, policies, procedures and practices.		
Professional-ism	I will exercise due professional care in conducting/supervising the audit and in preparing reports.		
	I will use methods and practices of the highest possible quality in audits.		

Agreement of Team member

I, the undersigned, fully understand the requirements and my responsibilities in terms of the Code of Ethics stated in the above table.

I will comply with the ethical requirements set out in the table above relating to the audit of (Name of audited entity)

(Signature)
Name of Team Leader/member
Designation

Conclusion

To the best of my knowledge and analysis, after consideration of the above declarations and staff interviews, I conclude that all the requirements contained in the Code of Ethics for SAI (country name) auditors are understood by (name and designation). Any potential threat to the audit team's independence are considered to have been reduced to an acceptable level, as documented in Annex 1.4.

(Signature)
Name of Supervisor
Date:

Completing the audit team declaration to comply with the SAI Code of Ethics: Suggested process guide

<table>
<tr><td>Objective of completing the template</td><td>The objective is to obtain a declaration from the audit team member, including the audit team leader, confirming compliance with the SAI's Code of Ethics while conducting the audit. It also confirms that the audit team members will maintain objectivity and independence throughout the audit.</td></tr>
<tr><td>ISSAI requirements covered</td><td>ISSAI 4000.45, ISSAI 4000.48</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Guide</td><td>Each member of the audit team including the audit supervisor should complete this declaration to confirm that he/she will comply with the SAI's Code of Ethics while conducting the given audit. For instance, if the audit team comprises five members including the audit supervisor, there should be five such declarations in the audit file.
There are four columns in this template. The explanation for columns 1 and 2 and guidance to complete columns 3 and 4 are given below:
<table>
<tr><td>Column 1</td><td>This contains the Code of Ethics in brief. These are the key statements of ethical conduct that the auditor needs to comply with while conducting the audit. The extent of the list would depend on the particular SAI's Code of Conduct, assumed to have been developed based on ISSAI 30.</td></tr>
<tr><td>Column 2</td><td>These are some of the pre-determined statements or declarations that each member of the audit team is expected to make on each code of ethics. Depending on the nature and type of entity identified for audit, the declaration statements can be customised to the needs of the SAI.</td></tr>
<tr><td>Column 3</td><td>Each member of the audit team needs to state either "Yes" or "No" against the pre-determined statement to comply with the code of ethics identified for the audit. As professionals, each member of the team is expected to provide his/her honest answer to each statement. With robust review process put in place in reviewing each declaration made herewith independently, this working paper is expected to demonstrate that due consideration has been given to the professional code of conduct of each audit team member.</td></tr>
<tr><td>Column 4</td><td>If the answer to any statement or declaration is "No", the reason for such answer needs to be recorded in this column, which can later be traced to Annex 1.4. For instance, the reason could be self-interest or self-review threat. The objective is to deal with these threats appropriately by putting safeguards in place.</td></tr>
</table>
</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Overall undertaking of the member</td><td>Based on the declaration of each statement under the SAI's Code of Ethics, the member of the audit team should provide an overall undertaking to reaffirm that he/she has understood the responsibilities in terms of the</td></tr>
</table>

	Code of Ethics and will comply with them accordingly. This needs to be signed off and submitted to the reviewer for independent review.
Conclusion of the supervisor	The supervisor or the independent reviewer in the SAI or the audit team should conclude that he/she has reviewed the declaration made by the aforementioned member of the audit team, and re-affirm that the member has understood the Code of Ethics and accordingly will comply with it while conducting the audit.
Recording the evidence of verifier and reviewer	The table indicating the details of verifier and reviewer needs to be completed at the end. This is to ensure that there was an independent check and balance system in the audit team, and that this was completed before commencement of audit. In this case, the verifier is usually the audit team leader, and the reviewer is the audit supervisor. Similarly, when the audit team leader and audit supervisor provide a declaration, the verifier and reviewer can then be addressed based on the organisation structure of the SAI. This needs to be signed off accordingly by the verifier and reviewer respectively.

Chapter 3

SAI-Level Planning for Compliance Audit

Contents

3.1 Introduction

This chapter is appropriate for the SAI's overall annual work plan, which covers all audit types that it conducts. It is important to note that SAI-level planning should not be done separately for each type of audit. Though this chapter restricts itself in SAI level planning for compliance audit, similar process can be used for other types of audit as well.

SAIs should plan their audit work on an annual or multi-annual basis. The legal framework could specify which audit types (financial, compliance, or performance) a SAI can do. Any multi-annual planning should encompass all audit types available to a SAI and should be based on a risk assessment. The work a SAI can undertake in a given period is further determined by the resources (staff and other) available to it. Therefore, resources available after deducting the resources needed for the mandatory requirements determine the extent to which a SAI can include additional tasks in an annual or multi-annual work plan. This chapter provides guidance on key considerations in an annual or multi-annual planning process.

3.2 Overview of the annual and multi-annual planning process

The main steps in identifying potential tasks that would be significant for the intended user of the SAI's output typically involve the following:

- A policy and risk review and strategic priorities, which provide the basis for planning.
- Identification of potential audit tasks and other tasks, and their ranking.
- Establishment of an annual or multi-annual work plan.

These different steps are discussed in the following parts of this chapter.

3.3 Policy and risk review and strategic priorities

Where the SAI has discretion to select the coverage of compliance audits, it should identify significant areas and/or areas with potential risk of non-compliance (ISSAI 4000.67). A SAI-wide policy and risk review helps ensure that the SAI selects tasks and products that best reflect risks, the public interest, and the potential for the SAI to add value.

The policy and risk review takes into account the overall strategic level, recent developments in the country, stakeholder interests, recent and ongoing work of other SAIs as well as any professional developments. The policy and risk review should consider in particular the pre-legislative process in order to determine the optimum delivery time of audit reports to ensure the best possible impact.

In performing this policy and risk review, the auditor may consider, among others, the following (ISSAI 4000.67):

Stakeholders priorities/interests:

- Public or legislative interests or expectations, e.g. achievement of Sustainable Development Goals (SDGs) by the country
- Interest of and impact on citizens
- Interests of beneficiaries of public funds
- Media coverage
- Non-compliance signaled by third parties

⇨ Main risks linked to stakeholders' priorities/interests

Changes to the legal framework and other developments in the area, for example:

- Developments/changes in the legal framework in the different areas
- Significance of certain provisions of the law
- Principles of good governance
- Other major/important changes and developments in the different areas
- Roles of different public sector bodies and changes thereto
- Rights of citizens and of public sector bodies
- Potential breaches of applicable laws and other regulations that govern the public entity's activity, or the public debt, public deficit and external obligations
- Projects with significant public funding

⇨ Main risks linked to changes and developments in the area

Results of recent audits and developments in audit, including:

- Non-compliance with internal controls, or the absence of an adequate internal control system
- Findings identified in previous audits of the SAI
- Works of other SAIs
- Developments in audit
- Mandate and audit coverage of the SAI

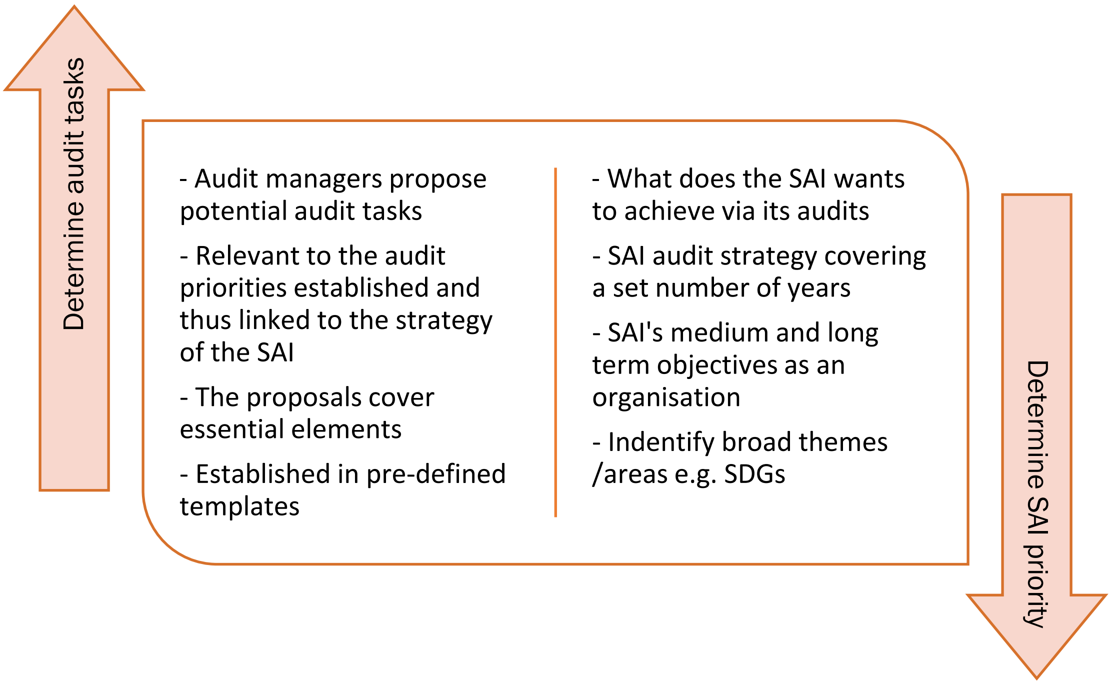
⇨ Main risks identified in audits

The policy and risk review should map the main developments and identify relevant high-level risks. It should be based on the knowledge and expertise of the SAI. When performing the policy and risk review, the auditor may find it valuable to read budget proposals, publications, evaluation reports, etc. Taking part in conferences and discussion fora may also give the auditor valuable information to form the basis for selecting subject matters by the SAI and reduce the risk of auditing low risk areas. The auditor may often come across examples of non-compliance in connection with other types of audit work being performed. It can therefore be useful to report such findings to the risk assessment work in the SAI for the coming year.

The strategic priorities are derived from the policy and risk review. They provide a high-level orientation for the annual/multi-annual work plan. The priorities could constitute policy areas requiring particular attention (e.g. social security, housing etc.) or the identification of specific or cross-cutting audit topics the SAI would like to cover (e.g. climate change, procurement, etc.).

Besides audit tasks, SAIs could consider establishing a strategic approach for other tasks it would like to achieve as an organisation in the medium and long terms, including internal capacity development (e.g., develop its approach to compliance auditing or ensure that a certain percentage of its audit staff obtain a professional qualification, etc.).

3.4 Identification of potential audit tasks and their ranking



The policy and risk review helps ensure that the SAI selects tasks and products that best reflect risks, public interest and the potential for the SAI to add value and contribute to accountability. Thus, SAIs should take account of their strategic priorities when establishing their potential audit and other tasks. Potential tasks consider a list of proposed audit topics, an estimate of resources required for each, and information on their relative priority. These potential tasks could be identified in a bottom-up and/or top-down approach and should be documented.

In the bottom-up approach, audit managers propose potential audit tasks. These are generally relevant to the audit priorities established and thus are linked to the strategy of the SAI. SAI can pre-design a template for facilitating the bottom-up approach to identifying the tasks.

The top down approach flows from SAI strategic plan, which spans a set number of years. The strategic plan is operationalized in multi-annual and annual plans and priorities. These priorities determine what the SAI wants to achieve as an organisation through its audits as medium- and long-term objectives. In this process, the SAI identifies broad themes/areas of significance that are of national or international interest, e.g., IT, SDGs, environment, etc.

Annex 3.1 Documenting a Potential Audit Task provides guidance on how this process can be completed. Following are important considerations in completing the template.

Assessing priority. The SAI—normally top down by a dedicated service/ad-hoc working group/top management—compares all the potential tasks proposed with the strategic priorities for the planning period concerned and assesses the extent to which the priorities are covered. This analysis should identify the audit tasks best suited to address the strategic priorities and identify priorities that have not been sufficiently covered by the proposed potential audit tasks.

Such an analysis should use a set of pre-established criteria such as relevance to the strategic priorities, importance of risks, political/public interest and potential added value through the audit. The latter can include considerations of financial importance, past coverage, auditability, etc. This analysis should rank the proposed audit tasks and should be documented. Assessing the proposed audit tasks against pre-established criteria is not an exact science. Professional judgment based on knowledge and experience is needed.

The relevance of an audit task to the strategic priorities could be assessed as not relevant/low/medium/high.

Assessing risk. The risk associated with a proposed audit topic could be assessed as low, medium or high, depending on the likelihood of occurrence of the main factors identified and their potential impact. Such a risk assessment could be documented as shown in Table 3.1.

Table 3.1: Determining the importance of risks

		Likelihood of occurrence	
		Low	High
Potential Impact	Substantial	Medium Risk	High risk
	Minimum	Low risk	Medium risk

Assessing political/public interest. Tasks considered for audit should be of potential interest to the SAI's main stakeholders, e.g. the parliament. Main sources of information are decisions made by parliament and reports and other documents it has produced. Additional points to take into account are the interest shown by the national administrations, by the press or the general public, and by other SAIs. The level of public interest (low – medium – high) should be determined for each proposed audit task.

Assessing potential added value. This entails the following considerations:

- SAIs should consider the potential added value of the topic in terms of the financial importance of the area concerned.
- Furthermore, SAIs should assess whether they can say something new and useful. For this purpose, SAIs should also take into account the audits, the control reviews and the evaluations recently carried out or planned by themselves and by other bodies. Higher priority should be given to areas and topics that have never been audited, or audited only partially, or audited many years previously.

- The potential impact in terms of identifying weaknesses and making recommendations should be considered.
- A key element is also timeliness. The selection of topics should be timed to contribute to changes such as major reforms or the introduction of new initiatives. A report that is late will be unable to influence events and it therefore loses relevance.
- Auditability or feasibility should also be taken into account and assessed, that is, whether it is technically or practically possible to carry out the audit and whether the SAI has the capacity and skills needed. External expertise, for example, might be needed.

For each task, the SAI should translate the result of the assessment of these four pre-established criteria into a priority ranking. The SAI could allocate the degree of priority to the audit tasks in terms of a total score achieved. The topics are then ranked in accordance with their level of priority (i.e. total score). Table 3.2 proposes how the degree of priority (total score) could be allocated to a particular task.

Table 3.2: Priority ranking of a task

Audit task:											
Priority			Risk			Interest			Added value		
N/R		Score 0									
Low		Score 1	Low		Score 0	Low		Score 0	Low		Score 0
Medium		Score 2	Medium		Score 1	Medium		Score 1	Medium		Score 1
High		Score 3	High		Score 2	High		Score 2	High		Score 2
Total Score:											

3.5 Establishment of the annual or multi-annual SAI work plan

The annual or multi-annual work plan should include information on the audit and non-audit tasks to be carried out, a brief description of each task, the human resources and other resources (e.g. travel costs, expertise needed, etc.) to be allocated to each task, and the intended implementation and reporting calendar.

Establishing the annual or multi-annual work plan requires the following steps:

- Determine the total staff resources available. Establish the standard number of weeks for a full-time member of staff. From this deduct, for example, vacation leave, a reserve including non-assignable resources due to parental leave, part-time work, sick leave, training, and administration.

- From the total staff resources available, deduct the resources needed for mandatory and other recurrent tasks including non-audit work. In addition, allocate other resources for these tasks.

- After determining the remaining staff resources and other resources, identify the number of potential audit tasks ranked with the highest priority that can be carried out in the given planning period.

These considerations could be documented in an overview sheet. Annex 3.2: Annual/multi-annual work plan provides a template to complete this process with a suggested process guide.

Realistic deadlines and timelines should be set and the workload should be spread out over the planning period. To this end, SAIs should make sure that resources allocated to each task are sufficient in terms of quantity and quality. A margin for contingencies and unforeseen events that could occur during the implementation of the task should also be foreseen.

Once the annual or multi-annual work plan is established and approved by the hierarchy of the SAI, the individual tasks should be implemented. The considerations and steps to follow in this are covered in chapters 4 to 7 of this Handbook.

The implementation of the annual or multi-annual work plan should be monitored on a regular basis by the SAI to inform management of the progress made in implementing the plan, the use of resources, the milestones attained, the objectives achieved, and the work still pending. For example, a half-yearly report on the annual plan's implementation could be established. For this purpose, SAI staff time reporting on tasks is considered good practice.

Based on the monitoring results, the plan should be revised if underlying assumptions change, the priority ranking is no longer valid, or other reasons for needed change become apparent.

3.6 Compliance audit planning – considerations at SAI level

After the SAI has made its annual work plan it needs to make some SAI level decisions on how the SAI teams should perform the individual audits. These are the initial considerations relevant to audit planning at the SAI level. At this level SAI may identify the subject matters for audit which may come from the topics identified for the coverage of audit. SAIs need to identify the intended users of the audit and consider the type of audit engagement. SAIs need to make informed decisions on whether to conduct a reasonable or a limited assurance audit of a subject matter. Once these decisions are made SAI teams will follow these in their individual audits starting with engagement level planning as explained in chapter four.

3.6.1 Determining direct reporting or attestation engagement

The decision whether to carry out an attestation engagement or a direct reporting engagement is based on the availability of the subject matter information. Regardless of the characteristics of the engagement, the audit criteria can include both regularity and propriety.

Direct reporting engagement. In a direct reporting engagement, it is the auditor who measures or evaluates the subject matter against the criteria. The auditor selects the subject matter and criteria, taking into consideration risks involved and materiality. By measuring the subject matter against the criteria, the auditor is able to form a conclusion. The conclusion is expressed in the form of findings, answers to specific audit questions, or an opinion followed by recommendations.

The audit criteria in a direct reporting engagement will be derived from the various authorities governing the subject matter. A direct reporting engagement may also be either a reasonable assurance or a limited assurance engagement.

For a direct reporting engagement with reasonable assurance, detailed audit planning using a variety of evidence-gathering techniques is important in order to arrive at the audit conclusion, expressing the auditor's view that the subject matter is or is not compliant in all material respects with the applicable criteria.

Attestation engagement. In an attestation engagement the responsible party or the entity measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for forming a conclusion. The conclusion is expressed in the form of findings, conclusions, recommendations or an opinion. The existence of subject matter information based on a certain pre-defined framework is necessary in order to conduct an attestation engagement. For instance, an example of such subject matter information could be the annual financial reports prepared based on rules and regulations, or a budget execution report, or the activity reports, all of which are prepared by the entity based on a defined framework and the requirements provided in a legislation or in a guideline.

If the audit team decides to plan for an attestation engagement given that the subject matter information is available, the audit criteria will be derived from the framework (generally this framework is set by the governing authorities for the entity) based on which the subject matter information is prepared. An attestation engagement can be a reasonable assurance or a limited assurance engagement.

For an attestation engagement with reasonable assurance, the auditors need to plan and conduct sufficient audit procedures using variety of evidence-gathering techniques, in order to arrive at the audit conclusion and express the auditor's view on whether the subject matter information is in compliance with the applicable criteria.

How this handbook provides guidance on the two types of engagement

This handbook explains the difference and provides guidance in audit process starting from planning to conducting for both types of engagements.

Sampling:

The important difference between the two process is that in attestation engagements it is a must that statistical sampling is used. This is because, the deviations or non-compliances are extrapolated for the entire population and opinion or conclusion is made on the whole population. This is possible when sampling is representative of the entire population and the only way to ensure that in audit is by applying statistical sampling procedures. It is not appropriate to use judgmental sampling and then extrapolate the result because judgmental sampling may not be representative of the population to conclude on. For this reason, in planning chapter 4 sampling is explained in detail considering attestation engagement. It is also possible to use statistical sampling in direct reporting engagements as well, in that case the part for attestation engagement will be applicable.

Risk assessment:

In attestation engagement auditor selects the subject matter and criteria, taking into consideration risk and materiality. The three audit risk components (inherent risk, control risk and detection risks) are considered altogether during the evaluation of the audit risk in attestation engagement. In a direct reporting engagement - where the auditor is involved in producing the subject matter information - may apply the audit risk model in forming a conclusion on the subject matter[36]. In planning chapter risk assessment is explained - with the three risk components - considering both types of engagement.

Materiality:

Materiality is considered in attestation engagement, and the same applies for direct reporting engagement. The auditor selects the subject matter and criteria, taking into consideration risk and materiality[37]. This handbook covers application of materiality throughout the audit process without differentiating attestation engagement and direct reporting as it can be applied in similar manner.

All these are covered in planning and conducting part as required by the ISSAIs. In reporting chapter format for attestation engagement is suggested following ISSAI 4000 which is a standard opinion, and in case of direct reporting it is conclusion.

3.6.2 Determining the availability and competence of resources

Determining the availability and competence of resources is important, as the audit team plays a significant role in delivering a quality audit.

At the onset of audit planning, consideration must be given to whether the audit team has sufficient and appropriate competence to conduct the audit, is capable of selecting criteria free from bias, has general access to accurate information, has considered available information, and has sufficient time to complete the audit assignment. Determining the availability of competent resources is a factor in deciding the level of assurance that can be provided. If the SAI lacks competent resources knowledgeable of the subject matter, it will be difficult to conduct a reasonable assurance engagement.

The SAI needs to assign adequately skilled resources that are available when needed in the different phases of the audit process. Where specialized techniques, methods or skills are not available within the team or the SAI, external experts may be used in different ways, e.g. to provide knowledge or conduct specific work. When in need of external expertise, the SAI evaluates whether experts have the necessary independence, competence, capabilities and objectivity. The SAI also determines whether their work is adequate for the purposes of the audit. Even if external experts perform audit work on behalf of the SAI, the SAI is still responsible for the audit conclusion(s).

[36] ISSAI 4000.54-55
[37] ISSAI 4000.37

Refer to Annex 3.3: Audit team competency matrix, template for team competency. Competency mentioned here has reference from ISSAI 4000. It is suggested that SAI customize this template to make it compatible with its practice and context. Some SAIs may have fixed audit teams at least for one audit cycle year with designated supervisors. In that case - instead of for each engagement - it is sufficient (and manageable) to make the selection of teams based on the competency matrix template once a year at SAI level. If there is a change in the team composition it can be updated periodically as necessary.

I also feel that some of the working paper templates in the HB will be sufficient to be filled up once a year instead of for every audit assignment. For instance

3.6.3 Determining whether the engagement is on regularity or propriety

Compliance auditing includes the aspects of regularity (adherence to formal criteria such as relevant laws, regulations and agreements) and/or propriety (observance of the general principles governing sound financial management and the conduct of public officials). Regardless of the source of criteria, the auditor should perform the audit and form the conclusion with the selected level of assurance, in accordance with the requirements in the standard.

If the subject matter is governed by legislation, regulations or any other formal authorities from which the audit criteria can be derived, the audit criteria will be more acceptable to the audited entity.

While regularity is the main focus of compliance, propriety may also be pertinent given the public-sector context, in which there are certain expectations concerning financial management and the conduct of public officials. Depending on the mandate of the SAI, audits may also examine compliance with generally accepted principles and generally acknowledged good practices governing the conduct of public officials. Suitable audit criteria for a compliance audit of propriety will be either generally accepted principles or national or international good practices. In some cases they may be uncodified, implicit, or based on overriding principles of law.[38] This would provide sufficient flexibility to the SAI to adopt criteria relevant to its country in an audit of propriety.

If there are no such formal authorities governing the subject matter, the audit team needs to ensure the appropriateness of the source from which audit criteria are selected. In the audit of propriety, criteria taken from acceptable standards or good practice guides need to be discussed with the entity. This handbook covers the regularity aspects of compliance audit.

3.6.4 Determining the level of assurance to be provided

ISSAI 4000.121: Depending on the mandate of the SAI, the characteristics of the subject matter, and the needs of the intended user(s), the auditor shall decide whether the audit shall provide reasonable or limited assurance.

When assessing the level of assurance, the auditor considers the needs of the intended user(s). This could be done through communicating with the intended user(s) or those charged with governance.

38 ISSAI 400/32.

There may also be generally accepted practices in the jurisdiction to support the auditor in deciding the level of assurance.

Providing reasonable assurance requires more extensive audit work. Some SAIs have mandated requirements that already define the level of assurance.

In some circumstances an SAI may conduct a compliance audit engagement to provide limited assurance. In a limited assurance engagement, the auditor reduces the engagement risk to a level that is satisfactory or acceptable in the given situation; however, the risk in such an audit engagement is greater than in a reasonable assurance engagement.

In a limited assurance engagement, as the name suggests, the auditor carries out procedures that are limited in comparison with the level of procedures required in a reasonable assurance engagement.

This chapter of the Handbook covers the compliance audit methodology for reasonable assurance in direct report and attestation engagements. Chapter 5 on gathering and evaluating evidence provides some guidance on conducting a limited assurance direct reporting engagement. It highlights the differences between conducting limited assurance engagements and reasonable assurance engagements.

The level of assurance to be provided in an audit needs to be considered when the scope and subject matter of an audit is being identified. Conducting a limited or a reasonable assurance audit is a strategic decision that needs to be made at the SAI, after considering the following:

- Needs of the intended user.
- State of internal control environment and control systems of the audited entity.
- Availability of and access to information.
- Existing competencies of the auditors.
- Availability of resources.

Although some of these factors may take precedence, all relevant factors should be considered in reaching a decision. The list above is not exhaustive. SAIs may consider other factors while making a decision on the level of assurance to be provided in an audit.

Needs of intended user. User needs are the most important factor to consider in determining the level of assurance to be provided by the audit. An SAI has to assess the needs of the intended users to determine which type of conclusion is more appropriate. This requires an understanding of the decisions made by the users, and the type of information they use for decision making.

It can be said that if the decision making process of the users requires sophisticated information on the subject matter and its functioning, a reasonable assurance audit would be more appropriate. This assurance level provides an insight into the systems of the subject matter and their reliability. However, if the users are interested in findings, and do not request an insight into the systems and controls, then a limited assurance audit would be more suitable.

Different SAIs may take different approaches in an audit planning. Some may be making a longer term strategic audit plan while others may be making annual audit plans. Other SAIs may be using a hybrid system involving both longer-term and annual planning. These variations in planning do not limit SAIs to following a consistent approach in conducting individual audits. While planning a compliance audit at a macro level, SAIs may consider the following factors:

- Significant funding by donors, linked to compliance with provisions of contracts/agreements;
- Instances of non-compliance by the entity;
- Findings/recommendations made by parties other than the SAI;
- Risk assessment performed in connection with financial or performance audits, indicating areas where risk of non-compliance is higher;
- Public interest or expectations (for example, suspected fraud, mismanagement, information reported in the media, etc.).

Another factor to consider in planning the compliance audit can be the urgency of the need for information on a particular subject matter by the intended users. If there is an immediate need or a request by users for audit results, conducting a limited assurance audit would be more feasible.

Availability of information. Although access to information is a fundamental aspect of an audit, and SAIs usually have strong powers to ensure the necessary access, an SAI can still face situations where information available for the audit is limited; some information may not even exist. Or the auditor may not have sufficient access to existing information. In such cases, due to the specific nature of public sector audit the SAI may not be in a position to decline to conduct the audit. However, this factor would have an impact on the level of assurance to be provided.

This is especially important regarding outsourced services. Today, more and more public entities outsource their services. And this can be more common with services pertaining to information systems. In such a case, the auditor needs full access to the entity providing the services in order to conduct the audit. In some instances, this would require the SAI to audit the service provider. However, many SAIs do not have a mandate to do such audits, which severely limits the audit and its effectiveness.

Reasonable assurance audits require the auditor to have access to the systems and processes used in the subject matter (e.g. internal controls of an entity), and therefore necessitate more information than a limited assurance audit. Therefore, limitations on information would likely lead to a limited assurance audit.

Existing competencies of the audit teams. Standards state that “the individuals in the audit team should collectively possess the knowledge, skills and expertise necessary to successfully complete the audit.”[39] An SAI needs to consider what competencies already exist when deciding on the scope of audit and level of assurance to be provided. If necessary competencies are not available within the audit team, then the SAI should consider options such as changing the audit team’s composition or hiring an expert.

In a reasonable assurance audit, the auditor is likely to do test of controls as well as detailed substantive testing to reach to an overall conclusion about the subject matter. For example, this could be done by identifying a sample of transactions that are representative of the total population and extrapolating the results of sampling to the whole population. In order to reach an overall conclusion in a reasonable assurance audit, the auditor is also likely to evaluate the systems and processes of the subject matter—for example, conduct an internal controls assessment. To take this approach, the audit team would need the necessary competencies that would be relevant in the circumstances.

[39] ISSAI 4000.85.

In limited assurance audits, the aim is to obtain a level of assurance meaningful to the intended users based on a limited nature, timing and extent of audit procedures.

Availability of other resources. Reasonable assurance audits usually require more time and resources than a limited assurance audit of the same subject matter with the same scope, considering the number and extent of audit procedures tested in a reasonable assurance audit. Therefore, an SAI with limited resources would be more inclined to conduct a limited assurance audit. However, this should be considered carefully by giving precedence to user needs and by considering other factors such as materiality and risk.

3.7 Conclusion

This chapter explains the SAI annual or multi-annual planning process. This process is linked to the SAI strategic plan, which is then operationalized with the annual plan. The annual plan preparation process requires the analysis of tasks to be accomplished by the SAI and the resources available for the tasks. The SAI needs to operate within its resources to complete both its mandatory tasks and its selected tasks. It also explained the considerations for SAI level planning. Working paper templates and guidance are provided for completion of this process. Once the SAI selects the audit topics, make decisions on the SAI level issues, next step is to plan the individual audit. Chapter 4 will cover the audit planning process for an individual compliance audit.

Annex 3.1: Documenting a potential audit task

ISSAI requirement covered: ISSAI 4000.64

Potential Audit Task assessed by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Potential Audits Tasks		
Organisation Unit	Title of task	Reference:
Link to SAI strategic priority		
I – Audit field		
Main activities: Legal framework: Financial and other information: Roles and responsibilities:		
II – Reasons for the audit		
Risks		
Public and stakeholder interest	Relevance: Materiality:	
Potential added value (incl. impact, timeliness, and coverage)	Previous audits: Timeliness:	
III – Audit organisation		
Audit question (main question and possible sub-questions) or what could be assessed by the audit: Audit criteria (or sources for criteria): Main sources of audit evidence: Audited bodies:		
IV – Remarks		
Feasibility (possible difficulties in the audit/auditability issues,..):		
Estimated audit resources:		
Use of existing audit findings (SAI or other auditor) ☐ Yes ☐ No		
V – Contact persons		

Completing the audit task documentation template: Suggested process guide

<table>
<tr><td>Objective of completing the template</td><td>To document the process of identification of potential audit tasks. There can be different audit tasks identified by different teams in the SAI. This process needs to be repeated for each audit task identified to enable management to agree on a list of audit tasks. The supervisor or management will address the identified tasks in the SAI- level overall planning for compliance audit.</td></tr>
<tr><td>ISSAI requirement covered</td><td>ISSAI 4000.64</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Guide</td><td>Consider the text in Chapter 3 section 3.4 along with this guide. On the top row write the linkage with the SAI strategic priorities. This may come from the SAI strategic plan where it has identified the key priority areas on which the SAI will focus in its strategic planning period. If there is no apparent link with the strategic plan but the team feels that the topic needs to be considered, write the reason for it.
<table>
<tr><td>Row 1</td><td>Refers to main activities of the audit field; legal, financial and other relevant information; and who are responsible for the field. This will give an overview of the field to be considered.</td></tr>
<tr><td>Row 2</td><td>Write the key risks perceived at this point from the field; public and stakeholder interest in the field; any potential added value including impact, timeliness, and coverage. Materiality by nature is covered at this stage of SAI-level planning as well. Write how it is material to the stakeholders.</td></tr>
<tr><td>Row 3</td><td>Write how the audit would be organized. At this point it is not very precise, but the tentative audit questions could be assessed, along with possible audit criteria, potential main sources of audit evidence, and the audited bodies that can fall within the audit.</td></tr>
<tr><td>Row 4</td><td>Write the possible difficulties in the audit i.e. auditability issues, required audit resources, possible use of existing audit findings. This will assist management in deciding whether it should be included in the plan.</td></tr>
<tr><td>Row 5</td><td>Write the details of the team members who proposed the tasks for audit.</td></tr>
</table>
</td></tr>
<tr><td>Review</td><td>A person senior to the auditor may review the proposal keeping in mind SAI context with pragmatism. This could be documented in the template. It will be based on the SAI structure and the form of the audit teams. The reviewer signs off the proposal and sends it to management or the supervisor.</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Conclusion</td><td>The audit supervisor and management are to conclude whether the task proposed has potential for audit. This process will assist management in aligning the strategic priorities set by the strategic plan and in achieving the planned goals.</td></tr>
</table>

Annex 3.2: Establishing the annual or multi-annual work plan

ISSAI requirement covered: ISSAI 4000.64

Plan prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Annual Plan Period: (……….)							
Planned Tasks and Resources							
	Description	Total person week for entire task	Total person week for the planning period	Costs (travel, experts etc.)	Planned start date	Planned end date	Comments
Non audit tasks	Example: Annual planning						
	Task 2 etc.						
	Non-audit tasks total						
Mandatory audit tasks	Task 1						
	Task 2 etc.						
	Mandatory tasks total						
Selected audit tasks	Task 1						
	Task 2 etc.						
	Selected tasks total						
Support functions	Example: Legal services						
	IT services etc.						
	Support Total						
Total resources							

Conclusion

Annual and multi-annual audit tasks and corresponding resources have been prepared considering the above.
(Signature)
Name:
Date:
Reviewer:
Signature, Date:

Completing the annual or multi-annual work plan: Suggested process guide

Objective of completing the template	The objective is to prepare a work plan that includes all the tasks of the SAI; and to guide how the SAI can identify resources for the selected audit tasks in compliance audits.
ISSAI requirements covered	ISSAI 4000.64
Guide	The audit plan period is mentioned at the top. Planned tasks are covered in the rows, and resources required are in the columns. Rows are explained below. Resource columns include person week, cost and timeline. These are covered along with the tasks in rows below: **Row 1** Write all non-audit tasks that the SAI conducts. These can be the SAI's annual plan, administrative work, training, other consultation work, specific tasks allocated by the stakeholders unrelated to audit, etc. For each non-audit task, complete the respective row considering the resources columns, e.g. person-weeks required, costs, and timeline. Once all tasks are recorded with resources, add the columns in the "total" row for all non-audit tasks. **Row 2** In a similar manner write all mandatory audit tasks the SAI is required to conduct under its legal mandate each year. These could include financial audit, performance audit, compliance audit and other audit requirements mandated by the legislation. Complete the resources column for each tasks and calculate the total resources of all mandatory tasks. **Row 3** The selected audit task row should be filled in similar manner. For each task selected, complete the columns with person-weeks, costs, and timelines. Calculate the total the resources required for the selected tasks. **Row 4** Complete the resources required for all support functions of the SAI. These include IT, legal, advisory, external training, etc. Add the rows for each service to get the full picture of resources required to provide support functions. **Row 5** Determine the total resources required by the SAI to conduct all activities or tasks. From here, it would be evident what resources SAI has, and what it would need to complete the mandatory, non-audit tasks and support functions. Deduct all these from the total resources, and the remaining resources can be allocated to the selected audit tasks.
Overall conclusion by the audit team member	Based on the information gathered in the table and the analysis of the resources, the resources available for the selected tasks are determined and submitted for approval.
Review by supervisor	The supervisor reviews and sends it to SAI management for consideration in future audit assignments for the teams.

Annex 3.3: Audit Team Competency Matrix

ISSAI requirement covered: ISSAI 4000.85

(This template is to be filled up once every year before the start of each audit cycle, not for every engagement)

Entity Name	
Audit Period	

Team competency assessed by		**Signature**	**Reviewed & approved by**	**Signature**
Name:				
Designation:				
Date:				

A. Competency Matrix

No.	Detail of Audit Team members with designation	**Competency aspects** (Refer to Table B)			
		Required competency in terms of qualifications and experience	Actual qualification and experience of audit team members	Gap between actual and required competencies	Number of years the auditor has been auditing this particular entity or similar entities
1	Audit supervisor				
	Name				
2	Team Leader				
	Name				
3	Team member				
	Name				
4	Team member				
	Name				
5	Team member				
	Name				

B-1. Assessment of the required core competencies of audit team members and actions to address any gap

Audit Team	Involvement in the prior year's audit of the entity	Do the respective team members have relevant **core competencies***? (Yes/No) (From Table A)				
		Leads by example	Engages effectively with stakeholders	Behaves in a professional manner	Contributes to value and benefits of SAI	Time frame to address the gap
Team leader						
Name						
Team member						
Name						
Team member						
Name						
Team member						
Name						

Conclusion
The engagement team collectively has the core competencies to perform the audit. Measures are identified to address the lack of competencies before the start of the audit, and during the course of audit.

B-2. Assessment of the required functional competencies and actions to address the gap

Audit Team	Involvement in the prior year's audit of the entity	**Do the respective team members have relevant functional competencies*?** (Yes/No) (From Table A)				
		Adds value by conducting ISSAI-compliant compliance audits	Demonstrates understanding of context, environment and entity in a compliance audit	Assesses and manages risk in a compliance audit	Performs and documents compliance audit procedures as per ISSAIs	Effectively communicates and follows up on compliance audit results
Team leader						
Name						
Team member						
Name						
Team member						
Name						
Team member						
Name						

Overall Conclusion
The engagement team collectively has the appropriate capabilities, core competencies, functional competencies and experience to perform the audit. Appropriate measures have been identified to address the lack of competencies before the start of the audit, and during the course of audit.

(*Name of Supervisor*)
Designation
Date:

Completing the Audit Team Competency Matrix: Suggested process guide

Objective of completing the template	To determine whether the audit team collectively possess the required core competencies and functional competencies to plan and perform the audit. It will identify the gaps between the required competencies for conducting the audit against the actual competencies of the team assigned for the audit. The supervisor or management will address the gaps identified in the team competency matrix before the start of audit, and during the audit.
ISSAI requirement covered	ISSAI 4000.85
Guide	**Table A: Team competency matrix** – Objective is to determine the required competencies and actual competencies of each team member, and address the gap, if any. It is also to determine the experience of each team member in conducting the audit of this particular entity or similar entities. **Column 1** The team members and their designations. Designation provides a basis for the supervisor to ensure the correct combination of experience of audit team members. **Column 2** Write the required competency in terms of qualifications and experience to conduct the audit of this entity. It is the judgment of audit supervisor or team leader to decide on the required qualification and experience considering the nature and complexity of entity's operations. Competencies are based on the Table B 1 and B2. **Column 3** Write the actual qualification and relevant experience of each team members. **Column 4** Note if any difference exist between actual and required competencies for each team member. **Column 5** Write the number of years the auditor has been auditing the entity or similar entities. Experience of auditing the entity for number of years may compensate for gaps other competencies.
Guide	**Table B-1: Assessment of the required core competencies of audit team members and actions to address the gap** – Objective is to recognize the relevant core competencies of audit team members required to conduct the audit. Based on gaps identified under Table A above, action can be identified and appropriately addressed before, during & after the audit. It can form a basis to identify training needs of audit team members. **Column 1** Write the team members and their designations in the SAI. **Column 2** Write the experience of each member in prior year's audit of the entity. During the risk assessment process of the entity, this information provides valuable input as they have institutional memory of the inherent risks and controls risk.

<table>
<tr>
<td></td>
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<table>
<tr><td>Column 3</td><td>Write if the team members demonstrate ethical behaviour in all situations, display personal accountability and respect diversity.</td></tr>
<tr><td>Column 4</td><td>Write if the team members demonstrate understanding of stakeholders, and communicate effectively with stakeholders.</td></tr>
<tr><td>Column 5</td><td>Mention if the team members strive to achieve quality by applying relevant ISSAIs, demonstrate core audit and information technology skills, and continuously pursue excellence.</td></tr>
<tr><td>Column 6</td><td>Write if the team members contribute to SAI performance, contribute to effective management, act in the public interest in general.</td></tr>
<tr><td>Column 7</td><td>If there are any competency gaps, suggest options to address them. The audit supervisor or team leader may consider whether the knowledge and skills possessed by the team overall would compensate for any gap in competencies. If not, the supervisor may propose actions to resolve the gap.</td></tr>
</table>
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<td>Guide</td>
<td>
Table B-2: Assessment of the required functional competencies, and actions to address any gap. – Objective is to identify the relevant functional competencies of audit team members required to conduct the audit. Based on gaps identified under Table A above, action can be identified and appropriately addressed before, during and after the audit. It can form a basis of training needs of audit team members.
<table>
<tr><td>Column 1</td><td>Write the team members and designations.</td></tr>
<tr><td>Column 2</td><td>Write the experience of each member in the prior year's audit of the entity. During the process of risk assessment for the entity, this information provides valuable input, as experienced team members have institutional memory of the inherent risks and control risks.</td></tr>
<tr><td>Column 3</td><td>Mention if the team members demonstrate an understanding of how compliance audit practice adds value by promoting accountability and transparency in the use of public money; demonstrate ability to apply key concepts of compliance auditing appropriately in audit practice; ensure quality in conducting a compliance audit; and exercise professional judgment and skepticism. throughout the compliance audit.</td></tr>
<tr><td>Column 4</td><td>Write if the team members demonstrate understanding of the wider context of the public sector and compliance</td></tr>
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		frameworks at institutional level, and demonstrate understanding of the entity/entities operations and associated compliance risks.
	Column 5	Mention if the team members have the capacity to assess audit risk in compliance audit and to manage risk throughout the compliance audit process.
	Column 6	Write if the team members are able to evaluate the applicable authorities and criteria; can conduct preliminary assessment of entity's internal control system; and have the ability to develop and conduct procedures to manage audit risk, apply sampling techniques, gather sufficient and appropriate audit evidence, evaluate results of all audit procedures and determine potential effects on audit conclusions and recommendations; and maintain documentation and communication with stakeholders throughout the audit.
	Column 7	Mention if the team members are able to prepare audit reports using the prescribed formats, and to follow up on audit results
Conclusion	The audit supervisor is to conclude whether the audit team collectively possess the appropriate capabilities, core competencies, functional competencies and experience to plan and perform the audit. The supervisor should suggest measures to address any competency gap. The audit supervisor may send this to SAI management to address the issues at an organizational level in order to ensure competencies for future audits.	
Evidence of supervisor and reviewer	Person who assessed the team's competency and who reviewed it will record their evidence. Assessor can be the audit team leader, and the reviewer can be the audit supervisor. It will be based on SAI structure and operations and the audit team. Reviewer signs off once the assessment has been completed and reviewed.	

Chapter 4

Engagement Level Planning Compliance Audit

Contents

4.1 Introduction

Chapter 3 discussed how the possible audit topics or areas to be audited are prioritized and the SAI annual audit plan is prepared. This chapter will cover the process of planning the individual audit assignments. Planning an audit involves collecting and assessing information and making decisions as to the audit scope, approach, timing and resources. The aim is to reduce the audit risk or the risk of reaching a wrong conclusion or opinion on the audit, where required, to an acceptably low level by developing an audit strategy and audit plan that describes how the audit will be performed and the resources needed to efficiently deliver the audit. ISSAI requires the auditor to plan the audit in a manner to ensure that an audit of high quality is carried out in an economic, efficient and effective way and in a timely manner. Auditors planning the audit need to be knowledgeable about the compliance requirements applicable to the subject matter to be audited. We first look into the initial considerations for planning a compliance audit, followed by a detailed explanation of the audit planning process, including risk assessment and materiality.

ISSAI 4000.137 The auditor shall develop and document an audit strategy and an audit plan that together describe how the audit will be performed to issue reports that will be appropriate in the circumstances, the resources needed to do so and the time schedule for the audit work.

4.1.1 Outputs of planning

The output of audit planning is an audit strategy and plan that commits the resources and sets out the overall strategy for the audit, and audit programmes that contain the instructions for the nature, timing and extent of audit procedures to be performed. Auditors should not start the audit until the plan is prepared and approved by the relevant authority in the SAI.

In general, compliance audit planning has two aspects. First, auditors develop an overall strategy for the scope, emphasis, timing and conduct of the audit. And second, based on that strategy, auditors prepare an audit plan that shows a detailed approach and specific steps for the nature, timing and extent of procedures to be performed, and the reasons for selecting them.

Adequate planning helps to direct appropriate attention to important areas of the audit, identify potential problems on a timely basis, and properly organize and manage the audit to respond to users' needs efficiently and effectively. Adequate planning also helps the auditor to properly assign work to the team members and facilitates the direction, supervision, and review of their work. Further, where applicable, it assists in the coordination of work done by auditors and, if required, by experts.

The nature and extent of planning activities will vary with the circumstances of the audit, for example, the complexity of the underlying subject matter and criteria. The following are examples of some of the main matters that may be considered in planning:

- The characteristics of the audit that define its scope, including the characteristics of the underlying subject matter and the criteria.
- The expected timing and the nature of the communications required.
- The relevance of knowledge gained on other audits performed by the auditor for the responsible party.
- The audit process.

- The auditor’s understanding of the responsible party and its environment, including the risks that the subject matter may not be in compliance with the criteria.
- Control environment and internal control of the entity.
- Identification of intended users and their information needs, and consideration of materiality and the components of audit risk.
- The extent to which the risk of fraud is relevant to the audit.
- The nature, timing and extent of resources necessary to perform the audit, such as personnel and expertise requirements, including the nature and extent of experts’ involvement.
- The existence of the internal audit function and its coverage.

The auditor may decide to discuss elements of planning—for example, the audit scope and criteria—with the responsible party’s personnel to facilitate the conduct and management of the audit. Although these discussions often occur, the overall audit strategy and the audit plan remain the auditor’s responsibility. When discussing matters included in the overall audit strategy or audit plan, it is important not to compromise the effectiveness of the audit. For example, discussing the nature and timing of detailed procedures with the responsible party may compromise the effectiveness of the audit by making the procedures too predictable.

In smaller or less complex audits, the entire audit may be conducted by a small audit team. With a smaller team, co-ordination and communication between team members is easier. Establishing the overall audit strategy in such cases need not be a complex or time-consuming exercise; it varies according to the size of the entity, the complexity of the audit including the underlying subject matter and criteria, and the size of the audit team.

The auditors should also establish legal elements for their work by understanding the mandate of the SAI, the responsibilities of public sector auditors, and the constitutional status and responsibilities of the audited entity as well as the expectations of the intended users. This understanding provides public sector auditors with a frame of reference to be used in applying professional judgment throughout the entire audit process.

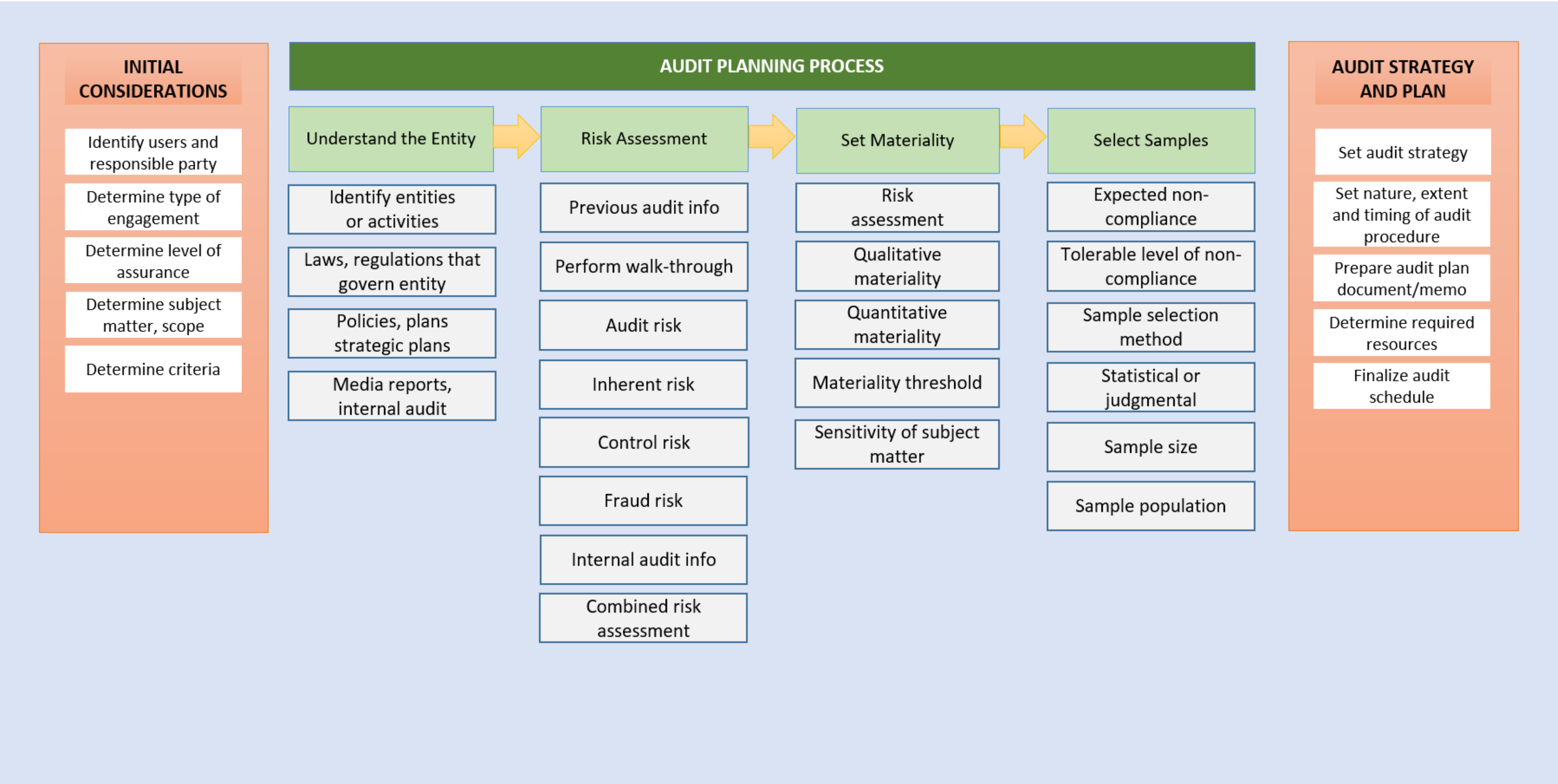
4.1.2 Importance and nature of planning

Good planning helps to ensure that audit effort is allocated on the basis of risk; potential problems are identified and resolved on a timely basis; and the audit is properly organised and managed in order to be performed in an economic, efficient and effective manner.

The nature and extent of planning activities will vary according to the size and complexity of the audited subject and the auditor's previous experience with the auditee. Although concentrated in the planning phase, audit planning takes place not only at this stage, but rather is a continual and iterative process. It is an activity that continues throughout the audit, responding to new circumstances such as unforeseen changes in the auditee's operations or systems, or unexpected results coming to light during the examination phase of the audit.

It should be recognised that a compliance audit is not a series of mechanical steps to be completed. Most important, professional judgment and scepticism should be exercised when planning as well as performing and reporting on audits. Auditors should also take account of knowledge obtained from relevant performance audits in the area. Figure 3.0 illustrates the planning process, which this chapter covers step by step.

Figure 4.0 Audit Planning Process



Audit Planning Process

4.2 Audit strategy

The audit strategy is the basis for deciding whether the audit is possible to execute. The audit strategy describes what to do, and the audit plan how to do it. The purpose of the audit strategy is to document/design the overall decisions, and the strategy may contain the following:

- The subject matter, scope, criteria and other characteristics of the compliance audit, taking into account the mandate of the SAI.
- The type of engagement (attestation engagement or direct reporting engagement).
- The level of assurance to be provided.
- Composition and work allocation of the audit team, including any need for experts, and the dates of quality control.
- Communication with the auditee and/or those charged with governance.
- Reporting responsibilities, as well as when, to whom and in what form such reporting will take place.
- The entities covered by the audit.
- The materiality assessment.
- Quality control arrangements

Annex 3.1 in chapter three covers aspects of audit strategy. Information from this annex can be used to formulate audit strategy. To complete the audit strategy, refer to Annex 4.1: Audit strategy matrix strategy, with a process guide to complete the template.

4.3 Determining subject matter, scope and criteria

ISSAI 4000, 107: Where the SAI has discretion to select the coverage of compliance audits, the auditor shall define the subject matter to be measured or evaluated against criteria.

Subject matter

Determining the subject matter and criteria is one of the first steps to be carried out in planning and performing a compliance audit. The subject matter of the audit may or may not be similar to what has been initially identified and included in the SAI's annual compliance audit plan. This is because the risks that were initially identified at the annual audit planning stage may no longer exist, or there could be additional risks that were not apparent at the annual planning stage. Hence, the audit team needs to assess whether the same subject matters in the SAI's annual audit plan are still valid, or need changes.

The concepts of subject matter, criteria and scope are interrelated. Auditors need to appreciate that these concepts influence each other, as illustrated in Figure 3.1 below.

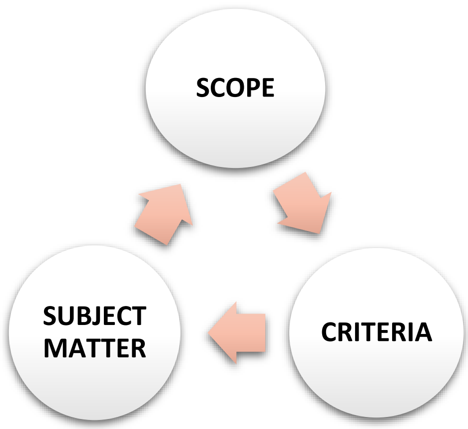


Figure 3.1: Interrelationship between subject matter, scope and criteria

Auditors need to exercise professional judgment while reviewing the relationships depicted in the figure above. The objective of this review is to properly identify the scope of a compliance audit to ensure that it gives sufficient coverage that the audit is meaningful and adds value for the intended users. It is important here to note that the scope of a compliance audit may change while conducting the audit, if the auditors identify material information that makes it necessary to reconsider the scope. Such changes must be brought into the audit plan.

Invariably, SAIs have the obligation and interest to produce high-quality audit reports. They need to zero in on the subject matter and criteria so a meaningful report can be produced to meet the expectations of the intended users. Thus, SAIs always try to find:

- Significant aspects of a subject matter; and
- Whether suitable criteria are available for measurement of the subject matter.

Some examples of subject matter are mentioned below as reference:

- Financial performance:
  - use of appropriated funds (budget execution)
  - revenue collection, e.g. council taxes, application of fines and penalties
  - use of grants and loans
- Procurement
- Expenditures
- Service delivery—medical, education, etc.
- Public complaints
- Heritage protection
- Propriety of auditee officials/decision making
- Health and safety
- Environmental protection
- Internal control framework
- Payments of social benefits, pensions
- Physical characteristics, zoning density, access to government buildings etc.

The subject matter should be identifiable and assessable against suitable audit criteria. It should be of a nature that enables the auditor to conclude with the necessary level of assurance. This means gathering sufficient and appropriate audit evidence to support the audit conclusion or opinion.

The subject matter can be either thematic or entity-based. Thematic subject matter may include multiple entities across the government and will require careful planning and execution of the audit to ensure that the subject matter is properly addressed in order to reach an audit conclusion. If an audit team planning a thematic compliance audit contemplates placing reliance on controls, the controls in place across various entities that affect the subject matter need to be considered before making that decision.

Audit scope

Audit scope basically refers to the area, extent and time period covered in the audit of a given subject matter. Once planning work begins, clearly defining the audit scope is important in determining the budget, human resources, and time required for examination work in the audit; and in determining what will be reported to Parliament. Scoping the audit involves narrowing the audit to relatively few matters of significance that pertain to the audit objective and that can be audited with resources available to the audit team. In a multi-entity or thematic compliance audit, the scope includes identifying the entities that will be included in the audit.

To identify matters of significance to the intended users, the audit team needs to thoroughly understand the subject matter, keeping in mind the following issues:

- Public or legislative interests or expectations or issues of high visibility.
- Impact on citizens.
- Projects with significant public funding.
- Beneficiaries of public funds.
- Significance of certain provisions of the law.
- Principles of good governance.
- Roles of different public sector bodies.
- Rights of citizens and of public sector bodies.
- Potential breaches of applicable laws and other regulations that govern the public entity's activity, or the public debt, public deficit and external obligations.
- Non-compliance with internal controls, or the absence of an adequate internal control system.
- Findings identified in previous audits.
- Risks of non-compliance signaled by third parties.
- Appropriateness of the timing for auditing the issue.

Carefully scoping the audit early in the process helps increase the efficiency and effectiveness of the audit. The statement of scope should be clear about any areas that are related but not included in the audit.

Audit criteria

ISSAI 4000.110: Where the SAI has discretion to select the coverage of compliance audits, the auditor shall identify relevant audit criteria prior to the audit to provide a basis for a conclusion/an opinion on the subject matter.

The subject matter and audit criteria are linked and consistent. Therefore, identifying audit criteria that correspond to the subject matter is an iterative process. When auditing a subject matter, the auditor has to make sure there are corresponding audit criteria. The subject matter and relevant audit criteria might already be defined by the mandate of the SAI or national legislation.

In an attestation engagement the audit criteria are implicitly given by the presentation of the subject matter information on the basis of which the information has been prepared. In these cases, the auditor needs to identify relevant audit criteria to draw conclusions on the correctness of criteria implicitly given in the subject matter information by the responsible party.

A compliance audit may be concerned with regularity 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, propriety may also be pertinent given the public sector context, in which there are certain expectations concerning financial management and the conduct of public officials. Depending on the mandate of the SAI, audits may also examine compliance with generally accepted principles and generally acknowledged best practice governing the conduct of public officials (propriety). Suitable audit 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. This would provide sufficient flexibility to the SAI to adopt criteria relevant to its country in an audit of propriety.

Suitable propriety criteria may derive from the following:

- Public expectations for financial management, such as compliance with an effective and efficient internal control system.
- Beneficiaries' expectations regarding the utility of goods, or the quality of the services and works.
- Requirements for a transparent and unbiased allocation of public funds and human resources.
- Financial rules and regulations.
- Prescribed/stipulated conduct rules and ethical principles.
- Pronouncements and recommendations of the public accounts committee or similar parliamentary committees.

In some cases, laws and regulations require further interpretation in order to derive relevant audit criteria. If situations arise where there are conflicting provisions or there may be doubt as to what is the correct interpretation of the relevant law, regulation or other authorities, the auditor 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 auditor may also consider relevant earlier decisions made by judicial authorities.

Suitable audit criteria for either regularity or propriety exhibit the following characteristics:

- **Relevance:** Relevant criteria result in subject matter information that assists decision-making by the intended users.
- **Completeness:** Criteria are complete when subject matter information prepared in accordance with them does not omit relevant factors that could reasonably be expected to affect decisions of the intended users made on the basis of that subject matter information.

- **Reliability:** Reliable criteria result in consistent conclusions when used and examined in the same way by another auditor in the same circumstances.
- **Neutrality:** Neutral criteria result in subject matter information that is free from bias as appropriate in the engagement circumstances.
- **Understandability:** Understandable criteria result in subject matter information that can be understood by the intended users.
- **Usefulness:** Useful criteria result in findings and conclusions that meet user information needs.

Example: Identifying the subject matter, scope, and criteria	
Case	
The audit aims to review the National Health Service (NHS) procurement policy against national procurement requirements and the extent to which the procurement practices followed by NHS comply with the guidelines for government procurement and contracting. In this respect, the audit will cover the procurement policy as well as the planning and sourcing stages of the procurement lifecycle. It will encompass an assessment of all procurement activities for the 18-month period from 1 July 2014 to 31s December 2015. From the above paragraph we can identify the subject matter, the scope, and the authorities from which the audit criteria are taken	
Subject matter	The subject matter is the activity, project, process or program the auditor decides to examine. In the above case, the subject matter is the procurement policy and procurement practices of the National Health Service.
Audit Scope	Audit scope basically explains the coverage and extent of the audit examinations. In the above case, the audit scope can be identified as *the procurement policy and the planning and sourcing stages of the procurement lifecycle, covering* all *procurement activities for the 18-month period from 1 July 2014 to 31 December 2015.*
Criteria	Audit criteria are the benchmarks used to measure the subject matter. Criteria are taken from authorities (laws and regulations, policies, guidelines etc.). In the above case the criteria will be taken from the following: • Guidelines for government procurement and contracting • National procurement policies

4.4 Set audit objective

The audit objective determines what the auditor aims to answer in the audit. Auditors need to demonstrate objectivity in selecting their audit objectives, including identifying the criteria. Auditors should ensure that they maintain adequate documentation to demonstrate how they defined the audit objective, subject matter, criteria and scope. These will be reflected in the audit strategy to document/design the overall decisions, which may contain the audit objective, subject matter, scope, criteria and other characteristics of the compliance audit, taking into account the mandate of the SAI.

Audit objectives for different engagements entail different considerations. For example, if the engagement is derived from the SAI's strategic plan, the audit objective should be set considering what the strategic plan intends to achieve. On the other hand, if the audit engagement is undertaken due to a request from parliament, the parliamentary need should be considered in determining the audit objective.

4.5 Audit planning process

The auditor develops an audit plan for the compliance audit. The audit strategy provides essential input to the audit plan. The audit plan may include:

- An assessment of risk and of internal controls relevant to the audit.
- The audit procedures designed as a response to risk.
- Nature, timing and extent of planned audit procedures and when they will be performed.
- The potential audit evidence to be collected during the audit.

Assessment of risk requires an understanding of the entity or subject matter and its internal control to follow the audit risk model and come up with a risk register. The auditor then designs audit procedures for all identified risks and identifies sources of evidence to make a conclusion on the risks and ultimately on the audit objective. The step-by step-process of audit planning is described below.

4.5.1 Understanding the entity or subject matter

ISSAI 4000.131: The auditor shall have an understanding of the audited entity and its environment, including the entity's internal control, to enable effective planning and execution of audit.

Understanding the audited entity/subject matter is crucial for compliance audit, as it might be used to determine the subject matter, scope and criteria, audit materiality and risk of non-compliance that will inform the audit approach. The auditor should therefore examine factors described below to understand the audited entity in light of relevant authorities. Thematic compliance audit can cover more than one entity and in such cases auditors should obtain an understanding of all entities whose activities fall under the audit scope. For example, some SAIs conduct a compliance audit of the use of a fund that is used by more than one entity. To achieve this, the auditor may need to consider the *strategies, operations and governance of the entity.*

More specifically, the auditor should understand and evaluate whether the fundamental goals and objectives and measures to be implemented as outlined in the strategic plan of the audited entity are aligned to the mandatory coverage and standards required; the goals specified in the strategic action plans and programmes are linked to the results; activities and operations are directed toward attainment of the goals and objectives of the audited entity, which in turn should respond to all compliance requirements of the entity; legal acts applied to the operations of the audited entity and other authorities such as administrative policies, internal procedures and instructions/orders do not contradict the normative legal acts.

The auditor's understanding of the entity and its operations should focus on those elements necessary to help reach a conclusion about the audit objectives. Typically, the team needs to acquire an understanding of the following:

- *Legal framework*—legal basis for the activity and relevant parts of the Financial Regulation, Implementing Rules and other rules and regulations.
- *General organisation and governance* of the activity/audited entity, including operational structure, resources and management arrangements.

- *Business processes*—the policy concerned, objectives and strategies, locations, and types/volume/values of programmes/projects.
- *Business risks* related to the entity's objectives and strategies that may result in material non-compliances. This includes an understanding of the entity's related party relationships and transactions (e.g. obtain from management the names of related parties, the nature of the relationships, and any transactions entered into with such parties during the period).
- *Performance measures*—an understanding of such measures (e.g. performance indicators, variance analysis) allows the auditor to consider whether pressures to achieve performance targets may result in management actions that increase the risk of material misstatement or irregularity.

A thorough understanding of the audited entity as outlined in the laws, policies, or standards helps auditors to recognize when non-compliance has occurred, and to evaluate evidence obtained through audit procedures.

Refer to Annex 4.2: Understanding the entity and its environment, including the process guide and a reference to possible sources of documents to understand the entity.

4.5.2 Risk assessment

ISSAI 4000.52 The auditor shall perform procedures to reduce the risk of producing incorrect conclusions to an acceptable low level.

Risk assessment is the most important step in the planning process. It guides the auditor to focus on the key issues to be considered for audit, considering the resource and time constraint. Also, risk assessment is related to audit risk, which is derived from the assurance engagement concept as explained in the sections below. Risk assessment and audit risk must not be confused. Risk assessment is a process of assessing the risk that the subject matter is not in compliance with the criteria, and it is related to the intended users' need to be provided with information that can lead to sound decisions. Audit risk is the risk that the auditor might reach an incorrect conclusion, and it is related to the amount of audit evidence the auditor needs to collect to reach a conclusion with the necessary level of assurance.

Understanding the relationship between audit risk and audit assurance

Assurance model. According to the ISSAIs, compliance audit is an assurance engagement. The auditors provide the intended user with assurance on the compliance of the audited subject matter against the criteria. As explained earlier, assurance can be either reasonable or limited in nature. Assurance is directly linked with the audit risk. If the audit risk is low, the assurance provided is high.

An audit assurance level of 95% corresponds to an audit risk of 5%. Overall audit assurance can be obtained from three components: inherent assurance, control assurance and substantive assurance. These complement the inherent risk, control risk and detection risk in the audit risk model.

Audit risk is the inverse of audit assurance. It is the risk of reaching a wrong conclusion that the auditor is willing to tolerate. In practice, audit risk is unavoidable. In the public sector, audit risk is *normally* 5% for audits providing reasonable assurance. As a consequence, the degree of assurance is DA = 100 – audit risk (5%) = 95%. However, the auditors need to consider if specific policies regarding this are in place in the SAI. Auditors need to perform audit procedures to ensure that audit risk is 5% or less to provide reasonable assurance from the audit.

The components of audit risk are:

- the subject matter's inherent risk (IR);
- the control risk (CR)—the risk that the relevant internal controls associated with the inherent risks are inappropriate or do not work properly;
- the detection risk (DR)—the risk that the procedures performed by the auditor will lead to an incorrect conclusion/opinion.

The three audit risk components (IR, CR and DR) are all considered together during the assessment of the audit risk.

Audit risk model. The audit risk model shown below helps auditors to determine how comprehensive the audit work must be to attain the desired assurance for their conclusions. The audit risk model is an abstract model to enhance the auditors' attention to the collection of audit evidence.

Audit risk (AR)= IR x CR x DR

This equation must always be in balance. The higher the auditor assesses the level of inherent and/or control risk to be, the lower the detection risk must be. This requires more substantive audit work (larger sample sizes). Equally, the lower the combined inherent and control risk is assessed to be, the higher the detection risk will be. This in turn means less substantive work and more work on systems and internal controls. More systems and controls need to be tested, as the planning assumption must be verified; and the systems work also contributes to overall assurance. Fraud risk is an element of both inherent and control risk.

By identifying and assessing the entity's inherent and control risks, the auditor can define the nature and extent of the evidence-gathering procedures required to test compliance with the criteria. The higher the level of risk, the greater the extent of audit work required to lower detection risk sufficiently to achieve the acceptable level of audit risk.

Assessment of risks is a *judgment* rather than a precise measurement. The level attributed to each component is estimated by the auditor on the basis of his/her professional judgment, informed by the procedures outlined below.

Audit risk should be considered when:

- planning the audit, including the design of audit procedures;
- carrying out audit procedures; and
- evaluating the results of the audit tests carried out

It is clear that risk assessment is the most important aspect of the assurance model in the ability to provide reasonable assurance. While detection risk would be that the auditor fails to perform procedures and makes wrong conclusions, determining inherent risk and control risks and thereby identifying the overall risks of non-compliance is the key part of the audit planning process.

The starting point of a risk assessment process is the assessment of the inherent risk and the preliminary evaluation of the supervisory and control systems (poor, good, excellent), the aim being to estimate the degree of confidence that can be derived from these systems. Depending on the results, the level of substantive testing to provide the remaining confidence level has to be determined. Given that 95% assurance is generally required of audit testing, the nature and extent of planned audit tests will vary, depending on the auditor's assessment of both inherent and control risk (known as the combined risk assessment).

It is not practical or cost-effective for auditors to collect evidence in order to have absolute (100%) assurance or confidence that they will detect all material non-compliance. Instead, auditors try to ensure that their conclusions and opinions give the desired level of assurance, depending on the type of the audit engagement.

In order to identify and assess the risk that the entity will not meet its objectives for compliance, the auditor should perform risk assessment procedures as early in the audit as possible. Risk assessment includes identifying inherent risks and control risks and determining the detection risks.

4.5.3 Determining inherent risk

Inherent risk: Inherent risk described as "risk in the absence of controls." In audit terms, inherent risk is the risk, related to the nature of the activities, operations and management structures, that non-compliance will occur that, if not prevented or detected and corrected by internal control, will result in the entity not achieving its objectives in terms of reliability and legality/regularity. Inherent risk is estimated by the auditor, based on his/her understanding of the entity's activities.

A good practice to find inherent risk is to ask, "What could go wrong?" and then, "Do the auditors care about what could go wrong?" In assessing inherent risk, auditors need to take a detailed and methodical approach. Inherent risk can be viewed from three perspectives:

- Generic risk
- Fraud risk, and
- The "flipside of criteria" risk

Generic risk

These risks can be called generic risks: risks that apply every time an action is taken. Leaving the house and getting on the highway puts drivers at most of these risks, which are simply a part of life. During the risk assessment process for an entity under audit, the auditor needs to think about these types of risk as generic risks.

Example
Consider a river in a tourist town. If the tourist town is known for its water activities and the water in the river is contaminated, and the tourist town, would that cause any of the above-mentioned risks? Yes, it would actually cause all of them. Death and injury could occur to a young rafter, or swimmer. Shame could be brought upon the region for injuring scores of tourists. Obviously, tourists will make alternative travel arrangements and take money from the town and, if this small town has a goal of economic prosperity and hospitality, a contaminated river will not help them.

Fraud risk. Then auditors have to consider fraud risk, which is the risk that someone will deceive the entity or mislead the entity in some significant way. Fraud is often defined as a deception deliberately practiced in order to secure unfair or unlawful gain. The Certified Fraud Examiners divide fraud into three main categories: corruption, asset misappropriation, and fraudulent statements.

In the example of the river in the tourist town, fraud risk might include collusion between the city employees responsible for water safety and the largest resort on the river. The owner of the resort might bribe city employees to overlook poor water quality during peak tourist season. In section 4.5.3 of this chapter, determination of fraud risk is elaborated further.

Fraud risk is somewhat dependent on the last type of risk—the "flipside of criteria" risk.

"Flipside of criteria" risk. This is the risk that the entity will not comply with or meet the audit criteria.

Example
An auditor is evaluating whether the entity meets a government requirement that all participants in a particular programme have income below the poverty level. The auditor's criterion is the poverty level. And the flip side of this criterion (i.e. the inherent risk) is that there are participants in the programme who are above the poverty level and therefore not eligible for the programme support. To take it one step further, the inherent risk is that those who should benefit from the programme are not benefiting. Even more risky, the relatively well-off people could be getting resources designed to help the poor. In the example of the river in the tourist town, the town's goal (or criteria set by the authority) is to achieve maximum tourism. The flip side of that goal or criteria (i.e. inherent risk) is that tourism could decrease because of water contamination.

Forecasters of trouble. The auditor needs to be good at forecasting trouble (or in this case, risks of non-compliance) in the subject matter under audit. That is what assessing inherent risk is about: analysing the entity and forecasting all the troubles that surround it. The auditor should consider whatever criteria against which he or she is evaluating the entity, and ask why (s)he is using those criteria. What is the purpose of the requirement? What did the lawmakers or authorities intend to prevent with that law or regulation? And then auditor can imagine that what the regulators were trying to prevent actually happened. Who or what would it impact? What would the impact be?

At this point the auditor needs to exercise professional skepticism in his or her thinking and then note down the potential trouble areas identified in the thinking process. By this process the auditor will have a list of inherent risks to the entity.

Entity's risk assessment process. The entity's own risk-assessment process, if it exists, can also be a source of information on risks. For example, the entity's annual plan may contain the critical risks identified for particular areas of the entity concerned, and its annual activity report provides an overview of critical risks encountered and their impact on the achievement of the entity's objectives. However, the auditor should exercise professional skepticism, as risks identified by the audited entity may not address those that are important for audit purposes, and such information may be biased.

Once the risks are identified, the auditor needs to place the risks in order through a risk assessment process by considering "magnitude and likelihood".

Magnitude and likelihood. After risks are identified, the next step is to filter the risks one more time by considering their magnitude and likelihood. First, forecast the generic, fraud, and "flip side of criteria" risks and forecasting the troubles for the audit subject matter. Next, consider the realities of the risks identified, so that auditors do not have to pursue all sorts of peculiarities of the subject matter under the audit.

In order for a risk to stay on the matrix of inherent risks, it has to cover both the magnitude and likelihood aspects. Magnitude asks, "is the risk significant?" And likelihood asks, "Would/could that really happen?"

Auditors would pay less attention to a risk that is high magnitude but low likelihood, and one that is low magnitude but high likelihood. The risks that the auditors consider to be both high magnitude and high likelihood are those assessed as valid inherent risks in the risk assessment.

How the auditor can come up with inherent risks? As part of the risk assessment process the audit team may hold a brainstorming session to consider the nature and magnitude of possible risks of non-compliance. This session may be combined with the brainstorming session on fraud risk. The auditor might challenge himself or herself to be objective and critical when updating past risk assessments and documenting changes in the business environment.

Team may consider the conditions and events that may indicate the existence of risks of non-compliance. These could cover a broad range of conditions and events e.g. on existing regulation, and the environment entity is operating, information technology systems and reliability, financial and operational management, personnel management of the entity.

The above issues plus other factors identified in the standards may facilitate productive discussions during the audit team's brainstorming session. These factors have roots in business risks that in the past have led to audit issues.

Determining significance of risks. It is expected that in every audit the auditor will identify one or more significant risks before considering the related controls. For example, a significant inventory of precious metal might be a significant risk in an audit of entity engaged in metal business. For significant risks, the auditor should:

- Consider the design and implementation of related controls,
- Avoid reliance on analytical procedures alone, and

- Rely on evidence gathered only in the current period for control assurance.

As part of the risk assessment, the auditor should determine which of the risks identified are, in the auditor's judgment, risks that require special audit consideration (defined as "significant risks").
The determination of significant risks, which arise in the course of most audits, is a matter for the auditor's professional judgment. In exercising this judgment, the auditor should consider inherent risk to determine whether the nature of the risk, the likely magnitude of the potential non-compliance (including the possibility that the risk may give rise to multiple instances of non-compliance), and the likelihood of the risk occurring are such that they require special audit consideration.

Significant risks are often derived from business risks that may result in non-compliance. In considering the nature of the risks, the auditor should consider a number of matters, including the following:

- Whether the risk is a risk of fraud.
- Whether the risk is related to recent significant economic, accounting, or other developments and therefore requires specific attention.
- The complexity of transactions.
- Whether the risk involves significant transactions with related parties.
- The degree of subjectivity in the measurement of financial information related to the risks, especially those involving a wide range of measurement uncertainty.
- Whether the risk involves significant non-routine transactions that are outside the normal course of business for the entity, or that otherwise appear to be unusual.

Significant risks often relate to significant non-routine transactions and judgmental matters. Non-routine transactions are transactions that are unusual, due to either size or nature, and that therefore occur infrequently. Judgmental matters may include the development of accounting estimates for which there is significant measurement uncertainty.
The auditor should make a preliminary assessment of inherent risk at the overall level (the policy area or the entity as a whole) in order to identify risk areas specific to the audit that must be taken into account when planning and carrying out audit procedures. The auditor may assess inherent risk to be high-risk, medium-risk, or low risk. In areas where inherent risk is high, assurance is needed that control risk is being managed adequately.

4.5.4 Determining control risks

Control risk is the risk that the internal control arrangements will fail to prevent material non-compliance or detect and correct them on a timely basis. Control risk is assessed by the auditor, based on his/her evaluation of the entity's internal control. Where control risk is likely to be high, i.e. no or limited controls exists, the auditor should obtain the required audit assurance mostly from substantive testing, as reliance cannot be placed on the entity's internal controls.

The preliminary assessment of control risk requires the auditor to consider the five components of internal control. However, the auditor's primary consideration is whether, and how, a specific control prevents or detects and corrects non-compliance, rather than its classification as a particular component. If an expected control does not exist, auditors should enquire about any *compensating* *controls* that may be in place that would have the same effect. The auditor's assessment of control risk may be *no control, weak control, decent control,* or *strong control*,

In addition to evaluating the control risk for all significant risks, the auditor should also evaluate the entity's controls over those risks that, in the auditor's judgment, it is not possible or practicable to reduce to an acceptable level using only substantive procedures. This is the case, for instance, if an entity's information system permits highly automated processing with minimal manual intervention. Only evaluation and testing of controls on the accuracy and completeness of information will provide sufficient appropriate audit evidence.

Internal control

Internal control, as used in international standards, is an integral process (i.e. a series of actions that permeate an entity's activities) that is affected by an entity's management and personnel. Internal control is designed to address risks and to provide reasonable assurance that, in pursuit of the entity's mission, the following general objectives are being achieved:

- fulfilling accountability obligations;
- complying with applicable laws and regulations;
- safeguarding resources against loss, misuse and damage;
- executing orderly, ethical, economical, efficient and effective operations.

Internal control is covered best in the COSO model shown here. Auditors following the model would ask questions regarding controls structured around the five components on the cube.

These five components are control environment, risk assessment, control activities, information and communication, and monitoring. The client's responses should be documented.

Components of internal control. Internal control systems, including information technology (IT) systems, can be divided into five following interrelated control components:

- Control environment
- Risk assessment
- Information and communication
- Control activities
- Monitoring

Understanding the linkages between the five elements of the COSO model

To show relationships between the five elements, it is important see that all controls are created to mitigate a risk. In other words, the entity's assessment of risk in its own organisation creates the need for controls. After the entity identifies the risks it faces, it needs to design controls (control activities) to mitigate those risks, and these controls need to be shared throughout the organisation (information and communication).

But all of the formal processes in place do the auditor no good if those who are responsible for managing the entity break the rules and override controls. Respect for controls speaks to the "control environment." And management should not assume that all is well and take a hands-off approach once the control system is designed. It needs to set up a process for monitoring to see that what management thinks is happening is actually happening. Each of these components is explained in detail below.

The control environment

The control environment includes the governance and management of an organisation. it sets the tone of an organization, influencing the control consciousness of its people. It focuses largely on the attitude, awareness and actions of those responsible for designing, implementing and monitoring internal controls. It is the foundation for all other components of internal control, providing discipline and structure.

Elements of the control environment that are relevant to the auditor’s obtaining an understanding include the following:

- communication and enforcement of integrity and ethical values;
- commitment to competence;
- participation by those charged with governance;
- management's philosophy and operating style;
- organisational structure;
- assignment of authority and responsibility; and
- human resource policies and practices.

Evidence regarding the control environment is usually obtained through a mix of enquiry and observation, although inspection of key internal documents (e.g. codes of conduct and organisation charts) is possible.

Risk assessment

Risk assessment is the process of identifying and analysing relevant risks to the achievement of the entity’s objectives, forming a basis for determining how the risks should be managed. Because economic, regulatory and operating conditions of the entity will continue to change, mechanisms within the entity are needed to identify and deal with the specific risks associated with change.

Auditors also should obtain sufficient information about the entity’s risk assessment process to understand how management considers risks that are relevant to the subject matter and decides how to address those risks. Examples of circumstances that can cause risks include new personnel, changes to the entity’s mandate, budgetary restrictions, new legislation, new activities, new technology, or changes to information systems and corporate restructurings.

Information and communication

Information and communication systems includes those systems and mechanisms or methods and records established to identify, assemble, analyse, classify, record and report an entity’s activities and transactions. This is to maintain accountability for the related activities. Information systems produce reports containing operational, financial and compliance-related information. The reports make it possible to run and control the entity’s operations. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to inform decision making and external reporting.

Communication involves providing a clear understanding of individual roles and responsibilities pertaining to internal control over the activities. Effective communication also must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as parliament, other line ministries, regulators and other stakeholders.

Control activities

Control activities are those policies and procedures that help ensure that management directives are carried out. They help ensure that necessary actions are taken to address risks in order to achieve the entity's objectives. Control activities have various objectives and are applied at various organisational and functional levels. Control procedures can be categorised as follows:

- Proper authorisation and approval of transactions and activities.
- Adequate segregation of duties that reduces opportunities for any person to be in the position to both perpetrate and conceal errors or irregularities in performing his or her duties—for example, assigning different people the responsibilities of authorising transactions, recording transactions, and maintaining custody of assets.
- Design and use of adequate documents and records to help ensure the proper recording of transactions and events, such as pre-numbered documents and invoices.
- Adequate safeguards over access to and use of assets and records, such as secured facilities and authorisation to access computer programs.
- Independent checks on performance and proper valuation of recorded amounts, for examples, clerical checks, reconciliations and management review of reports.

Monitoring

Monitoring is a process that assesses the quality of internal control performance over time. It involves assessing the design and operation of controls on a timely basis and taking necessary corrective actions. This is accomplished through ongoing monitoring activities, separate evaluations, or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

There is a direct relationship between the objectives, which are what an entity strives to achieve, and internal control components, which represent what is needed to achieve the objectives. All components are relevant to each category of objectives. When looking at any one category—the effectiveness and efficiency of operations, for instance—all five components must be present and functioning effectively to conclude that internal control over operations is effective.

Internal control in small organisations

Most small organisations, or organisations that are not following the model, neither have a monitoring program in place nor prepare a formal risk assessment. Some entities are so small (or their control systems so weak) that often they do not have any formal controls in place at all. Though it is not ideal to not have all of the COSO components in place, for smaller entities it is reasonable.

Big corporate entities or efficient government entities can manage the whole spectrum of the COSO model, because they have the money, efficient human resources, leadership, and a highly motivating

fear of the authorities constantly checking their compliance, factors that allow them to establish the model in full.
Rather than covering the full details of the five elements, auditors may ask the following questions in smaller entities, or entities with weaker control systems, to uncover the COSO components:

Components of COSO	Questions to Ask
Control activities	How are you certain that your entity is: • In compliance with the relevant criteria? • Creating financial or other statements which are compliant to the standard reporting framework? • Operating effectively and efficiently?
Risk assessment	How did you learn that (control activity) was necessary to ensure compliance?
Information and communication	How and when do you notify people that the (control activity) is required?
Monitoring	What is the process used to ensure that the (control activity) is performed correctly and consistently?
Control environment	What is the management attitude about controls? By looking at the answer to the other questions, the auditor can get real insight on management's attitudes. The control environment is a summary of the other control components.

How the auditor can understand the entity's internal control

The auditor's objectives in understanding and making a preliminary evaluation of internal control should be defined at the outset. These objectives may include the following:

- To help design the nature, timing and extent of audit procedures.
- To gain an understanding of the extent to which improvements in internal control systems are being made year-on-year.
- To reach conclusions about the effectiveness of an internal control system

Walk-through tests. The auditor considers the design of a control when determining whether to consider its implementation. In order to understand and confirm the operation of a control, (s)he carries out "*walk-through tests*" of a small number of transactions (no more than three). Obtaining an understanding of an entity's controls should not be considered to be a test of their operating effectiveness; such testing is carried out in the examination phase.

Focus on relevant key controls. Only those controls that are relevant to the audit objective should be considered. It is a matter for the auditor's professional judgment as to whether a control, individually or in combination with others, is relevant. Furthermore, the auditor should determine which controls are to be considered key. The number of key controls to be selected for testing is the absolute minimum to ensure that all relevant risks are covered. Relevant factors may include such matters as:

- Materiality.
- The significance of the related risk.
- The size of the entity.

- The nature of the entity's business, including its organisation and ownership characteristics.
- The diversity and complexity of the entity's operations.
- Applicable legal and regulatory requirements.
- The circumstances and the applicable component of internal control.
- The nature and complexity of the systems that are part of the entity's internal control, including the use of service organisations.
- Whether, and how, a specific control, individually or in combination with others, prevents, or detects and corrects, material misstatement.

Refer to Annex 4.3 Understanding the Internal Control and Control Environment and the process guide to complete it.

Refer to Appendix 4-A: for conditions and events that may indicate the existence of risks of non-compliance.

Setting detection risk

Detection risk, which is under the control of the auditor, is the risk that (s)he will not detect non-compliance that has not been corrected by the organisation's internal controls. Detection risk relates to the nature, timing, and extent of the auditor's procedures that are determined by the auditor to reduce audit risk to an acceptably low level. It is therefore a function of the audit procedure's effectiveness and its application by the auditor. The following matters help to enhance the effectiveness of an audit procedure and its application and reduce the possibility that an auditor might select an inappropriate audit procedure, misapply an appropriate audit procedure, or misinterpret the audit results:

- Adequate planning.
- Proper assignment of personnel to the engagement team.
- The application of professional skepticism.
- Supervision and review of the audit work performed.

Example
• If a lower audit risk is required, detection risk can be reduced by carrying out more substantive procedures, as this affords a greater probability that the auditor will detect material non-compliance or irregularities. • If the auditor intends to place reliance on internal control, tests of control must be carried out. If the control does not function as intended (thus increasing control risk), detection risk must be decreased, meaning an increase in substantive procedures.

Detection risk, however, can only be reduced, not eliminated, because of the inherent limitations of an audit. Accordingly, some detection risk will always exist.

The way to reduce detection risk—the risk that auditor will not detect an error or non-compliance—is to audit the subject matter in a planned, structured way as mentioned above by identifying the inherent and control risks to the greatest extent possible.

Inherent risk and control risk effects on detection risk. So far we have discussed how the inherent risk and control risks are analysed and in combination guide the auditor to determine the audit procedures. A matrix will allow the auditor to consider what he or she will do in response to inherent and control risk combinations. The response of the auditor is called the detection risk.

Here is a menu of choices for the auditor to consider:

If inherent risk is…	And controls are…	The auditor can respond by…
• High • Medium • Low	• No controls • Weak controls • Decent controls • Strong controls	• Spending more time on it • Spending a little time on it • Scanning it • Not considering it for audit • Writing a finding • Recommending fewer controls

Following this process, the auditor will have a list of risks to consider for the audit, which will then be registered in the combined risk register covered in section 4.5.6 of this chapter.

4.5.5 Determining fraud risk

ISSAI 4000.58 The auditor shall consider the risk of fraud throughout the audit process, and document the result of the assessment

Fraud and corruption pose serious risks to the public sector. The potential damage of fraud and corruption extends well beyond any financial loss, as it also causes substantial negative effects on the entity's reputation and internal working environment. Several cases of fraud and corruption can also severely reduce people’s trust in the public sector as a whole. Fraud risks and assessments of materiality in relation to fraud are considered in the context of the broader scope of public sector auditing.

What are fraud and corruption?

Fraud and corruption can take many forms. Fraud is normally characterized by some form of deliberate deception to facilitate or conceal misappropriation of assets, whereas corruption typically involves breach of trust in the performance of official duties.[40] Corruption is a type of fraud involving a public agent who receives a benefit, bribe, or kickback (financial or intangible) in exchange for providing an undue advantage or benefit for the briber.[41]

There are three key elements normally present when someone commits fraud or corruption: opportunity, incentive/pressure, and rationalization/attitude. All these elements should be dealt with through the entity's internal controls. Hence, weak internal controls may indicate risks of fraud and corruption. Depending on their mandate, this may be an appropriate starting point for auditors looking for indicators of possible acts of fraud and corruption. Much can be done to prevent fraud and corruption by addressing weak internal controls.

[40] Fraud and Corruption Control, Guidelines for Best Practice, Crime and Misconduct Commission, Queensland, Australia
[41] The Brazilian Court of Audit developed a strategy to fight fraud and corruption in national governance. The whole text of the strategy is available on the website http://portal2.tcu.gov.br/portal/pls/portal/docs/2053600.PDF

Determining fraud risk. When performing assessments of fraud risks specifically, the auditor must bear in mind that even though the relevant internal controls exist on paper, it is no guarantee that in practice the controls function as intended. Potential fraudsters are more focused on weaknesses of the controls than in their strengths, and therefore auditors are encouraged to "think like a thief" during the assessment and seek to find possible loopholes or methods that could lead to unjust or illegal advantage to someone inside and/or outside the entity. SAIs with sufficient resources may establish a risk assessment team, which can provide various sorts of input based on different knowledge, experience and skills.

As part of the audit and following the initial fraud risk assessment, public sector auditors gather sufficient appropriate evidence related to the audit topic through the performance of suitable audit procedures. 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.

Management of public property is also a vulnerable area. Valuable property is vulnerable to theft or loss. This includes money, goods or real estate, human capital, and information as valuable public assets.

In performing compliance audits, if public sector auditors come across instances of non-compliance that may indicate 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. [42]

Furthermore, auditors may communicate their suspicions to the appropriate levels of management or to those charged with governance, and then follow up to ascertain whether 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.[43] Public sector auditors take action to ensure that they respond appropriately based on the mandate of the SAI and the particular circumstances.

Appendix B covers questions that may be relevant to consider while performing a fraud risk assessment of an entity.

Refer to Annex 4.4: Assessment of fraud risks at the audit planning stage.

Also refer to Appendix 4-A: The questions that may be relevant to consider while performing a fraud risk assessment of an entity.

4.5.6 Result of risk assessment: Combined risk register

When an entity handles its operations with controls, auditors check them. Auditors perform procedures to be able to give assurance that the entity's operations are in compliance with the audit criteria.

[42] ISSAI 300
[43] ISSAI 400

In a risk assessment process, auditors first ask, "What could go wrong?" regarding the subject matter, determining whether management has put enough controls in place to ensure that nothing has gone wrong, and then respond appropriately. What could go wrong is the inherent risk. Management's response or lack of response with controls to mitigate the inherent risk is control risk. And the auditor's response is called detection risk.

Once the risks are identified following the process explained in section 4.5.4 and section 4.5.5, all these risks are added to a risk register. From there, they will be considered in the audit planning memorandum with the audit procedures to be performed for each risk. Annex 4.5: Risk register provides a working paper template with process guide.

At this stage auditor needs to revisit the audit strategy. In compliance audit planning, the auditor considers the linkage of identified risks to the audit strategy. On the basis of the value of detection acceptable for auditors in the evaluation of internal controls, they can then decide on the audit strategy to follow—that is, whether it will be a control-based approach or an approach based on substantive testing. In real life, auditors perform walk-throughs of identified controls in order to gain a degree of confidence in the operating effectiveness of these controls. During walk-throughs, auditors exercise professional judgment in determining what could potentially go wrong and how to collect sufficient and appropriate evidence to test this assumption. The audit strategy may consist of either relying on tests of controls or performing substantive procedures.

4.5.7 Setting the materiality threshold

In the public sector, when auditors are to obtain reasonable assurance they plan and perform the audit to determine whether the subject matter information, in all *material respects*, is in compliance with the stated criteria. This section covers how to set materiality in the planning stage.

Materiality should be considered by the auditor during:

Planning phase: to help assess material risks and determine the nature, timing and extent of audit procedures;

Examination phase: examination when considering new information that may require planned procedures to be revised, and evaluating the effect of non-compliances;

Reporting phase: reporting when reaching final conclusions and, where required, forming an audit opinion.

Materiality is a fundamental concept in compliance audit. It sets the threshold or the level of non-compliance that is likely to influence the decisions of the intended users. In identifying materiality, the auditor pays attention to specific areas of legislative focus, public interest or expectations, requests, significant public funding, and fraud.

Determining materiality is a matter of professional judgment 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.

Materiality is often considered in terms of value, but it also has other quantitative and 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. Factors to be considered in making this judgment are mandated requirements, public interest or expectations, specific areas of legislative focus and requests, and significant funding. Issues such as fraud may also be considered material, even if the amount involved is small.

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

Quantitative and qualitative aspects

Auditors should consider both quantitative and qualitative materiality.

Quantitative materiality. This is determined by setting a numerical value – the *materiality threshold*. This threshold serves as a determining factor both in the calculation of sample sizes for substantive testing and in the interpretation of the results of the audit. The numerical value is achieved by taking a *percentage* of an appropriate *base*, which both reflect, in the auditor's judgment, the measures that users of the information are most likely to consider important. For quantitative materiality, a threshold *percentage* between 0.5% and 5% could be applied. While this choice is a matter of judgment, based on the auditor’s assessment of internal control, risk assessment, sensitivity of the subject matter, and needs of the intended users. Based on users’ needs, a different threshold percentage may be applied. In addition to the threshold percentage, a ceiling may also be set in terms of the absolute amount.

The *base* is usually total expenditure (i.e. use of commitment appropriations for the audit of commitments and use of payment appropriations for the audit of payments) or total revenue for audits of legality and regularity, or the balance sheet amount for reliability audits.

Quantitative factors relate to the magnitude of non-compliance relative to reported amounts for those aspects of the subject matter information are:

- expressed numerically; or
- when the subject matter information is a statement that the control is effective, the number of observed instances of non-compliance with a control may be a relevant quantitative factor.

Illustration: Calculation of overall quantitative materiality

For calculating quantitative materiality, the auditor first needs to identify the appropriate materiality base and the percentage to be applied. The percentage is determined based on the status of risks and controls, sensitivity of the subject matter and user needs. In this example we are using 1.5% considering that the subject matter is relatively sensitive.

	Decreasing sensitivity of subject matter 0.5% → 5%
Materiality base	**Materiality threshold - 1.5%**
Gross Expenditure	345,000,000
Materiality level	345,000,000 x 1.5/100 = **5,175,000**

The quantitative materiality level is 5,175,000. This means that if the value of non-compliance exceeds this limit, it can be considered material and would affect the audit conclusion. Auditors should consider the pervasiveness of the non-compliance.

When using the table, the threshold percentage applied to the chosen materiality base will increase as the profile or sensitivity of the subject matter being audited decreases. The profile/sensitivity of a subject matter will increase, for example, with the amount of political or media attention that it attracts and how much it is actually used by managers or parliamentarians to hold the responsible party accountable.

The level of materiality will directly influence the amount of audit work to be undertaken. The percentage ranges to be used are set by the audit team depending on the materiality basis adopted. The choice of percentage should be solely based on the risk profile/characteristics of the subject matter being audited, i.e. the level of public and parliamentary interest in them, particularly if the audit report is going to be used as key tool in holding the responsible party accountable. The audit team should also be considering the risk profile of the particular areas of the subject matter and should plan additional tests on specific risks identified rather than setting a low materiality base just because particular areas reside in some parts of the subject matter.

The audit team should be aware that in a compliance audit, there could be situations where quantitative materiality is not applicable at all to a particular subject matter being audited. Hence, the qualitative aspects of materiality become more prominent.

As the risk profiles, sensitivity of the transactions, and the effectiveness of internal controls may be different for different areas of the subject matter, materiality threshold may also be set for different areas of the subject matter. In such a case, the auditor may consider setting materiality thresholds for different areas apart from the overall materiality. This can be done either by applying the overall threshold percentage used to determine the overall materiality level on the population value of that particular area of the subject matter, or if the risk profiles, sensitivity and the effectiveness of internal control varies significantly, the auditor may apply an appropriate threshold percentage to reflect that.

Qualitative materiality. In compliance audit, qualitative materiality should also be assessed by auditors. Even though quantitatively immaterial, certain types of non-compliance or irregularities could have a material impact on the subject matter. Qualitative materiality includes items that may be either material by nature or context**.**

Qualitative aspects. These are nature and characteristics etc. In some cases, qualitative aspects can reflect that the lower amount of non-compliance is material as well; in some cases, non-compliance does not relate to value, amount or size at all. For further understanding of the qualitative materiality that is not related to quantity, some examples given below may be helpful.

Example 1:
The terms of a building code require annual inspections to be performed. The government agency has not performed inspections for the past five years. This 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.
Example 2:
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. 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.

The relative importance of qualitative factors and quantitative factors when considering materiality in a particular audit is a matter of the auditor's professional judgment. Qualitative factors may include, for example:

- The relationship between various parts of the subject matter if non-compliance in one area of the subject matter affects the others.
- The nature of non-compliance, for example, the nature of observed non-compliance with a control when the subject matter information is a statement that the control is effective.
- Whether non-compliance is the result of an intentional act or was unintentional.

Material by nature. Material by nature is related to *inherent characteristics* and concerns issues where there may be specific disclosure requirements or high political or public interest. It includes any suspicion of serious mismanagement, fraud, illegality or irregularity or intentional misstatement or misrepresentation of results or information. Materiality by nature may arise due to the following circumstances:

- Non-compliance involving high-level officials who raise suspicion involving conflicts of interest.
- Other non-compliance that may suggest fraudulent activity or corruption.
- Non-compliance in an area where there is a high degree of public interest.
- Non-compliance where the legislation or regulations make clear that it is a serious offence, regardless of the monetary value.

Material by context. Material by context concerns items that are *material by their circumstance*, so that they change the impression given to users. It includes instances where a minor error or non-compliance may have a significant effect, e.g. misclassification of expenditure as income, so that an actual deficit is reported as a surplus**.**

An example would be where, while the total value of non-compliance is below the materiality threshold, the auditor is aware that the stakeholders such as parliament have expressed a special interest in irregularities in the subject matter. The auditor thus considers the issues material, even though its value is immaterial. Issues that are material by nature or context are to be disclosed.

Setting a qualitative threshold or tolerable level of non-compliance

Where a quantitative materiality threshold cannot be set because the non-compliance cannot always be quantified with amounts or monetary values, it could be more appropriate for the audit team to set as thresholds a tolerable rate of non-compliance on the subject matter as a whole and to different areas of the subject matter where appropriate. However, the team should also define clearly what a material non-compliance or deviation would be, as non-compliance with different levels of authorities such as parliamentary legislations, regulations, guidelines will differ in significance.

If the profile of the subject matter is sensitive and there is high interest from parliament, the public and the media, a lower tolerable non-compliance rate would entail more audit tests and greater assurance on the areas assessed.

As already noted, materiality is considered in the context of qualitative factors and, when applicable, quantitative factors. In general, the quantitative aspect is size. Usually in terms of value, it can be a percentage, number, amount etc. Concluding on the materiality of non-compliance identified as a result of the procedures performed requires the auditor's professional judgment. This can be further clarified through the following example:

> In a compliance audit, the entity may have complied with nine provisions of the relevant law or regulation, but did not comply with one provision. Professional judgment is needed to conclude whether the entity complied with the relevant law or regulation as a whole. For example, the auditor may consider the significance of the provision with which the entity did not comply, as well as the relationship of that provision to the remaining provisions of the relevant law or regulation.

Annex 4.6 provides the working paper template on setting materiality at planning stage, with a process guide.

4.5.8 Determining sample size and selecting samples

ISSAI 4000.172: The auditor shall use audit sampling, where appropriate, to provide a sufficient amount of items to draw conclusions about the population from which the sample is selected. When designing an audit sample, the auditor shall consider the purpose of the audit procedure and the characteristics of the population from which the sample will be drawn

Audit sampling is defined as the application of audit procedures to less than 100 percent of items within a population of audit relevance. A sample may be quantitative or qualitative, depending on the audit scope and the need for information to illuminate the subject matter from several angles.

Quantitative sampling is used when the auditor seeks to draw conclusions about the whole population by testing a sample of items selected from it. In quantitative sampling, the sample risk must be reduced to an acceptable low level. However, the technical approach to quantitative sampling may require statistical techniques. If the audit team does not have the skills to apply them, an expert statistician may be required.

Qualitative sampling is a selective procedure conducted as a deliberate and systematic process to identify the factors of variation in the subject matter. The auditor might sample on the basis of characteristics of individuals, groups, activities, processes or the audited entity as a whole. Qualitative sampling always requires careful assessment and sufficient knowledge of the subject matter.

When the auditor selects cases for in-depth study, it usually results in relatively small samples that can answer more explorative questions and provide new information, analyses and insight into the subject matter. It may be appropriate to use risk-based sampling instead of a statistical approach when selecting items for testing, for instance when addressing a specific significant risk.

Determining the sample size

Before deciding on the sample size, the audit team need to decide on the *tolerable rate of non-compliance* and the *expected population non-compliance rate.*

Tolerable rate of non-compliance. The tolerable rate of non-compliance for compliance testing is the maximum rate of non-compliance that auditors are willing to accept from the population. In general terms it is a limit beyond which, if exceeded by the actual rate of non-compliance, will affect the auditor's conclusion or opinion on the population and the subject matter. Here, it is important to keep in mind that not all non-compliance with the criteria is of the same significance and not all non-compliance becomes an audit finding to be reported. Auditors need to exercise their professional judgment to determine what material non-compliance would be for the given subject matter, considering for example the hierarchy of authorities not complied with and the nature, cause and possible impact of the non-compliance.

In determining the tolerable rate of non-compliance, the audit team at the planning stage should consider

- The assessed level of control risk.
- The degree of assurance required.

The auditors also need to consider the sensitivity of the subject matter, for instance the attention from parliament, the media and the public. There is an inverse relationship between the tolerable rate of non-compliance and the sample size. If the combined risk assessment shows that greater substantive assurance is required, than the tolerable rate of non-compliance will be low and vice versa. A range of tolerable non-compliance for a 95% confidence level is given in the table in Appendix 4-B. However, the decision on the tolerable rate of non-compliance is a professional judgment of the auditor, considering the factors discussed above.

Expected population non-compliance rate. Based on the understanding of the previous audits conducted on the subject matter and the inherent and control assurance, the audit team at the planning stage also needs to determine the expected population non-compliance rate. This is the extent of deviation/non-compliance the auditor hopes to find in the population. There is a direct relationship between the auditors' determination of the expected population non-compliance rate and the sample size.

This is due to the fact that if large number of cases of non-compliance were reported in the previous year's audit and the combined risk assessment gives little assurance, the risk that the subject matter is not complying with criteria is high. Therefore, greater substantive assurance is required, for which a higher sample size is needed.

The expected population non-compliance rate would rarely equal or exceed the tolerable rate of non-compliance. The Statistical Sample Table in Appendix 4-C can be used to determine the sample size after the audit team has decided on the tolerable non-compliance rate and the expected population non-compliance rate.

Illustration: Determining the sample size

For example, if the expected non-compliance rate is 1.5% and the tolerable non-compliance rate is 6%, the statistical sample table can be used to identify the sample size as below:

	Tolerable non-compliance Rate					
Expected Non-compliance Rate	2%	3%	4%	5%	6%	7%
0.00%	149	99	74	59	49	42
0.25%	236	157	117	93	78	66
0.50%	313	157	117	93	78	66
0.75%	386	208	117	93	78	66
1.00%	590	257	156	93	78	66
1.25%	1030	303	156	124	78	66
1.50%		[illegible]	[illegible]	124	103	66
1.75%		562	227	153	103	88

The sample size is 103 as identified in the table.

With small populations—for example, populations less than 250 items—the SAI may adopt a policy of testing 10-15% of the population at a minimum. The determination of sample size is subject to professional judgment and depends on the specific engagement's risk assessment and user needs.

Selecting items for testing

When deciding which items to test, there are three methods available to the auditor:

- selecting all items (100% examination);
- selecting specific items; and

- audit sampling.

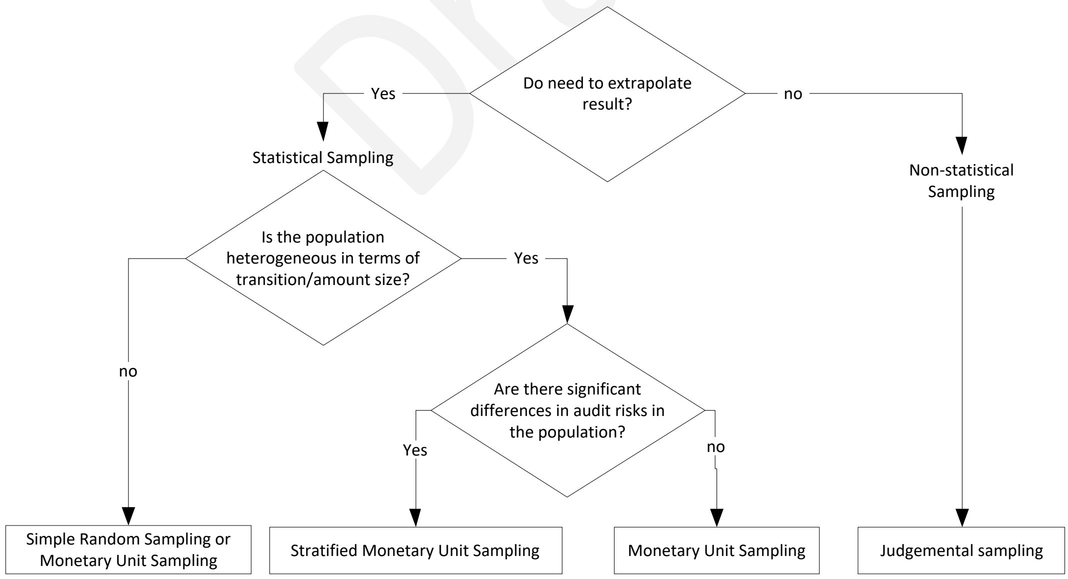
The choice of method is a matter for the auditor's professional judgment, based on risk assessment, materiality, audit efficiency and cost, but the method chosen should be effective in meeting the purpose of the audit procedure. The three methods are described below.

Selecting all items. Selecting all items is appropriate when the number of items is small but of high value, when the risk is high, or when computer-assisted audit techniques (CAATs) allow all items to be tested efficiently. It is more common for substantive testing (tests of details) than for tests of controls.

Selecting specific items or audit sampling. The auditor selects certain items from a population because of specific characteristics they possess. These are typically high-value or high-risk items (e.g. relatively high or low amounts, negative value items, etc.) or items that represent a large proportion of the subject matter under review. It is useful for tests of controls and substantive testing, and also to gain an understanding of the entity or to confirm the auditor's risk assessment. While an efficient means of gathering audit evidence, it is not audit sampling, and the results cannot be projected to the entire population. However, it may play a role as part of an audit approach that provides reasonable assurance without audit sampling.

The sampling method to be used in selecting the sample should match the characteristics of the population. The audit team should decide the most appropriate method of selecting the samples. The following chart will help in arriving at the most suitable method.

Determining which sample selection method to be used



Judgmental sampling (Risk-based sampling). Involves selecting items from a population in accordance with pre-determined and documented criteria based on the auditor's judgment. Judgmental or risk-based sampling cannot be used if the objective of the sample is to extrapolate the results. When reporting results, auditors should take care to ensure that readers are not misled into thinking that the results are representative of the population.

Simple random sampling. The main characteristic of simple random sampling is that all transactions or sampling units have the same chance of being selected for testing. A high-value transaction is no more likely to be selected than one of low value. While the method is the most straightforward to apply, its use for tests of detail is generally restricted to situations where the sampling units making up an area are of the subject matter are fairly homogeneous**.**

Systematic sampling. Systematic sampling is a method of statistical sampling in which every item has an equal chance of selection. The practical implementation of systematic sampling method uses a random starting point and then an average sampling interval (ASI) for progression through the expenditure. For example, if the auditor wishes to select 100 items from a population of 20,000 items, the uniform interval is every 200th item. The auditor selects the first item within the first interval and selects every 200th item. The first item is selected randomly.

Monetary unit sampling (MUS). Monetary unit sampling is a statistical sampling method in which a high-value transaction is more likely to appear in the sample than one of lower value. The chance of a transaction being selected is in direct proportion to its size. Any transaction above the average sampling interval will certainly be selected. Monetary unit sampling is more widely used in auditing than simple random sampling because it is usually more efficient, in the sense that the margins of uncertainty in the estimates of error are generally narrower.

However, the calculations involved in extracting a monetary unit sample can be cumbersome and the method is only really practical if it can be computerised. Also, statistically this method is only valid for populations with low error rates.

Stratified MUS. Stratified monetary unit sampling divides the population into several sub-groups (strata). The strata have to be pre-defined according to different characteristics within the population e.g. according to risk. The auditor should use professional judgement when determining these characteristics including his/her knowledge of the population subject to audit. In each stratum, a number of items is selected with MUS. The number of items to be selected can be different in every stratum.

Evaluating the sample results for non-monetary compliance attributes

Instances of non-compliance identified in a sample are important and should be evaluated to see if they have a direct and material effect on the subject matter. Whether the sampling technique applied is statistical or judgmental, the auditor should evaluate the nature, cause and impact of the non-compliance to determine whether each instance is material or immaterial, and arrive at the conclusion on the compliance of the subject matter with the established criteria.

When evaluating the results, to form a statistical conclusion about the compliance tests, the auditor should compare the upper non-compliance rate with the tolerable non-compliance rate. The upper non-compliance rate is the sum of the actual non-compliance rate and the appropriate allowance for sampling risk.

For non-monetary compliance attributes, calculating the actual non-compliance rate in the compliance test sample involves dividing the number of observed non-compliance instances by the sample size. For instance, if 4 cases of non-compliance are detected in the sample of 103, the actual non-compliance rate is 3.88% (4/103*100). The exception rate in the sample is generally the auditor's best estimate of the population from which it was selected. To identify the upper non-compliance rate, the auditor can use the statistical sample results evaluation table in Appendix 4-C. The table does not provide evaluation upper non-compliance rates for all possible sample sizes or all possible occurrences of non-compliance identified. Therefore, to be more conservative the auditor can use the next smallest sample size to identify the upper non-compliance rate.

If the upper non-compliance rate is less than the auditor's tolerable non-compliance rate, the auditor should consider the materiality of the identified non-compliance taking into account the nature, cause and impact of the non-compliance on the subject matter and the users, and consider modifying the opinion or conclusion depending on the pervasiveness of the non-compliance.

Alternatively, if the upper non-compliance rate exceeds the auditor's tolerable non-compliance rate, the auditor would consider concluding that the subject matter in not in compliance with the established authorities.

The calculation of actual non-compliance rate and upper non-compliance rate is shown in the illustration below.

Illustration: Calculation of upper non-compliance rate

For example, if:
Tolerable non-compliance rate: 6%
Expected non-compliance rate: 1.5%
Sample size :103
Actual non-compliance cases found in the sample :4
The actual non-compliance rate therefore is 4/103*100 = 3.88%
Confidence level :95%
Then the
Upper non-compliance rate =
Actual non-comp. rate + sampling risk
Upper non-compliance rate :9.0%

Next smallest sample size

Sample size	Actual number of noncompliances found										
	0	1	2	3	4	5	6	7	8	9	10
20	14.0	21.7	28.3	34.4	40.2	45.6	50.8	55.9	60.7	65.4	69.9
25	11.3	17.7	23.2	28.2	33.0	37.6	42	46.3	50.4	54.4	58.4
30	9.6	14.9	19.6	23.9	28.0	31.9	35.8	39.4	43.0	46.6	50.0
35	8.3	12.9	17.0	20.7	24.3	27.8	31.1	34.4	37.5	40.6	43.7
40	7.3	11.4	15.0	18.3	21.5	24.6	27.5	30.4	33.3	36.0	38.8
45	6.5	10.2	13.4	16.4	19.2	22.0	24.7	27.3	29.8	32.4	34.8
50	5.9	9.2	12.1	14.8	17.4	19.9	22.4	24.7	27.1	29.4	31.6
55	5.4	8.4	11.1	13.5	15.9	18.2	20.5	22.6	24.8	26.9	28.9
60	4.9	7.7	10.2	12.5	14.7	16.8	18.8	20.8	22.8	24.8	26.7
65	4.6	7.1	9.4	11.5	13.6	15.5	17.5	19.3	21.2	23	24.7
70	4.2	6.6	8.8	10.8	12.7	14.5	16.3	18.0	19.7	21.4	23.1
75	4.0	6.2	8.2	10.1	11.8	13.6	15.2	16.9	18.5	20.1	21.6
80	3.7	5.8	7.7	9.5	11.1	12.7	14.3	15.9	17.4	18.9	20.3
90	3.3	5.2	6.9	8.4	9.9	11.4	12.8	14.2	15.5	16.9	18.2
100	3.0	4.7	6.2	7.6	9.0	10.3	11.5	12.8	14.0	15.2	16.4
125	2.4	3.8	5.0	6.1	7.2	8.3	9.3	10.3	11.3	12.3	13.2

- To form audit conclusion, the upper non-compliance rate is then compared with the tolerable non-compliance rate.
- If upper non-compliance rate is > tolerable non-compliance rate, the subject matter is not in compliance with criteria.
- If upper non-compliance rate is < tolerable non-compliance rate, the subject matter is in compliance with the criteria.
- However, auditors need to consider materiality of the issues and pervasiveness of the non-compliance and decide on the most appropriate audit conclusion or opinion.

If the auditor performs non-statistical or judgmental sampling, the sampling risk may not be directly measurable; however, it is generally appropriate for the auditor to conclude that the sample results do not support an acceptable level of compliance if the actual rate of non-compliance exceeds the expected rate of non-compliance used in designing the sample.

Evaluating the sample results for monetary value of non-compliance

If the sample population is based on monetary values, the auditor may evaluate the sample results to identify the monetary value of non-compliance and then project it to the population to calculate an estimation of the likely value of non-compliance.

There are two approaches commonly used to project compliance results to a monetary population. First, if the monetary non-compliance is 100 percent errors from a population of similar-sized transactions, the same actual non-compliance rate discussed previously for non-monetary compliance attributes can be used for the population to estimate the likely monetary value of non-compliance. The first example in the illustration below explains this approach.

The second approach to projecting compliance sample results to identify the dollar value of non-compliance in the total population is to first calculate the rate of non-compliance identified in the sample; this is explained in the second example in the illustration below.

Illustration: Calculation of monetary value of noncompliance
Example 1:
If 4 non-compliance instances are observed in a sample of 103, the non-compliance rate is 3.88 percent (4/103). Assuming that 4 were 100 percent non-compliant and the population is made of homogenous transactions, the 3.88 percent non-compliance rate can be applied to the total population's monetary value to estimate the monetary value of non-compliance in the population. If the total value of the sampling population is 5,000,000, then the projected likely monetary value of non-compliance is 194,000 (5,000,000 X3.88%)
Example 2:
For example, the auditor selected samples whose monetary value totals $20,000 and the value of non-compliance identified in the samples amounts to $650, which gives a rate of 3 percent non-compliance in the transactions tested (660/20,000). Assuming that the total monetary value of the population is $5,000,000, then the projected likely monetary value of non-compliance is $150,000 (5,000,000 X3%). The monetary value of non-compliance is then compared against the threshold/materiality in order to arrive at the conclusion.

4.6 Preparing the audit plan

ISSAI 4000.137: The auditor shall develop and document an audit strategy and an audit plan that together describe how the audit will be performed to issue reports that will be appropriate in the circumstances, the resources needed to do so and the time schedule for the audit work.

Preparing the audit plan is the final step of the planning process. The standards emphasize the need for an audit strategy and audit plan because this helps SAIs in determining how the audit will proceed from start to end. All critical aspects of a compliance audit are examined and an understanding reached on what will be done (audit strategy) and how (audit plan). Both the audit strategy and the audit plan should be documented in writing and are updated as necessary throughout the audit. Planning also involves considerations related to the direction, supervision and review of the audit team. Both the audit strategy and audit plan together are also referred as the audit planning memorandum.

4.6.1 Audit plan

The auditor establishes the overall audit strategy and audit plan in the document, which sets out the scope, timing and direction of the audit and guides the development of the more detailed audit programme. The audit plan may include:

a. Nature, timing and extent of planned audit procedures and when they will be performed.
b. An assessment of risk and of internal controls relevant for the audit.
c. The audit procedures designed as a response to risk.
d. The potential audit evidence to be collected during the audit.

A suggested audit plan template is provided with process guide in Annex 4.7.

4.6.2 Updating the audit plan

The auditor updates both the audit strategy and the audit plan as necessary throughout the audit. When planning and performing compliance audits, the auditor operating in SAIs with jurisdictional powers may take into consideration the need to:

- Identify the person(s) who may be held liable for acts of non-compliance.
- Take into consideration any applicable prescription period.
- Distinguish personal liability for acts of non-compliance from the liability for unlawful acts (suspected fraud).

In some jurisdictions, compliance audits might be undertaken as an integral part of the audit of financial statements. The auditor might find it efficient to embed an audit strategy, an audit plan and audit procedures required for compliance audit into those required for the audit of financial statements.

4.6.3 Planned audit procedures

In preparing an audit plan, SAIs review, rearrange and document every step of audit process in sufficient detail. Thus, audit plans eventually work as benchmarks against which the flow of compliance audit activities is appraised.

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, i.e. the authorities that govern the entity, and then measuring the relevant subject matter information against those authorities. Chapter 5 on performing compliance audits and gathering evidence discusses audit procedures.

4.7 Conclusion

This chapter covered the initial considerations for compliance audit planning and the detailed, step-by-step process of planning a compliance audit. The chapter also provides guidance on when to provide ‘limited’ or ‘reasonable’ assurance in an assurance audit. Auditors develop their audit plan considering audit risk, including fraud risk, with the objective of arriving at an appropriate conclusion or opinion. All working papers required to make an audit plan are provided at the end.

Annex 4.1: Audit Strategy Matrix

ISSAI requirement covered: ISSAI 4000.137

Entity Name	
Audit Period	

Audit Strategy Matrix Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

1	2	3	4			
Areas of consideration	State the matters observed and noted	Do the matters have any impact on detailed audit plan, execution and reporting? Yes/No	If yes, explain detailed implications for, but not limited to, following areas			
			Scope, Timing and Directions	Assessing Risks	Conducting Phase	Reporting Phase
Overall conclusion from the analysis of team competency and ethical requirements						
Decisions on the engagement						
The subject matter, scope, criteria and other characteristics of the compliance audit taking into account the mandate of the SAI.						
The type of engagement (attestation engagement or direct reporting engagement).						
The level of assurance to be provided.						
Composition and work allocation of the audit team, including any need for						

1	2	3	4			
Areas of consideration	State the matters observed and noted	Do the matters have any impact on detailed audit plan, execution and reporting? Yes/No	If yes, explain detailed implications for, but not limited to, following areas			
			Scope, Timing and Directions	Assessing Risks	Conducting Phase	Reporting Phase
experts, and the dates of quality control. • Consider audit quality control reviewer and assigning area of audit to experienced team members • Consider budgeting appropriate time in the area where there may be higher risks of non-compliance						
Communication with the auditee and/or those charged with governance.						
Reporting responsibilities, as well as to whom and when such reporting will take place, and in what form.						
The entities covered by the audit.						
The materiality assessment. – Determine qualitative materiality – Determine quantitative materiality						
Quality control arrangements						
Other significant matters						

Completing the Audit Strategy Matrix: Suggested process guide

Objective of completing the template	The objective of this audit working paper template is to prepare an overall audit strategy matrix detailing the areas of consideration, and see how each item will impact planning and performing the audit, and also at the reporting phase of the audit. It takes into account the results of analysis of the ethical requirement and audit team competency.
ISSAI requirements covered	ISSAI 4000.137
Guide	**Column 1** List the areas of consideration for the audit of entity, including the analysis from the ethical behavior and team competency. Based on the nature and complexity of entity considered for audit, the list of matters to be considered in a particular audit could be more than the ones suggested. Areas could be broken down to questions. **Column 2** State the matters observed against the questions listed under column 1. **Column 3** Note whether the matters observed and stated against each area of consideration listed under column 1 will have an impact on planning, execution and reporting phase of the audit. **Column 4** If the answer to the question under column 3 is yes against the areas of consideration, then this column would require description of how it would affect areas such as scope, timing and direction of audit, risk assessment, performing audit procedures and reporting results.
Conclusion	The audit team leader and supervisor need to conclude that adequate consideration have been given to all significant areas affecting the audit, and an appropriate strategy put in place to deal with the matters that were likely to affect planning and performing the audit. Strategy document should include this conclusion. Audit strategy working paper document should be updated continuously.
Evidence from preparer and reviewer	The table indicating the name of the person who prepared and documented the working paper, and the reviewer's name, need to be completed at the end. While the team should collectively prepare and complete this working paper, it could be the team leader or one of the members who took the role of preparing this to sign. The reviewer signs off the document.

Annex 4.2: Understanding the entity and its environment

ISSAI requirement covered: ISSAI 4000.131

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Background of the entity
External environment affecting the entity
Parliamentary directive and interest
Laws and regulations affecting the entity
Issues relevant to audit reported in the media
Significant areas of work affecting the lives of the citizens
Internal environment affecting the entity
Organizational set-up and source of funding
Objectives and strategies of the entity

Core function or nature of the entity
Existence and independence of internal audit functions
Selection and application of financial management systems
Budget process
Accounting systems
Reporting requirements and deadlines
Consideration of other factors affecting the business of the entity
Key personnel of the entity
Overall conclusion: Significant risks affecting the entity (risk as a result of operation of an entity)

Completing the template for understanding the entity and its environment: Suggested process guide

Overall objective of completing the template	The objective of this audit working paper template is to establish and document understanding of the entity and its environment including the internal controls relevant to an audit. ISSAI 4000.131 requires the auditor to assess the risk of non-compliance through understanding the entity and its environment.
Applicable ISSAIs	ISSAI 4000.131
Guidance	In order to assess the risk of non-compliance in the operations of the entity and in its financial activities, the auditor needs to understand the entity and its environment. Based on list provided in the template above, the auditor can gather a general understanding of the entity, taking into account both internal and external factors. It is critical for auditor to understand the core business of the entity. While documenting the understanding of the entity and its environment, the auditor needs to bear in mind the risk related to the entity (business risks or entity risk) that may occur during the course of its operations, and that may result in material non-compliance in the entity. Consider the list of source documents provided in the table below as a possible source for finding and documenting the information required.
Conclusion	The audit team needs to conclude that an adequate understanding of the entity has been established, and that every auditor on the team has the knowledge of the entity. The team should also ensure that this documentation is well linked to assessing the risk of material non-compliance and assessing the control environment and identification of control activities relevant to the risks identified.
Recording the evidence from responsible team member and from the reviewer	The table indicating the name of a person who prepared and documented the material and the reviewer's name need to be completed at the end. While the team should collectively document the understanding of the entity, it could be the name of the team leader or one of the members who took the role to prepare this document who signs under the preparer. The reviewer, usually the audit supervisor, should sign off this document to ensure that the document has been reviewed.

Completing the template for understanding the entity and its environment: Suggested process guide

Sources of documents to understand the entity:

No.	Documents	Documents obtained (Yes/No.)	Working Paper Reference
1	Mandate and roles and responsibilities of the organization		
2	Draft financial statements		
3	Approved budget of the government, projects and NGOs		
4	Plan documents		
5	List of major activities carried out during the period to be audited		
6	Project organization		
7	Accounts of grants and borrowings		
8	Project documents		
9	List of laws, rules and regulations that are relevant and applicable		
10	Loans and grant agreements		
11	Consolidated Budget Fund Accounts		
12	Other sources of funding of the entity		
13	List of major agencies incurring expenditure		
14	Minutes of review meeting		
15	Important correspondence files		
16	Standard financial reporting requirement		
17	Fund flow procedures including re-imbursement and repayments		
18	Past audit reports and internal audit reports		
19	List of bank accounts and statements		
20	Financial rules and regulations		
21	Procurement rules		
22	Other		

Annex 4.3: Understanding the internal controls and control environment

ISSAI requirement covered: ISSAI 4000.131

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

COSO Framework of Internal Control: Evaluation	Yes	No	Comment
CONTROL ENVIRONMENT: Demonstrates commitment to integrity and ethical values			
1. Do comprehensive standards of conduct exist addressing acceptable business practice, conflicts of interest, and expected standards of ethical and moral behaviour for the company? Is the entity accountable for the definition and application of the standards?			
2. Is the auditor furnished with the results of employee surveys regarding behaviour, and with similar information from external parties?			
3. Are the standards of conduct communicated and reinforced regularly to all levels of the organisation, outsourced service providers, and partners? Are management's efforts to communicate the standards both sufficient and effective in creating awareness and motivating compliance?			
4. Do the board and management demonstrate through actions and behaviours their commitment to the standards of conduct? Is there consistency at all levels of the organisation?			
CONTROL ENVIRONMENT: Exercises oversight responsibility			
5. Does the board or similar body define, maintain and evaluate periodically the skills and expertise needed among its members to enable them to ask probing questions of senior management and take commensurate actions?			
6. Does the board or similar body set the expectations for the			

COSO Framework of Internal Control: Evaluation	Yes	No	Comment
performance, integrity, and ethical values of the head of entity (or equivalent role)?			
7. Does the board or similar body assume oversight responsibility for management's design, implementation, and conduct of internal control?			
CONTROL ENVIRONMENT: Establishes structure, authority, and responsibility			
8. Has the board or similar body established appropriate oversight structures and processes (i.e. board and committees) for the entity?			
9. Does the board or similar body retain authority over significant decisions and review management's assignments and limitations of authorities and responsibilities?			
CONTROL ENVIRONMENT: Demonstrates commitment to competence			
10. Does the board or similar body contain members who have the requisite level of skills and expertise commensurate with the responsibilities?			
11. Are oversight effectiveness reviews by the board or similar body commissioned periodically and/or as required for regulator purposes, with opportunities for improvement identified and addressed?			
12. Is the board or similar body effective in exercising its fiduciary responsibilities (as applicable under the relevant jurisdiction's legislation) and due care in oversight (for example, prepare for and attend meetings, review the entity's financial statements and other information)?			
13. Does the board or similar body evaluate the performance, integrity and ethical values of the head of the entity (or equivalent role) and act as necessary to address shortcomings?			
14. Do succession plans, contingency plans, or both exist for the head of the entity and other key roles in order to assign responsibilities important to internal control?			
CONTROL ENVIRONMENT: Enforces accountability			
15. Does the board or similar body challenge senior management by asking probing questions about the			

COSO Framework of Internal Control: Evaluation	Yes	No	Comment
entity's plans and performance, and require follow-up and corrective actions, as necessary?			
16. Does the board or similar body act to address shortcomings in competence, internal control, and standards of conduct among the head of entity, the organisation, and its outsourced service providers?			
17. Does the board or similar body align compensation, incentives, and rewards appropriately, including consideration of related pressures, with the fulfilment of internal control responsibilities in the achievement of objectives?			
RISK ASSESSMENT			
1. Does the board or similar body consider significant risks to the achievement of objectives from external sources, such as creditor demands, economic conditions, regulation, labour relations and sustainability? Does the organisation identify related issues and trends?			
2. Does the organisation consider significant risks to the achievement of objectives from internal sources, such as business continuity, retention of and succession planning for key employees, financing and the availability of funding for key programmes, competitive compensation and benefits, and information systems security and backup systems? Does the organisation identify related issues and trends?			
3. Does management have a process in place to assess risk proactively as significant changes occur, such as changes in government, economic/geopolitical shifts, fraud, and management override of internal controls?			
4. Does the board or similar body apply an appropriate level of scepticism and challenge management's assessment of risks?			
CONTROL ACTIVITIES			
1. Does the board or similar body assume the responsibility to oversee senior management effectively in its performance of control activities?			
2. Does the board or similar body have necessary assurance from management, internal and external auditors, and others (as appropriate) that control activities are designed effectively and operating to address all significant risks to			

COSO Framework of Internal Control: Evaluation	Yes	No	Comment
the preparation of reliable financial statements?			
3. Does the board or similar body make specific inquiries of management regarding the selection, development and deployment of control activities in significant risk areas and remediation as necessary? Does the entity design control activities proactively to address emerging significant risk areas?			
INFORMATION AND COMMUNICATION			
1. Do the board or similar body and management have an effective level of communications in place to enable fulfilment of their roles with respect to the entity's objectives and to enable consistency in direction and tone at the top?			
2. Does the board or similar body receive the necessary operational and financial information relating to the entity's achievement of objectives on a timely basis and in a format that facilitates its use? Does the board review and discuss this information?			
3. Does the board or similar body apply critical judgment effectively to scrutinize information provided and present alternative views?			
4. Does the board or similar entity review disclosures to external stakeholders for completeness, relevance, and accuracy?			
5. Does the board or similar body receive communications regarding relevant information from third-party assessments?			
6. Do open communication channels exist to allow relevant information to flow to the board or similar entity from citizens, users, suppliers, external auditors, regulators, financial analysts and others?			
7. Is there an effective process established and publicised periodically to officers, employees, and others to allow open communication of suspected instances of wrongdoing by the entity or employees of the entity?			

Completing the template for understanding internal controls and the control environment: Suggested process guide

Objective of completing the template	This template provides an understanding of key board-level responsibilities within each of the five interrelated components of an entity's internal control system, as described in the COSO Framework of Internal Control. The auditor's role within this system focuses on internal controls over financial reporting and the processes in place to design, implement, and monitor the entity's broader system of internal control.
ISSAI requirements covered	ISSAI 4000.131
Guide	

Overall	Within each component is a series of questions that the audit committee should evaluate to assure itself that board-level controls are in place and functioning. These questions should be discussed in an open forum with the individuals who have a basis for responding to the questions. The auditor should ask for detailed answers and examples from the management team, which should include key members of the management team, internal auditors, and others.
Control environment	The control environment is the set of standards, processes and structures that provide the basis for carrying out internal control across the organisation. The senior management establish the tone at the top regarding the importance of internal control and expected standards of conduct.
Risk assessment	Risk assessment involves a dynamic and iterative process for identifying and analysing risks to achieving the entity's objectives, forming a basis for determining how risks should be managed. Management considers possible changes in the external environment and within its own business model that may impede the ability to achieve its objectives.
Control activities	Control activities are the actions established by policies and procedures to help ensure that management directives to mitigate risks related to the achievement of objectives are carried out. Control activities are performed at all levels of the entity and at various stages within business processes, and throughout the technology environment.
Information and communication	Information is necessary for the entity to carry out internal control responsibilities in support of achievement of its objectives. Communication occurs both internally and externally, and provides the organisation with the information needed to carry out day-to-day controls. Communication enables personnel to understand internal control responsibilities and their importance to the achievement of objectives.
Monitoring activities	Ongoing evaluations, separate evaluations, or some combination of the two are used to ascertain whether each of

	the five components of internal control, including controls to affect the principles within each component, is present and functioning. Findings are evaluated and deficiencies are communicated in a timely manner, with serious matters reported to senior management and to the board.
Conclusion	The audit team leader and supervisor need to conclude that adequate consideration has been given to all significant areas of the control environment under evaluation.
Evidence from preparer and reviewer	The table indicating the names of a person who evaluated the control environment and the reviewer needs to be completed at the end. One of the team members could evaluate the control environment, in which case she/he should sign off as evaluator. The reviewer, usually the audit supervisor, should sign off this document to ensure that the work done by the team has been reviewed accordingly.

Annex 4.4: Assessment of fraud risks at the audit planning stage

ISSAI requirement covered: ISSAI 4000.225

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Nature and extent of audit procedures	Record of work done	Risks identified
Enquire of various parties and obtain evidence relating to the following:		
Processes that have been put in place for identifying and responding to the risks of fraud in the entity.		
Whether management is aware of any fraud, suspected fraud or fraud investigation currently being conducted and place a copy of the report(s) of the special/forensic etc. audit(s) on file.		
Any concerns that the person/party may have regarding a risk that the financial statements may be materially misstated as result of fraud.		
Whether any material weaknesses in internal control identified during the year have been successfully and appropriately addressed.		
By enquiry with the person/party, document any concerns about the nature, extent and frequency of management's assessment of the accounting and control systems in place to prevent and detect fraud.		
Testing of mitigating controls		
By discussion with management, identify any specific controls which management considers appropriate to mitigate the risk of errors resulting from fraud.		
Perform tests of control to assess the effectiveness of each of these mitigating controls. Document: – The audit procedure designed; and – Audit finding of the procedure(s).		
If the controls proved to be ineffective, perform the following: – Document whether or not the original risk assessment		

Nature and extent of audit procedures	Record of work done	Risks identified
needs to be revised; and – Determine the impact on the planned audit procedures.		
Procedures to identify fraud risks and non-compliance due to management override of controls		
By discussion with other non-management personnel, determine whether unusual pressure is being exerted by management with the intention of overriding any internal controls that may exist.		
Obtain an understanding of the business rationale for significant transactions that the audit team becomes aware of that are outside the normal course of the business of the auditee or that appear unusual given the auditor's understanding of the auditee and the environment.		
Inspect any relevant documentation that supports the need for this type of transaction and evaluate the reasonableness thereof.		
Procedures to identify fraud risks and non-compliance due to use of accounting practice		
Obtain an understanding of the financial reporting process and controls over journal entries or any other adjustments.		
Evaluate the design of controls over journal entries and adjustments and determine whether they have been implemented.		
Review the journal entries processed during the financial year and identify inappropriate or unusual journal entries or other adjustments, particularly at year end.		
Determine the timing of testing and selection of items for testing.		
For selected journals, test the appropriateness of entries recorded in the general ledger and other adjustments made in the preparation of financial statements.		

Completing the template for assessment of fraud risks at the audit planning stage: Suggested process guide

<table>
<tr><td>Objective of completing the template</td><td>The objective of this template is to have information regarding fraud risk as part of overall understanding the entity and control environment.</td></tr>
<tr><td>ISSAI requirements covered</td><td>ISSAI 4000.131</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Guide</td><td>
<table>
<tr><td>Overall</td><td>While detecting potential unlawful acts, including fraud, is not the main objective of conducting a compliance audit, the auditor does include fraud risk factors in his/her risk assessments, and remains alert to indications of unlawful acts, including fraud, in carrying out his/her work.</td></tr>
<tr><td>Consult legal Counsel</td><td>Auditors may consider consulting with legal counsel or appropriate regulatory authorities. Furthermore, they may communicate their suspicions to the appropriate levels of management or to those charged with governance, and then follow up to ascertain that appropriate action has been taken.</td></tr>
<tr><td>Court of law</td><td>Because of the different mandates and organizational structures that exist internationally, a court of law can determine whether a particular transaction is illegal and constitutes a criminal offence. But SAIs with jurisdictional powers may also conclude that a particular transaction is illegal and may justify imposing sanctions on the responsible person and determining the reimbursements of funds, misappropriated assets, and undue or improper payments.</td></tr>
<tr><td>Sanctions or reimbursement of undue payment</td><td>Although auditors do not determine if an illegal act constitutes a criminal offense or if civil liability has occurred, they do have a responsibility to assess whether the transactions concerned are in compliance with applicable laws and regulations and whether they constitute infringements that will lead the court to impose sanctions or reimbursement of undue or improper payments or of misappropriated assets.</td></tr>
</table>
</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Conclusion</td><td>The audit team leader and supervisor need to conclude fraud risk assessment and risk of unlawful acts.</td></tr>
<tr><td>Evidence from preparer and reviewer</td><td>The table indicating the names of a person who evaluated the fraud risk and the reviewer needs to be completed at the end. IOne of the team members could evaluate the fraud risk, in which case she/he should sign off as evaluator.

The reviewer, usually the audit supervisor, should sign off this document to ensure that the work done by the team has been reviewed accordingly.</td></tr>
</table>

Annex 4.5: Risk register

ISSAI requirement covered: ISSAI 4000.5.2

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

No.	Areas under the subject matter	Risks identified	Link to the inherent, control and fraud risks	Comments

Completing the template for risk register: Suggested process guide

Objective of completing the template	The objective of this audit working paper template is to record the risks of non-compliance identified while determining the risk assessment process. ISSAI requires the auditor to assess the risk of material non-compliance through understanding the entity and its environment.
ISSAI requirements covered	ISSAI 4000.52
Guide	**Overall** – Recording of risks in the risk register should take place simultaneously while determining the inherent, control and fraud risks. In the subsequent audit, this risk register can be updated based on new risks identified, without having to go through the whole process again. **Column 1** – In this column, the auditor can record different major areas of the subject matter where risks are identified. **Column 2** – In this column, the auditor needs to record the risks identified in different areas. While recording these risks, the auditor needs to bear in mind 'What could go wrong' as a result of the identified risk. **Column 3** – The risks identified and recorded in the risk register will later have to be linked to control activities and risk of material non-compliance. For this purpose, each risk identified can be provided with a unique identification number for ease of reference. **Column 4** – Add any comments for the identified risk and specifics that need to be considered during the audit.
Evidence from preparer and reviewer	The table indicating the names of a person who prepared this risk register and the reviewer needs to be completed at the end. The preparer, who could be a team leader or one of the team members, needs to sign off accordingly. The reviewer, usually the audit supervisor. should sign off this document to ensure that the work done by the team has been reviewed accordingly.

Annex 4.6: Setting materiality in the planning stage

ISSAI requirement covered: ISSAI 4000.125

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

1 **Benchmark**	2 **Threshold**	3 **Materiality % used**	4 **Population amount**	5 **Materiality amount**	6 **Revised materiality amount**
Payment amount	1 to 5%	5%	Xxxx	xxxx	
Revision	1 to 4%	4%	Xxxx		xxxx
Setting quantitative materiality					
Justification for benchmark used (how the total amount is derived)					
Justification for percentage used					
Reason for revised materiality					
Setting qualitative materiality					
Materiality by nature					
Materiality by context					
Setting qualitative threshold					

Completing the template for setting materiality in the planning stage: Suggested process guide

Objective of completing the template	The objective of completing this working paper template is to determine materiality for planning and performing the audit, and this is carried out as a part of the overall audit strategy. The materiality determined at the planning stage can be revised as the audit progresses.
ISSAI requirement covered	ISSAI 4000.125
Guide	The first step is to determine the materiality, which will also have an impact on forming an opinion or conclusion on the subject matter at the reporting stage. Using professional judgment and prior experience in the area of audit, the auditor determines the materiality level at the start of the audit. The purpose is to ensure that any non-compliance below the materiality level will not affect the conclusion and will not affect the purpose for which the reports are used by users.

Column 1	Select an appropriate benchmark in determining the planning materiality for the subject matter under consideration. In the given example, the benchmark chosen is the total payment amount. While choosing this benchmark, the auditor needs to consider whether this item is critical to the users. The reason for choosing the benchmark can be recorded accordingly in the first row provided for recording the narrative on determining overall materiality.
Column 2	Determine the threshold of materiality. The threshold will depend on the SAI's policy, and it could be, for example, between 0.5% to 2% or 1% to 5%. This may also depend on the type of benchmark chosen from the overall subject matter of the audit.
Column 3	From the given threshold, select a percentage to be applied to the total population value to arrive at the materiality amount (in the given example it is 5% of total payments). The percentage of the materiality to be applied will be determined by the sensitivity of items. Sensitivity is the extent to which the items are considered "critical" by the users. The percentage to be applied may be decided as follows: Very sensitive: 1% Sensitive: 2.5% Not sensitive: 5%
Column 4	Record the total population amount of the chosen benchmark derived from the subject matter.
Column 5	Derive the materiality amount by applying the chosen percentage (from Column 3) to the total population amount (Column 4). This is the planning materiality amount for subject matter.

	Column 6 — This is where the revised materiality amount needs to be recorded, if there is a need to revise the materiality. To arrive at this value, repeat the same process as above. Using professional judgment, the auditor may also simply state the revised materiality amount without having to apply the revised percentage to the total population.
	Recording descriptions related to determining materiality: 1. Under row 1, record the description for using the chosen benchmark, how the total amount is derived and used as a benchmark. 2. Under row 2, record the justification for using the chosen percentage. Primarily it is dependent on sensitivity. It may also depend on the nature of the entity and also the financial discipline. 3. Under row 3, record the reason for revising the materiality, to keep track of why the materiality amount was revised, and why there was a need to revise the materiality. Under qualitative materiality: 1. Under row 1, record the consideration of materiality by nature that needs to be considered throughout the audit. This particular aspect is very important in public sector auditing. 2. Under row 2, record the consideration of materiality by context that needs to be considered throughout the audit. This is sometimes minor non-compliance but may have a significant effect. Refer to section 4.5.7 on materiality. 3. Under row 3, record how the qualitative materiality threshold is determined for the subject matter under audit.
Evidence from who prepared and reviewed	The table indicating the names of a person who calculated the materiality and the reviewer needs to be completed at the end. It is usually the team leader who would calculate the materiality, but in consultation with the audit supervisor. In this case the audit team leader needs to sign off as a preparer. The reviewer, usually the audit supervisor, should sign off this document to ensure that it has been reviewed.

Annex 4.7: Audit plan

ISSAI requirement covered: ISSAI 4000.225

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

The audit planning memorandum is a combined document which consists of the following parts.

PART A:

Sections of planning memo
1. Introduction
2. About the entity
3. Type of compliance audit engagement
4. Subject matter, audit scope and criteria
5. Analysis of Internal control and risk assessment
6. Inherent risks

7. Control risks
8. Fraud risks
9. Combined result of risk assessment in risk register
10. Consideration of materiality
11. Sampling

PART B: Audit approach and planned audit procedures

1	2	3	4	5
Risks Identified (from risk register)	**Objective**	**Criteria**	**Source of evidence**	**Audit procedures to perform**

PART C: Administrative arrangements:

Table: Resource allocation (In hours)

Stages of audit	Total budgeted hours				
	Auditor	Team leader	Supervisor	Management	Total
Planning					
Preliminary assessment					
Preparation of audit file					
Understanding entity and carrying out risk assessment					
Preparation of audit plan					
Other					
Total					
Audit execution (gathering and evaluating evidence)					
Entry meeting					
Test of controls					
Substantive tests					
Review of policies					
Performing all procedures					
Other					
Total					
Reporting					
Preparation of management letter					
Preparing audit report with conclusion or opinion					
Total					
Grand total					

Part D: Audit schedule

Audit stages	Planned date	Achieved date	Comments
Audit plan			
Prepared			
Reviewed			
Approved by management			
Audit execution: Field work			
Start			
Completion			
Audit reporting			
Draft report prepared			
Reviewed			
Approved by management			
Audit report issued			

Part E: Audit team composition and specialist requirements

Name of auditor	Designation	Assignment role
Auditor-1		Team leader
Auditor-2		Team member
Auditor-3		Team member
Auditor-4		Supervisor

Completing the template for audit planning memorandum: Suggested process guide

Objective of completing the template	This working paper is the basis for the planning memorandum document that the team will submit to the management for approval. It includes the audit strategy and audit plan. The audit strategy is determined by using working paper Annex 4.1. Input from this annex needs to be added to the planning memorandum, which has five parts, from A to E, as shown in the audit memorandum template. The process for completing the template in all five parts and preparing the planning memorandum is explained below.
ISSAI requirements covered	ISSAI 4000.131
Guide	This part is the narrative part of the memo that takes input from the audit strategy and the working papers Annex 4.1 to 4.4. **Part A:**

Introduction	Write a short introduction about the audit, the SAI mandate and the intended users. Document the agency to be audited. This section is also intended to record the results of familiarisation work, including main activities, primary legislation the reporting requirements (intended users), etc.
About the entity	Write a description of the entity under audit including the regulatory framework for the audit, related parties where relevant, areas of the subject matter being covered by audit, monetary amounts involved, recent significant changes and developments that may affect the audit. Document the relevant legislation that requires the SAI to audit the particular subject matter in question. Refer to Annex 4.1: 2.1.
Type of engagement	Reference to Annex 4.1:2. Document the type of engagement is planned, e.g. level of assurance, reasonable assurance, if attestation or direct reporting engagement. Explain the reasons for the decision taken on engagement type. In most cases it is a reasonable assurance direct reporting engagement.
Audit Objective	Write the audit objective here. Document on how the audit objective is defined as to whether give an opinion or conclusion on the entity/subject matter. What question does the audit want to answer? It can depend on whether it is a direct reporting or attestation engagement.
Subject Matter, Scope, Criteria	Based on identified audit areas or entity above, write the subject matter of the audit. The subject matter should be identifiable, and possible to assess against suitable audit criteria. At the same time, write the audit scope and criteria determine based on the analysis. Describe where audit criteria are drawn from and present the key audit questions and the relevant audit criteria. Reference to Annex 4.1.
Analysis of internal control and risk	Write the risk assessment process followed, based on section 4.5 of Chapter 4. This is a preliminary assessment of risks (e.g. changes in the internal control systems and evaluation of inherent and control risk with conclusion on the combined risk

	assessment	assessment and the assurance gained). Mention the overall information from the understanding of the entity and understanding of internal control. Refer to Annex 4.2, 4.3 and 4.4
	Inherent risks	The assessment of inherent risk (IR) will be based on the overall evaluation of the entity/subject matter. Other matters such as 'government-wide' as well as subject matter area IR should be taken into account. Refer to section 4.5.3 of Chapter 4. List all inherent risks.
	Control risk	Write the assessment of overall control risk, based on the results of the understanding of the subject matter and initial assessment of control risks. Reference to section 4.5.3 of Chapter 4.
	Fraud Risk	Write the fraud risk identified. It should come from the completed working paper template Annex 4.4. Refer to section 4.5.3 of Chapter 4.
	Combined risk assessment result	Based on the assurance model, document the combined risk assessment results and the substantive assurance required in order to give reasonable assurance on the subject matter.
	Materiality	Reference to Annex 4.1 on materiality assessment. Both quantitative and qualitative aspects of materiality are to be considered and documented. Refer to section 4.6 of Chapter 4. Input should come from working paper template Annex 4.6. Setting materiality at planning.
	Sampling	Give a description of the sampling approach, the tolerable non-compliance rate, the expected population non-compliance rate, the sampling population, sampling unit, the sample size and the method of selecting samples. Refer to section 4.7 of Chapter 4.
Guide	**PART B: Audit approach and planned audit procedures**	
	Risks identified	From Annex 4.5 on the risk register template list all risks of material non-compliance here in this column. Example of an identified risk: The health department may not have a formally approved procurement policy and/or operating procurement manual, and if it has, the policy may not be aligned with relevant laws and regulations.
	Objective	Write what the audit aims to achieve by considering this risk. Example: For the risk above, the audit aims to confirm whether the health department has a formally approved procurement policy, and then to confirm whether the policy is in line with government rules and regulations.
	Criteria	In Part A all applicable criteria are identified in detail. Here the specific criteria that the entity should comply with have to be mentioned. Example: For the risk above, the audit will measure the actual condition against Section 3: Part D1.1(b) TI 2013 of the procurement regulations, and determine whether the health department has complied with it or not.
	Source of	Write a list of possible sources of evidence for the audit.

	evidence	Example: For the risk above, possible sources of evidence are: -Health department policy -Government policies and instructions -Meeting minutes
	Audit procedures to perform	Write what audit procedures the team plans to confirm whether the condition is in compliance with the criteria. Example: Make inquiries with staff and document discussions about the health department's policy framework on procurement. Also review policies and note non-compliance, for further discussions with client.
Guide	**PART C: Administrative arrangements:**	
		This part documents the organisation and administration of audit work, reporting, and communication arrangements with the responsible party, e.g. entry and exit meetings.
	Column 1	Stages of audit: Cover the major stages and sub-stages of the audit. The SAI team may consider revising based on its own sub-stages.
	Column 2	Enter total budgeted hours, i.e. person-days or hours required to complete the audit. This is an estimate, which needs to be modified according the SAI-specific scenarios. It will help the SAI management to allocate resources and plan the audit in a systematic manner. Write the number of hours or days, considering your SAI's situation and practice.
	PART D: Audit schedule: Detail the dates planned for the audit. When the audit is going on, there may be changes so the 'achieved date' part will have filled in later, and comments added based on the progress of the audit. **PART E: Team composition and specialist requirements:** Include the details of audit staff working for the particular assignment. If there is any need for the services of auditors, experts or specialists, this need should be described in terms of why and on what scope the expert will be used for the audit.	

Appendix 4-A:

Purpose	Questions to consider while performing a fraud risk assessment for an entity
Reference	Section 4.5.3

No.	Questions to consider in performing a fraud risk assessment
1	Has the audited entity developed a clear overall fraud and corruption control framework? A fraud control framework is a system of coordinated measures put in place to prevent, detect and respond to instances of fraud.
2	Do policies and procedures relevant to prevention and detection of fraud and corruption complement each other and operate in an integrated and cohesive manner?
3	Have all relevant users been involved in contributing to and developing the overall policy regarding fraud and corruption prevention and detection?
4	Does the overall policy address fraud-related elements such as tone at the top, fraud risk assessment, risk-based internal controls, internal reporting, external reporting, public interest disclosures, investigation, code of conduct, staff education and awareness, and client and community awareness?
5	Do the overall policy and any related policies and procedures reflect the specific needs of the audited entity?
6	Is the fraud control framework reviewed on a periodic basis? When was the framework last reviewed?
7	Is there a structured approach to implementing significant review recommendations?
8	Have the recommendations for changes or improvements to policy and operational procedures been prioritized or implemented?
9	Has the entity implemented effective communication or programs to raise awareness of its fraud control frameworks?
10	Is the framework easily accessible to all relevant parties?
11	Do the overall framework and its components clearly show the commitment of senior management to its principles and policies?
12	Is there a person/organizational unit responsible for 'ownership' and administration of the fraud and corruption control frameworks?

Appendix 4-B:

Purpose	Statistical sample size table for 95% confidence level
Reference	Section 4.7.3

	Tolerable non-compliance Rate										
Expected Non-compliance Rate	**2%**	**3%**	**4%**	**5%**	**6%**	**7%**	**8%**	**9%**	**10%**	**15%**	**20%**
0.00%	149	99	74	59	49	42	36	32	29	19	14
0.25%	236	157	117	93	78	66	58	51	46	30	22
0.50%	313	157	117	93	78	66	58	51	46	30	22
0.75%	386	208	117	93	78	66	58	51	46	30	22
1.00%	590	257	156	93	78	66	58	51	46	30	22
1.25%	1030	303	156	124	78	66	58	51	46	30	22
1.50%		392	192	124	103	66	58	51	46	30	22
1.75%		562	227	153	103	88	77	51	46	30	22
2.00%		846	294	181	127	88	77	68	46	30	22
2.25%		1466	390	208	127	88	77	68	61	30	22
2.50%			513	234	150	109	77	68	61	30	22
2.75%			722	286	173	109	95	68	61	30	22
3.00%			1098	361	195	129	95	84	61	30	22
3.25%			1936	458	238	148	112	84	61	30	22
3.50%				624	280	167	112	84	76	40	22
3.75%				877	341	185	129	100	76	40	22
4.00%				1348	421	221	146	100	89	40	22
5.00%					1580	478	240	158	116	40	30
6.00%						1832	532	266	179	50	30
7.00%								585	298	68	37
8.00%									649	85	37
9.00%										110	44
10.00%										150	50
12.50%										576	88
15.00%											193
17.50%											720

Source: AICPA, Audit Guide, Audit Sampling March 1 2014

Appendix 4-C:

Purpose	Statistical sample results evaluation table
Reference	Section 4.7.3

Upper noncompliance rate for 95% confidence level:

	Actual number of noncompliances found										
Sample size	**0**	**1**	**2**	**3**	**4**	**5**	**6**	**7**	**8**	**9**	**10**
20	14.0	21.7	28.3	34.4	40.2	45.6	50.8	55.9	60.7	65.4	69.9
25	11.3	17.7	23.2	28.2	33.0	37.6	42	46.3	50.4	54.4	58.4
30	9.6	14.9	19.6	23.9	28.0	31.9	35.8	39.4	43.0	46.6	50.0
35	8.3	12.9	17.0	20.7	24.3	27.8	31.1	34.4	37.5	40.6	43.7
40	7.3	11.4	15.0	18.3	21.5	24.6	27.5	30.4	33.3	36.0	38.8
45	6.5	10.2	13.4	16.4	19.2	22.0	24.7	27.3	29.8	32.4	34.8
50	5.9	9.2	12.1	14.8	17.4	19.9	22.4	24.7	27.1	29.4	31.6
55	5.4	8.4	11.1	13.5	15.9	18.2	20.5	22.6	24.8	26.9	28.9
60	4.9	7.7	10.2	12.5	14.7	16.8	18.8	20.8	22.8	24.8	26.7
65	4.6	7.1	9.4	11.5	13.6	15.5	17.5	19.3	21.2	23	24.7
70	4.2	6.6	8.8	10.8	12.7	14.5	16.3	18.0	19.7	21.4	23.1
75	4.0	6.2	8.2	10.1	11.8	13.6	15.2	16.9	18.5	20.1	21.6
80	3.7	5.8	7.7	9.5	11.1	12.7	14.3	15.9	17.4	18.9	20.3
90	3.3	5.2	6.9	8.4	9.9	11.4	12.8	14.2	15.5	16.9	18.2
100	3.0	4.7	6.2	7.6	9.0	10.3	11.5	12.8	14.0	15.2	16.4
125	2.4	3.8	5.0	6.1	7.2	8.3	9.3	10.3	11.3	12.3	13.2
150	2.0	3.2	4.2	5.1	6.0	6.9	7.8	8.6	9.5	10.3	11.1
200	1.5	2.4	3.2	3.9	4.6	5.2	5.9	6.5	7.2	7.8	8.4
300	1.0	1.6	2.1	2.6	3.1	3.5	4.0	4.4	4.8	5.2	5.6
400	0.8	1.2	1.6	2.0	2.3	2.7	3.0	3.3	3.6	3.9	4.3
500	0.6	1.0	1.3	1.6	1.9	2.1	2.4	2.7	2.9	3.2	3.4

Source: AICPA, Audit Guide, Audit Sampling March 1 2014

Chapter 5

Gathering and Evaluating Evidence

Contents

5.1 Introduction

The previous chapter discussed the initial considerations in planning and the planning process. Auditors move into the audit execution phase after they have reviewed the subject matter, criteria, scope, audit strategy and audit plan. Based on the audit procedures identified in planning the audit, auditors gather and evaluate audit evidence as part of the audit execution. This chapter explains the key considerations for the auditors in gathering audit evidence and evaluating the evidence in a reasonable assurance engagement. At the end of the chapter, guidance on conducting a limited assurance engagement is provided.

5.2 Audit evidence

Audit evidence is the information used by the auditor in arriving at conclusions on which the auditor's overall conclusion or opinion is based. Auditors typically do not examine all the information available. This would be impractical, too costly and unnecessary, as conclusions and opinions can generally be reached by using sampling and other means of selecting items for testing. Furthermore, the audit evidence available is usually persuasive (i.e. pointing the auditor in a particular direction) rather than conclusive (i.e. giving a definitive answer).

Auditors design and apply appropriate audit procedures to obtain sufficient and appropriate audit evidence in order to form a conclusion or opinion as to whether a subject matter complies, in all material respects, with established criteria. To cover the audit scope, the auditor has to decide when the audit evidence is sufficient and appropriate to provide the basis of a conclusion or an opinion. Sufficiency and appropriateness are interrelated. Professional judgment and skepticism need to be exercised in considering the quantity (sufficiency) and quality (appropriateness) of evidence when performing the engagement, in particular when determining the nature, timing and extent of the audit procedures to be performed.

During the audit planning, auditors identify control risks and other risks and keep these under consideration while they start gathering audit evidence. The auditor will often need to combine and compare evidence from different sources in order to meet the requirements for sufficiency and appropriateness of audit evidence. The nature and sources of the necessary audit evidence are determined by:

- the level of assurance
- the criteria
- materiality
- the subject matter and
- the scope of the audit.

5.2.1 Sufficiency of audit evidence: Quantity

Sufficiency is a measure of the quantity of evidence needed to support the audit findings and conclusions. There is no formula to express in absolute terms how much evidence there must be to be considered sufficient. In assessing the sufficiency of evidence, the auditor needs to determine whether enough evidence has been obtained to persuade a knowledgeable person that the findings are reasonable.[44]

The quantity of the audit evidence needed is related to the nature of the audit task. For example, to form a conclusion with reasonable assurance, the auditor needs to obtain more evidence than in a

[44] ISSAI 4000.147.

limited assurance engagement.[45] A wider audit scope normally requires more audit evidence than a narrower scope.

The quantity of evidence needed is also affected by 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 evidence may be required).[46] However, merely obtaining more evidence does not compensate for poor quality.[47]

The auditor's professional judgment as to what constitutes sufficient appropriate evidence is influenced by such factors as the following:

- Significance of a potential non-compliance or compliance deviation and the likelihood of its having a material effect on the subject matter information, individually or when aggregated with other potential non-compliance.
- Effectiveness of the responsible party's responses to address the known risk of non-compliance or compliance deviation.
- Experience gained during previous audits with respect to similar potential non-compliance or compliance deviation.
- Results of audit procedures performed, including whether such procedures identified specific non-compliance or compliance deviation.
- Source and reliability of the available information.
- Persuasiveness of the evidence.
- Understanding of the responsible party and its environment.

5.2.2 Appropriateness of audit evidence: Quality

Appropriateness is a measure of the quality of the audit evidence. It encompasses relevance, validity and reliability.[48]

Relevance refers to the extent to which the evidence has a logical relationship with, and importance to, the issue being addressed. For evidence to be relevant, it should help to answer the individual audit objective. Relevance also requires that the evidence apply to the period under review.

Validity refers to the extent to which the evidence is a meaningful or reasonable basis for measuring what is being evaluated. In other words, validity refers to the extent to which the evidence represents what it is purported to represent.

Reliability refers to the extent to which the audit evidence has been gathered and produced by a transparent and reproducible method. Evidence is reliable if it fulfils the necessary requirements for credibility. The reliability of audit evidence is affected by its source—whether internal or external to the audited entity, and type—whether physical, documentary, oral or analytical, and is dependent on the circumstances under which it is obtained.

While recognising that exceptions may exist, the following useful generalisations state that audit evidence is more reliable when it is:

- obtained from independent sources outside the entity (e.g. confirmation received from a third party), as opposed to being generated internally;
- subject to effective related controls, if internally generated;
- obtained directly by the auditor (e.g. observation of the application of a control) rather than indirectly (e.g. enquiry about the application of a control);

45 ISSAI 4000.146.
46 ISSAI 4000.151.
47 ISSAI 4000.152.
48 ISSAI 4000.148.

- in documentary form, whether paper, electronic, or another medium, rather than verbal statements;
- provided in original documents rather than photocopies.

5.2.3 Other important considerations concerning audit evidence

More assurance is ordinarily obtained from consistent evidence obtained from different sources, or of a different nature, than from items of evidence considered individually. In addition, obtaining evidence from different sources or of a different nature may either corroborate other evidence or indicate that an individual item of evidence is not reliable. In cases where evidence obtained from one source is inconsistent with that obtained from another, the auditor needs to determine what additional procedures are needed to resolve the inconsistency.

Special attention should be paid to confidential documents. If documents produced by management are classified as confidential, the auditor or his/her superior at the appropriate level will discuss how this confidential information might best be used. Information and documentation relating to cases of discovered or suspected fraud should be handled with particular care.

Auditors should adequately document the audit evidence in working papers. Such evidence includes the work performed, findings and conclusions, and the rationale for major decisions. Information that is not pertinent to work done or conclusions reached should not be included.

5.3 Gathering audit evidence

ISSAI 4000.144: The auditor should plan and perform procedures to obtain sufficient and appropriate audit evidence to form a conclusion with the selected level of assurance.

Obtaining sufficient and appropriate audit evidence is a systemic and iterative process as it involves:

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

As the auditor performs planned audit procedures, the audit evidence obtained may lead the auditor to modify the nature, timing or extent of other planed audit procedures. Information may come to the auditor's attention that differs significantly from the information on which the risk assessments were based at the outset. For example, the extent of deviation that the auditor detects by performing audit procedures may alter the auditor's judgment about the risk assessments and may indicate a material weakness in internal control. In such circumstances, the auditor should re-evaluate the planned audit procedures based on a revised consideration of assessed risks.

5.3.1 Performing audit procedures

ISSAI 4000.158: The auditor should select a combination of audit techniques to be able to form a conclusion with the selected level of assurance.

Evidence gathering techniques

Evidence may be obtained at the audit examination phase by carrying out a variety of techniques. The auditor should make a judgment as to which method (or combination thereof) for obtaining audit evidence will be suitably reliable, and should balance the reliability of evidence against the cost of obtaining it. Such techniques are:[49]

- Observation
- Inspection
- Inquiry
- External confirmation
- Re-performance
- Re-calculation
- Analytical procedures
- Test of key controls
- Substantive testing

Observation involves looking at a process or procedure being performed by others. Observation provides audit evidence of the performance of a process or procedure, but is limited to the point in time at which the observation takes place, and by the fact that the act of being observed may affect how the process or procedure is performed.[50] In performing a compliance audit this may, for example, include looking at how a bid tendering process is carried out or observing how benefit payments are processed in practice.

Inspection involves examining books, records or documents, whether internal or external, either in paper form, electronic form or a physical examination. The auditor considers the reliability of any documents inspected and remains conscious of the risk of fraud and the possibility that documents inspected may not be authentic.[51] In performing a compliance audit inspection may, for example, include the review of case files/relevant documents to determine if recipients of benefits met eligibility requirements, or examining an asset such as a bridge or a building to determine if it meets the applicable building specifications.

Inquiry involves seeking information from relevant persons, both within and outside the audited entity. Depending on the subject matter and the scope, interviews and questionnaires alone will in most cases not be sufficient and appropriate evidence. Other relevant evidence gathering methods to be considered are, e.g., written documentation from the audited entity.[52] 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 within a country/state, inquiries could be made of officers as to how relevant legislation, including changes and updates, is identified and interpreted.

SAIs with jurisdictional powers may use the method of inquiry as set out in the laws governing the auditing procedures. This may involve preparing and sending a written communication to the relevant responsible persons asking for specific information that the audit team considers to be necessary to support the conclusions.[53]

External confirmation represents audit evidence obtained by the auditor as a direct written response to the auditor from a third party. Hence, the auditor is obtaining feedback directly from beneficiaries or third parties who are not beneficiaries that they have received the grants or other

[49] ISSAI 4000.160.
[50] ISSAI 4000.161
[51] ISSAI 4000.162
[52] ISSAI 4000.163
[53] ISSAI 4000.171

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.[54]

Re-performance involves independently carrying out the same procedures already performed by the audited entity, controls that were originally performed as part of the entity's internal control. Re-performance may be done manually or by computer-assisted audit techniques. Where highly technical matters are involved, external experts may be needed.[55]

Re-calculation consists of checking the mathematical accuracy of documents or records. Re-calculation may be performed manually or electronically.[56] Some examples of re-performance are:

- Review of individual case files to test whether the audited entity made the correct decisions or provided the appropriate service in accordance with the relevant criteria.
- Process steps re-performed to test the appropriateness of visas or residence permits issued.
- Re-computation of taxation deductions on audited body staff payroll to confirm the correct amounts payable in taxes.

Analytical procedures can be used both as part of the risk analysis and when collecting audit evidence. Audit evidence can be collected either by comparing data, investigating fluctuations, or identifying relationships that appear inconsistent with what was expected based on either historical data or the auditor's past experience. Regression analysis techniques or other mathematical methods may assist public sector auditors in comparing actual to expected results. Analytical procedures must never be the only technique used.

In a limited assurance engagement, analytical procedures and inspections are normally enough to form a conclusion with limited assurance, while a conclusion with reasonable assurance must be formed on the basis of a combination of the audit techniques.[57]

However, in a compliance audit analytical procedures may, only in certain circumstances, assist the auditor in evaluating compliance. For example, where allowances under a grants scheme are subject to a maximum value and the number of recipients is known, the auditor may use analytical procedures to establish whether the permitted maximum has been breached.

These techniques or combinations thereof may be used for tests of controls or substantive procedures.

Test of key controls involves testing the controls that management has put in place to reduce the risk of non-compliance or the risk that the subject matter information is materially misstated. For most subject matters, testing key controls is an effective way to collect audit evidence. [58]

Substantive testing involves testing detailed transactions or activities against the audit criteria. Substantive testing must always be included in attestation engagements.[59]

The following sections describe in more detail how tests of controls and substantive tests should be performed in practice.

[54] ISSAI 4000.164
[55] ISSAI 4000.165
[56] ISSAI 4000.166.
[57] ISSAI 4000.169.
[58] ISSAI 4000.168.
[59] ISSAI 4000.167.

Performing tests of controls

The auditor performs tests of controls to confirm the preliminary assessment of those key controls upon which (s)he intends to rely. The objective of tests of controls is to evaluate whether those key controls operated effectively and continuously during the period under review.

If the tests of controls confirm that the controls have operated continuously and effectively throughout the period under review, then reliance can be placed on these controls and minimum substantive testing can be performed. When these controls are found not to have operated continuously and effectively throughout the period under review, the auditor should reassess the audit approach, and increase the extent of substantive testing to be performed.

The techniques that are generally used to test key controls are observation and enquiry, inspection and re-calculation, or a combination thereof. The following table gives an indication of how to test the operating effectiveness of key controls:

Table 5.1: How to test the operating effectiveness of key controls

Obtain evidence of:	By performing these audit tests:
The **quality** of the controls and data input.	<u>Testing application controls</u> • Based on mapping of application controls, identify the key processes, master files, interfaces with other modules and systems, the link to the accounting records and management reports. The control objectives (completeness, accuracy, validity, restricted access) addressing the specific risks (access, input, rejection, processing) for each component should be determined. • The key controls designed to meet these control objectives should be tested through enquiry, observation, inspection and some re-performance.
The **completeness** and **reliability** of the transactions the controls are expected to cover.	<u>Testing the assertions addressed</u> • Identify key controls that ensure completeness and reliability of transactions and ensure that they are effective, through re-performance if needed.
How controls were **applied**, and their **consistency**, at relevant times during the period.	<u>Walk-through testing of controls</u> • Understand/document the transaction flow and policies & procedures of the control. • Confirm the process, data used for controls, and time the control is in place. • Interview individuals performing the control about the type of information they look for, how they detect errors, non-compliance and/or anomalies, and how they treat them. <u>Testing individual items</u> • If the auditor cannot obtain sufficient audit evidence using walk-through testing, then (s)he can use sampling procedures to test individual items. • The sample used is either drawn for controls alone (single-purpose testing) or is the same as for substantive testing (multi-purpose testing).
The correction of detected **errors**.	• Review of corrective actions and enquiry about their follow-up.

Obtain evidence of:	By performing these audit tests:
The evidence and **documentation** supporting the application of the controls.	Reviewing evidence of controls • Evidence of authorisation of a selected transaction (signature of the authorising officer, the ex-ante unit, etc.). • Evidence of review by another official (of correct data computation, etc.). • Evidence of check of compliance with budgetary rules, legality/regularity, and documentation.
The **sensitivity** of management and monitoring controls.	Testing management and monitoring controls. • Ensure that management and monitoring controls have been operating regularly and consistently during the period under review. • Check that management analysed results of the controls and took corrective action if needed.

Annex 5.1: Testing operating effectiveness of controls provides a working paper template with a process guide for test of controls.

Performing substantive tests

The substantive procedures were designed during the planning phase to be responsive to the related risk assessment; their purpose is to obtain audit evidence to detect non-compliance. However, irrespective of the assessed risk and level of reliance, the auditor should design and perform substantive procedures (tests of details) for each material area. Tests of details that may typically be performed include those in Table 5.2.

Table 5.2: Substantive procedures

Test of Details	Areas
Computation	Re-performance of calculations regarding claims, grants, etc.
Analysis (excl. analytical review)	Analysis of findings of work by internal and other auditors Analysis of legal basis, legal and budgetary commitments, eligibility, tendering procedures
Re-performance	Re-performance of already inspected/audited transactions
Inspection	• Physical assets • Contracts • Claims • Ex-ante and ex-post control reports • Audit reports (internal and external) • Monitoring reports • Supporting documents, e.g. invoices, public procurement documents, cost-benefit analysis, photos, records of beneficiaries
Enquiry and confirmation	• Enquiry of auditee management and staff • Circularisation of bank balances • Circularisation of receivables
Observation	On-the-spot checks

The auditor should carry out tests of details as designed in the planning phase, unless the evaluation of the results of tests of controls requires her/him to reconsider the nature, timing and/or extent of the tests of details. When performing tests of details, the auditor may find that:

- A selected item is not appropriate for the application of the audit procedure. in this case, the audit procedure may be performed on a replacement item. For example, a voided cheque may be selected when testing for evidence of payment authorisation. If the auditor is satisfied that the cheque had been properly voided such that it does not constitute an error, an appropriately chosen replacement is examined.
- He or she is unable to apply the designed audit procedures to a selected item because, for instance, documentation relating to that item has been lost. If suitable alternative audit procedures cannot be performed on that item, the auditor ordinarily considers that item to be in error. (S)he also considers whether the reasons for the inability to apply appropriate audit procedures have implications for the assessed inherent or control risk or for reliance on management representations.

Annex 5.2: Performing substantive audit procedures provides a working paper template with a process guide for substantive testing. A finding form template from substantive testing is provided in Annex 5.3 with a process guide.

Professional scepticism and professional judgement in gathering audit evidence

The evidence gathering process continues until the auditor is confident that sufficient and appropriate evidence exists to support the agreed level of assurance that will support the auditor's conclusion or opinion.[60]

Auditors need to maintain professional scepticism throughout the audit to reduce the following risks:

- Overlooking unusual circumstances.
- Over generalizing when drawing conclusions from observations.
- Using inappropriate assumptions in determining the nature, timing and extent of procedures and evaluating the results thereof.

Professional skepticism in assessment of evidence gathered by the auditor includes questioning inconsistent evidence and the reliability of documents and responses to inquiries. It also includes consideration of the sufficiency and appropriateness of evidence obtained in the light of the circumstances.

Also, the auditor is not expected to disregard past experience with the honesty and integrity of those who provide evidence. Nevertheless, a belief that those who provide evidence are honest and have integrity does not relieve the auditor of the need to maintain professional skepticism during the audit.

Professional judgment applied in interpretation of relevant ethical requirements and relevant standards of audit, and in making informed decisions throughout the audit process. Auditor applies judgment with the application of relevant training, knowledge and experience to the facts and circumstances. The importance of professional judgment in determining materiality and risk is discussed in an earlier chapter. It is also equally important in the decisions about:

- The nature, timing, and extent of procedures used to meet the requirements of relevant audit standards and obtain evidence.
- Whether sufficient appropriate evidence has been obtained, and whether more needs to be done to achieve the objectives of relevant standards. In particular, in the case of a limited

[60] ISSAI 4000.150.

assurance compliance audit, professional judgment is required in evaluating whether a meaningful level of assurance has been obtained.
- The appropriate conclusions to draw based on the evidence obtained.

Considering non-compliance that Is indicative of fraud and unlawful acts

During the course of audit, the auditor may come across instances of non-compliance that may be indicative of fraud. 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.[61] When the auditor identifies instance of fraud, he or she should exercise due professional care and caution to abide by the legal mandate of the SAI in such circumstances. The auditor must ensure that his/her work does 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.

As pointed out in Chapter 4, Planning Compliance Audit, factors that contribute to fraud include:

- poor internal controls,
- management override of internal control,
- collusion between employees, and
- collusion between employees and third parties.

Auditors use different techniques for gathering evidence, as explained above. Some of the same techniques are extensively used in identifying fraud, as explained below.[62]

Observation: Auditors may observe the extent to which the management and staff are complying with policies, procedures, and internal controls. Observation may reveal a deficient control environment, including a lack of ethics and integrity on the part of top management. This implies higher fraud risk for the entity.

Inspection: Auditors may examine the record for journal entries involving large rounded amounts at or near the close of accounting.

Inquiry: Auditors may interview top managers/key officials and note changes in management and employee behavior indicating deception, corruption, red flags, and other abnormal occurrences that indicate fraud.

Analytical reviews: Auditors compare financial information from period to period to identify abnormal financial data relationships. An unexpected increase in expenditure or revenue may be a sign of fraud.

Auditors need to be aware of how the management of the audited entity responds to audit findings and to report on it. This is an indicator of the entity's seriousness toward compliance issues. Where the management does not give due importance to the irregularities identified, which the documents

[61] ISSAI 400.51, ISSAI 400.55.

[62] Risk Factors and Red Flags for State Auditors, Jerry E. Spratt (2009), Assistant Legislative Auditor for the Arkansas Division of Legislative Audit, USA. The full text of the paper can be seen at the website: http://www.nasact.org/conferences_training/nsaa/conferences/AnnualConferences/2009AnnualConference/PresentationsHandouts/Spratt,%20Jerry.pdf

would reflect by a lack of any information in reference to corrective actions taken, the risk of fraud in that kind of environment is going to be higher. Auditors need to be alert to such signals while carrying out risk assessment in the audit.

While gathering audit evidence, if auditors come across suspected unlawful acts or fraud, they are entitled to assess if the evidence is in compliance with laws and regulations. In cooperation with management of the SAI, the auditor considers the SAI's mandate and internal reporting policies. When the auditor has assessed that there is suspected fraud, he/she considers how to inform the relevant authorities, and follow up to ensure that relevant action has been taken.

Documenting the audit work

The results of audit testing should be recorded in the working papers. Discrepancies and outstanding issues should be discussed with the auditee and differences resolved before reaching conclusions. It is important for auditors to understand different techniques that may be used to collect evidence. Gathering evidence is an essential stage in the compliance audit process before evaluating and forming conclusions. In the next part we will discuss this.

5.4 Evaluating audit evidence

ISSAI 4000.179: The auditor shall compare the obtained audit evidence with the stated audit criteria to form audit findings for the audit conclusion(s).

The previous part of this chapter discusses the audit procedures identified in the audit planning process, based on which auditors gather sufficient and appropriate audit evidence. The next step in the audit is to evaluate the audit evidence and form audit conclusions as part of the audit execution. This part of the chapter explains the key considerations for the auditors in evaluating evidence and forming audit conclusions in a compliance audit, for both an attestation engagement and a direct reporting engagement.

5.4.1 Evaluating evidence gathered by different audit procedures

Using professional judgment and scepticism, the auditor evaluates the gathered evidence as well as the views received from the audited entity. In the evaluation process, the auditor assesses whether there is sufficient and appropriate audit evidence to form a conclusion. For a balanced and objective view, the evaluation process entails considering all evidence provided in relation to the audit findings. By evaluating the scope of work performed, the auditor determines whether he or she is able to draw a conclusion. If the scope of work is insufficient, the auditor might consider performing further procedures or modifying the opinion due to a scope limitation.

In evaluating the evidence, the auditor considers materiality. Based on the materiality, the auditor evaluates whether the audit findings are material enough to conclude that the subject matter, in all material respects, is or is not in compliance with the audit criteria. Depending on the characteristics of the subject matter, the auditor takes into consideration both value and nature or context. This means that instances of non-compliance that intended users would consider material by nature or context can also lead to a conclusion on non-compliance.

Materiality by value can involve amounts involved (monetary amounts) or other quantitative measures such as number of citizens or entities involved, carbon emission levels, time delays in relation to deadlines, etc.

In applying materiality, the auditor also considers:

- The visibility and sensitivity of the program in question (for example, is it the subject of significant public interest, does it impact vulnerable citizens, etc.).
- Needs and expectations of the legislature, the public or other users of the audit report.
- The nature of the relevant authorities.

Evaluating evidence

Auditors evaluate the evidence obtained and determine whether it is sufficient and appropriate to reduce the audit risk – of making incorrect conclusion - at an acceptably low level. For a balanced and objective view, the evaluation process entails considering all evidence provided in relation to the audit findings.

Evaluating the evidence will lead to forming conclusion by the auditor. Forming conclusion with the results of test of controls is a process common to both attestations engagements or direct reporting engagement. It is the usual audit process followed to arrive at audit conclusion when test of controls and statistical sampling is used for subject matters that are value driven and the non-compliances can be quantified. As the use of statistical sampling and reliance on internal control is also possible for direct report engagements, it is not compulsory that for every attestation engagement test of controls are carried out. It is professional judgment on the audit approach that is decided at the planning stage. It is possible to carry out attestation engagements without putting any reliance on the internal control (i.e. without testing controls) so that all the assurance would be obtained from substantive testing.

If statistical sampling is applied in a direct reporting engagement, the subject matter is value driven, and the non-compliances are quantifiable, the same process can be followed to form the conclusion.

Nature and causes of errors of non-compliance

When testing controls, an error is a control deviation and the total errors are expressed as a rate of deviation or frequency of deviation. When performing substantive tests of details, an error in a monetary amount, for example, is non-compliance and is expressed as a projected rate of error. In all circumstances, the auditor should investigate the nature and causes of errors identified and their possible effect on the objective of the particular audit procedure and on other areas of the audit. The consideration of the causes of errors can facilitate the drafting of clear and cost-effective recommendations in the audit reports.

When analysing errors that have been discovered, the auditor may observe the following causes and types of errors:

- Some errors may have a common feature, e.g. type of transaction, location, or time period. In such circumstances, the auditor may decide to identify those items in the population that possess the common feature, and extend audit procedures in that stratum.
- In rare circumstances, a misstatement or non-compliance may be an anomaly (i.e. demonstrably not representative of non-compliance in the population). For an instance of non-compliance to be considered an anomaly, the auditor should have a high degree of certainty that it is not representative of the population. The auditor obtains this certainty by performing additional audit procedures to obtain sufficient appropriate audit evidence that the error does not affect the remainder of the population.
- Errors may result from management override of a control, in which case the auditor should question the preliminary assessment of internal controls. The error may be due to one or a combination of the following types of causes:
    - Accidental
    - Deliberate
    - Due to complexity of the applicable regulations
    - Due to inadequate knowledge or bad application of the regulations
    - Due to weak design of the supervisory and control systems
    - Due to non-observance of the specified structures and procedures
    - Due to failure of the key controls of the supervisory and control systems

Projecting and evaluating sample results

Once the audit tests are performed, the auditor should review all errors identified and consider whether the audit evidence enables the auditor to **reach an appropriate conclusion** about the population for each audit test. The auditor should, separately for instances of non-compliance and control deviations, evaluate whether they are material, individually or in aggregate. Three scenarios are possible with regard to the rate of deviation or projected rate of error resulting from the audit tests and interpretation thereof.

<u>Possible scenarios resulting from audit tests and their interpretation</u>

The rate of deviation (tests of controls) or projected rate of error plus known error(s) (tests of details):	Interpretation
is below the materiality threshold set by the auditor.	• the controls can thus be relied upon • the assertions are deemed to have been satisfied
is less than but close to the materiality threshold.	• the auditor considers the persuasiveness of sample results in light of other audit procedures, and may obtain additional audit evidence
exceeds the materiality threshold set by the auditor.	• controls are assessed as not operating effectively • the assertions are not satisfied, and thus there is a risk of material non-compliance

If the evaluation of sample results indicates that the assessment of the relevant characteristic of the population needs to be revised, the auditor may request management to investigate identified errors and the potential for further errors, and to make any necessary adjustments; and/or modify the nature, timing and extent of further audit procedures. For example, for tests of controls, the auditor might extend the sample size, test an alternative control, or modify related substantive procedures.

Tests of control: Evaluating results

The auditor's assessment of what represents a material compliance deviation is a matter of professional judgment and includes considerations of context as well as both the quantitative (size) and qualitative (nature) aspects of the transactions or issues concerned. For example, the auditor considers the nature of the relevant laws and regulations and the extent or monetary value of the deviation.

The auditor should evaluate the results of controls testing at the level of each individual key control in order to reach an overall assessment of the effectiveness of the controls. The concept of effectiveness of the operation of controls recognises that some errors may occur in the way controls are applied by the entity. When considering the errors identified, the auditor should determine whether the tests of controls performed provide an appropriate basis for use as audit evidence, whether additional tests of controls are necessary, or whether the potential risks of non-compliance need to be addressed using substantive procedures.

Where the auditor has decided to rely on internal controls and has designed the audit approach accordingly, the objective of tests of controls is to confirm the extent of reliance on these controls. The results of tests of controls may be as follows:

- if, when testing the controls, the auditor has ensured that they are operating effectively and continuously throughout the period, then (s)he will maintain the audit approach adopted at the planning stage.
- if some weaknesses are noted, but the overall system is not considered unreliable, then the assessment of control risk is revised and the extent of substantive procedures is increased in accordance with the assurance model.

- if the controls are not operating as they should, then no assurance can be obtained regarding compliance with applicable laws and regulations. The auditor should then obtain the audit evidence mainly or solely from substantive testing.

Another separate objective may be to report on the effectiveness of internal controls, in which case the assessment is on the effectiveness of the controls as such (e.g. effective vs non-effective). In such a scenario, an assessment of the nature and causes of errors is also particularly important in the light of possible recommendations.

Substantive tests: Evaluating results

Errors found when performing tests of details should be accurately recorded, especially when testing a statistical sample, so that the audit results can be projected or extrapolated.

Table 5.3 provides an example of the decision making process and the different steps needed when using a statistical sample in a compliance audit. This section also explains necessary considerations in such a scenario. Please note that for compliance audit, the audit objectives or the audit questions, the subject under audit, etc. may not allow the use of a statistical approach; or such a statistical approach might not be the most efficient way to do the audit. In such cases, the auditor will have to apply professional judgment and alternative means to be able to reach an overall conclusion.

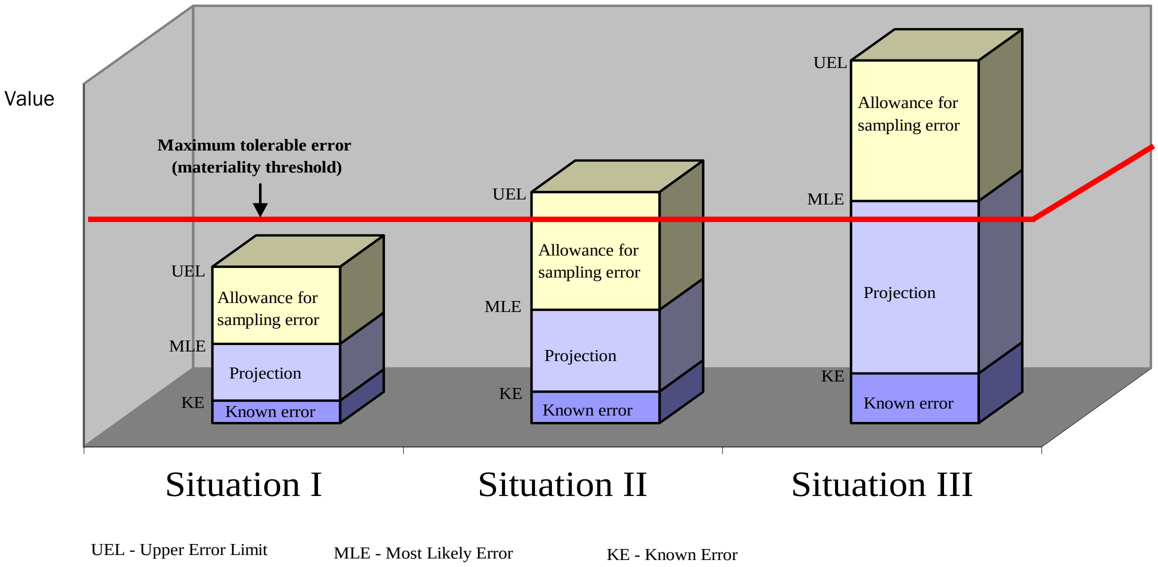
Table 5.3 - Example of evaluating the results of substantive test using a statistical sample

Audit phase	Relevant steps by the auditor	Key considerations and steps for the examination phase
Test of controls	(section 5.3.1) Determine whether risk assessment remains valid	Evaluate the results of controls testing at the level of each individual key control in order to reach an overall assessment of the effectiveness of the controls The auditor should determine whether the potential risks of non-compliance need to be addressed using substantive procedures, i.e. are the planning assumptions on control risk still valid and thus the sample size for substantive testing still sufficient?
Substantive testing	For transactions or activities in the statistical sample (section 5.3.1), analyse individually each transaction or activity tested	Analyse each transaction or activity tested: Is there a compliance issue? if yes, is the error quantifiable and material? if yes, is the error systematic or an anomaly?
Substantive testing	(5.3.1) Calculate the percentage error and the monetary value of the error	If the compliance error is not an anomaly and can be quantified, calculate for each relevant transaction or activity the percentage error and the monetary value of the quantifiable error discovered in relation to the recorded value of the transaction at the level concerned.
Substantive	(5.3.1) Analyse evidence per	Understand the nature and cause of the

testing	transaction or activity tested	errors found in the individual transactions
Evaluate test results	Extrapolate the results	Project all monetary errors found in the sample to the population
Evaluate test results	Consider the effect of the projected error on the particular audit objective and on other areas of the audit	The auditor projects the total error for the population to obtain a broad view of the scale of errors, and to compare this indicator of best estimate to the materiality threshold (tolerable error or non-compliance)

5.4.2 Evaluating overall results for statistical sampling

If the subject matter is value driven and the non-compliance can be quantified, the approach described here to reach an overall audit conclusion is used, given that statistical sampling was applied.



Conclusions to be drawn

Situation I: The upper error limit and the most likely error are less than the materiality threshold. This is a clear result, i.e. no material non-compliance.

Situation II: The upper error limit exceeds the materiality threshold, but the most likely error is lower than the materiality threshold. This is a result for which the auditor should consider:

- requesting the audited entity to investigate the non-compliance;
- carrying out further testing; and
- using alternative audit procedures to obtain additional assurance.

Situation III: The most likely error exceeds the materiality threshold error. As the lower error limit (LEL) is below the materiality threshold, the auditor should consider:

- requesting the audited entity to investigate the non-compliances;
- carrying out further testing; and
- using alternative audit procedures to obtain additional assurance

The lower error limit (LEL) can be either below or above the sum of known errors. Therefore, it is not shown in the diagram.

Situation IV: (not shown in the diagram): The lower error limit and the most likely error exceed the materiality threshold. This is also a clear result of non-compliance requiring no further consideration.

Due to the timing constraints, in real audit practice auditors are usually obliged to use the third of these possibilities—alternative audit procedures providing additional assurance—to obtain additional assurance.

Errors detected should be analysed in a step-by-step process in order to determine whether and to what extent they are relevant for inclusion in the audit conclusion or opinion. This involves an analysis of:

- whether legal requirements (conditions for payment or other compliance issues) are affected;
- whether errors are quantifiable and material (i.e. higher than the materiality threshold) and, if not, whether they are material by nature or context);
- whether errors are not quantifiable, i.e. the error is not related directly to the audited item or its effect is not measurable, in which case the whole amount of the item concerned is considered when determining the seriousness of the error;
- whether errors are systematic or an anomaly;
- the overall impact of errors as a result of the extrapolation of quantifiable findings. The findings can be extrapolated only if the selection procedure resulted in a representative sample.

If a compliance error can be quantified, the percentage error and the monetary value of the quantifiable error discovered should be calculated in relation to the recorded value of the transaction at the level concerned. Depending on the mandate of the respective SAI, a distinction can be made between the proportion financed by the budget for which the SAI has audit rights and the proportion financed by third parties.

Errors identified during supplementary work outside the scope of representative samples are taken into account only if they relate to transactions covered by the audit scope (audit population). They are not projected to the entire population, but are taken into consideration on the basis of the absolute amounts.

The auditor should understand the nature and cause of the errors found. The nature and causes of errors identified should be carefully evaluated and their possible effect on the particular audit objective and other areas of the audit assessed.

Errors that are detected and corrected on the initiative of the managing body before the closure of the financial year(s), and independently of the checks carried out by the audit, should normally not be taken into account since they demonstrate the efficient working of the system.

For tests of details, the auditor should project all monetary errors found in the sample to the population and consider the effect of the projected error on the particular audit objective and on other areas of the audit. For non-statistical samples, the auditor should make a judgment about the likely non-compliance in the population. Refer to the illustration in Chapter 4 on planning for how to project to the entire population the monetary value of non-compliance identified.

The auditor projects the total error for the population to obtain a broad view of the scale of errors, and to compare this indicator of best estimate to the materiality threshold (tolerable error). For tests of details (test procedures applied to selected individual items), tolerable error is the tolerable misstatement or non-compliance, and will be an amount less than the auditor's materiality threshold used for the individual class of transactions being audited.

When a compliance deviation is considered an **anomaly**, it is considered not to be representative of non-compliance in the population. Therefore, it may be excluded from projection. However, its effect, if uncorrected, still needs to be considered in addition to the projection of the non-anomalous non-compliance.

Annex 5.3 Finding form for compliance substantive testing can be used for the risks identified and the audit procedure performed to record the cause.

5.4.3 Evaluating overall results for judgmental sampling

ISSAI 4000.184: Based on the audit findings, and the materiality, the auditor shall draw a conclusion whether the subject matter is, in all material respects, in compliance with the applicable criteria.

The auditor forms the overall conclusion, or audit opinion, in evaluating all relevant evidence in relation to the identified materiality. Based on the materiality, the auditor evaluates whether the audit findings are material enough to conclude that the subject matter in all material respects is or is not in compliance with the audit criteria.

As discussed in the earlier section, types of audit conclusion depend on the type of audit engagement. If it is an attestation engagement, the auditor can form an opinion or a conclusion. If it is a direct reporting engagement, it is generally a conclusion, though an opinion is possible as well. This is further elaborated in Chapter 6 on reporting.

Where the instances of identified non-compliance cannot be quantified, the qualitative materiality threshold becomes more prominent. In the planning process the auditors are well aware whether a quantitative materiality or a qualitative materiality threshold is more relevant to the subject matter.

In evaluating audit results of subject matters with non-monetary compliance attributes, the qualitative materiality threshold (the tolerable level of non-compliance) set at the planning stage is to be used. This threshold or the tolerable level of non-compliance is determined after considering the factors discussed in the planning stage. A threshold can also be set for each individual area of the subject matter as well as for the subject matter as a whole. A materiality threshold for each area of the subject matter, apart from the overall materiality threshold may be helpful in evaluating the sample results and forming a conclusion.

Example
If the subject matter is the procurement practice of the Ministry of Infrastructure: ○ Overall threshold (tolerable level of noncompliance) could be set at 4% ○ Threshold for individual areas of the subject matter may be set as: • Procurement Planning - 3% • Sourcing - 5% • Contract management - 4%

The threshold for individual areas has to be set after considering the risks involved in each area, the status of controls, and the past compliance record of the entity in these areas, as well as considering the factors discussed in Chapter 4 on planning.

In forming the overall conclusion, the auditor has to calculate the actual non-compliance rate. First, the auditor determines the instances of non-compliance observed in the tests. For instance, if the sample size tested is 40 and out of which 5 samples were not complying with the criteria, then the instances of non-compliance observed is 5 which is the actual number of observed non-compliance. To determine the actual non-compliance rate which is expressed as a %, the formula is: (actual number of non-compliance/sample size) x100. At this stage the auditor applies the sample results evaluation approach used in Chapter 4 on planning.

Example
If the total sample size tested was 40 and the instances of non-compliance identified were 5, then the actual non-compliance rate would be (5/40) x100 = 12.50%. If judgmental sampling was used, the auditor may directly compare this non-compliance rate with the tolerable level of non-compliance (threshold) set for the subject matter. If the non-compliance rate exceeds the threshold, the auditor may conclude that the subject matter is not in compliance with the established criteria.

However, it may be possible that instances of non-compliance identified are from one particular area of the subject matter and not spread across the entire subject matter. In other words, the non-compliance is not pervasive. In that case, the auditor has to modify the conclusion is such a way that this is clearly communicated.

To form the overall conclusion, the auditor may directly compare the actual compliance deviation rate with the tolerable level of non-compliance. This is due to the fact that when judgment sampling is applied, it may not be appropriate to extrapolate to a result, because the sampling risk cannot be quantified.

If statistical sampling is used, the auditors can use the statistical table in Appendix 4-D of Chapter 4 to calculate the upper non-compliance rate and then compare it with the tolerable level of non-compliance (threshold) in order to form the overall conclusion.

5.4.4 Documenting audit findings and developing recommendations

The preceding section discussed a systematic approach used for evaluation of evidence in an attestation engagement, including evidence gathered and evaluated through testing of controls and substantive testing. This section describes the evaluation of evidence in a direct reporting compliance audit engagement. In most direct reporting engagements, auditors conduct substantive testing. This is because at the planning stage while identifying the risks, auditors have determined that there are very limited or non-existent internal controls in the entity. Depending on how well the entity has managed the subject matter, the auditors may decide not to separately test and evaluate internal controls but rather look into relevant controls along with substantive testing.

For a direct reporting engagement, auditors plan audit procedures to gather evidence of the risks identified at the planning phase. The planning memorandum documents in the risk table all the risks to the audit testing, which is done by applying various audit procedures. Once the audit procedures are performed for each risk identified at the planning phase, a findings matrix is filled for the respective risk and audit procedure performed. Table 5.4 shows a template for a findings matrix. This is for direct reporting where statistical sampling is not done because the non-compliance is qualitative in nature.

Table 5.4: Findings matrix template

No.	Risk	Audit criteria	Condition/ Evidence	Finding	Cause and effect of finding	Conclusion	Recommendation

In a direct reporting engagement, the auditor evaluates the evidence gathered and documents the process as a working paper in the findings matrix. This is similar to the findings form used in an attestation engagement; however, here it mostly originates from the substantive tests of details for all risks identified. A finding of non-compliance is the gap between the audit criterion and the condition found in the audit test. While explaining the condition, the auditor needs to support the statement with all relevant documentation, e.g. working paper and evidence and analysis of work done that will support the evidence. The auditor explains the methods used in the test, which may have been identified in the planning memorandum as well.

At this stage, the auditor determines the causes of the non-compliance and its effect. The effect of non-compliance may be monetary or other losses to the entity, and it can also point to the party responsible for the non-compliance. While identifying causes is important, it is more important to determine the root cause of the non-compliance. If the auditor ends the analysis of the cause at a surface-level cause or obvious cause (e.g. the entity failed to comply with the required service delivery of vehicles because it did not have enough vehicles), the main underlying cause of non-compliance will not be identified and it will be recurring non-compliance no matter how many audits are done.

For example, on the vehicle issue mentioned above, the root cause of the entity's not having enough vehicles has to be identified. Normally this type of root cause is identified with the use of appropriate root cause analysis tools, e.g. brainstorming, fishbone diagram, flow charting, five whys. The five whys tool is the simplest root cause analysis tool. "The 5 whys" technique uses a question-asking method to explore the cause-and-effect relationship underlying the problem. Essentially, the investigator keeps asking "why" until a meaningful conclusion is reached. Generally, a minimum of five questions should be asked, although additional questions are sometimes required if the real cause is yet to be identified. Root cause analysis of the findings on the vehicle issue and recommendations are explained further in the table below.

Finding	Fleet of vehicles did not meet the availability target
Root cause analysis with five whys:	
Why 1	The vehicles were often not available due to mechanical problems
Why 2	Not enough technicians are on site to do necessary repairs
Why 3	Too few technicians have completed training in recent years
Why 4	Not enough instructors are available to provide required training
Why 5	Many instructors retired in the same year, in the absence of any succession plan or recruitment strategy
Recommendation	Aimed at symptom: The entity should ensure that the fleet of the vehicles meets the availability target.
Recommendation	Aimed at root cause: The entity should establish a succession plan and recruitment strategy to support maintenance activities.

Based on the analysis, a conclusion is made on the particular risk, whether compliance or non-compliance. Appropriate and implementable recommendations are most often based on the root cause identified. If the root cause cannot be identified, a recommendation will not add any value to the entity for rectifying the particular non-compliance. For example, in the vehicle case, with a root cause analysis made by answering the five whys, it was found that the vehicle service was not provided because the budget for training drivers was cut and there were not enough skilled drivers for the service delivery. Whereas if the auditor ends the analysis with the surface-level or obvious cause, then the recommendation will be direct: the entity should ensure that vehicle service is provided as per the required system. This will not lead to any improvement of the entity's system involved.

After completing all of the findings matrix for all risks identified at the planning stage, the auditor determines if the non-compliance is material or not. Here the auditor applies the concept of materiality for value and nature or context. If the non-compliance can be quantified, the quantitative materiality determined at the planning stage can be applied. If the non-compliance is non-monetary but qualitative, the materiality threshold identified at the planning stage can be applied. (Refer to Chapter 4 on planning.) Below are factors that auditors need to consider in applying professional judgment to determine if non-compliance is material or not:

- Amount involved (this can be a monetary amount) or other measures such as number of people involved, delays in days or time, etc.
- Effects and consequences of non-compliance
- Visibility and sensitivity of the subject matter under audit
- Expectations by the legislative body, the general public, or other stakeholders and end users of the audit report
- Nature and significance of the authorities governing the subject matter
- Monetary value of the non-compliance

Annex 5.4: Audit findings matrix provides a working paper template with a process guide for preparing findings on each risk identified.

5.4.5 Using the work of others

When using the work of other auditors, the auditor should:

- consider the independence and objectivity of the other auditor;
- take account of the other auditor's professional competence for the specific audit;
- consider the scope of the other auditor's work;
- determine the cost-effectiveness of using such work;
- perform procedures to obtain sufficient appropriate audit evidence that the work of the other auditor is adequate for the auditor's purposes in the context of the specific audit (which may require access to the other auditor's working papers); and
- consider the significant findings of the other auditor when analysing and interpreting the results of that work. Where these findings are significant to the opinion, the auditor should discuss these findings with the other auditor and consider whether it is necessary to carry out additional audit testing him/herself.

The external auditor should obtain an understanding of the **internal audit** function, including its organisational status and scope, when obtaining an understanding of internal control. When considering using the work of internal audit, the auditor should evaluate the following, bearing in mind the materiality and risk involved, and the subjectivity of audit evidence:

- the objectivity and technical competence of internal audit staff;
- whether internal audit work is carried out with due professional care;

- the effect of any constraints placed on internal audit by management.

When using internal audit work, the external auditor should perform procedures to evaluate its adequacy, while considering the scope of work and whether the evaluation of the internal audit function remains appropriate. In particular, the external auditor evaluates:

- the skills and expertise of those performing the work;
- whether there is supervision, review and documentation of the work;
- whether sufficient, relevant and reliable audit evidence is obtained;
- whether conclusions reached are appropriate and reports are consistent with the work done;
- whether exceptions and unusual matters identified by internal audit are properly resolved.

Auditor's **experts** are used in order to make available to the audit team the technical knowledge or skills required to achieve the audit objectives. If technical expertise is required that is not available within the audit team or the SAI, the auditor should determine whether to engage an expert, and:

- evaluate whether the expert has the necessary capabilities, competence and objectivity (including no conflicts of interest) for purposes of the audit;
- understand the expert's area of expertise sufficiently to determine the nature, scope and objectives of work to be performed, and to evaluate its adequacy;
- agree, in writing, on the nature, scope and objectives of the work to be performed, the roles of expert and auditor, and the communication between both parties, including any report.

The auditor should evaluate the adequacy of the expert's work for audit purposes, including:

- the relevance and reasonableness of the expert's findings, and whether they are consistent with other audit evidence;
- if significant to the auditor's use of the expert's work, the relevance and reasonableness of assumptions and methods, and the completeness, relevance and accuracy of source data.

If the auditor deems the expert's work to be inadequate, the auditor should agree on further work to be performed, or perform other audit procedures that are appropriate.

The role of the expert is typically to assist the audit team, which remains responsible for the audit opinion or the conclusion. Thus, when issuing an unmodified ("clean") audit opinion, the auditor should not refer to the expert's work. However, if reference to the work of an auditor's expert is relevant to understanding a modification to the auditor's opinion, the auditor's report should indicate that such reference does not diminish the auditor's responsibility for that opinion.

5.4.6 Subsequent events

Subsequent events in relation to compliance audits are events, both favourable and unfavourable, that occur between the end of the reporting period and the date of the auditor's report. The auditor should perform audit procedures to determine if any events have occurred between the end of the reporting period and up until the date of the auditor's report that may result in material non-compliance and therefore require disclosure. However, the auditor is not expected to conduct a continuing review of all matters where audit procedures have already provided satisfactory conclusions.

The audit procedures are performed as near as practicable to the date of the auditor's report, and take into account the auditor's risk assessment. While dependent on the time that has elapsed since the last audit mission, such audit procedures typically include:

- reviewing management procedures to ensure that subsequent events are identified;
- reading minutes of meetings of those charged with governance held after the end of the reporting period;

- enquiring of management as to whether any subsequent events have occurred that might result in material non-compliance.

When the auditor identifies events that may result in material non-compliance, (s)he should determine whether such events are adequately disclosed.

5.5 Communicating audit findings

The auditor should communicate significant findings, including material weaknesses in internal control, on a timely basis to management throughout the audit process including the audit examination phase. This can be done via closing meetings at the end of an on-the-spot check, written exchanges after the testing of a certain sub-part of the audit (e.g. the audit of a particular geographical entity or a set of transactions etc.), dedicated closing meetings, etc.

Communicating preliminary findings to the audited entity provides the entity with the opportunity to respond and the auditor with the opportunity to check the correctness of the facts, for example, and the conclusions reached. The auditor should analyse the entity's response, ensuring that valid issues it raises are taken into account when drafting the final report.

5.6 Conducting limited assurance engagements

In rare circumstances, the SAI may come across subject matters where the intended user does not necessarily require that reasonable assurance be provided. In such situations, the SAI may opt for a limited assurance engagement; however, the SAI should ensure that the level of assurance meets the needs of the intended users.

Similarly, a SAI may also opt to provide limited assurance in a circumstance where the underlying subject matter is made up of a number of different areas or aspects. In such a case, different conclusions may be given on each area or aspect of the subject matter, and all such conclusions do not necessarily need to be at the same level of assurance. Rather, each conclusion is reached based on the extent of work the audit team was able to carry out. When separate conclusions on a subject matter are expressed with different levels of assurance, to provide for better understanding this has to be referenced in the audit report.

5.6.1 The nature, timing and extent of audit procedures in limited and reasonable assurance engagements

Since the level of assurance provided in a limited assurance engagement is lower than in a reasonable assurance engagement, the procedures the audit team carries out are different in nature and timing and are less extensive than in a reasonable assurance engagement. The auditors may use different procedures, as listed below, in planning or performing reasonable assurance or limited assurance engagements. However, the extent of and the context in which each procedure is used depends on the engagement circumstance and the level of assurance to be obtained.

- Observation
- Inspection
- Recalculation
- Re-performance
- Confirmation
- Inquiry
- Analytical review

The choice among these procedures in a particular audit engagement depends on factors such as the level of assurance to be obtained, the information needs of the intended users and other stakeholders, the nature of the subject matter, and the time availability and costs involved. Main differences between the two types of engagement include the following:

- The importance placed on the nature of different audit procedures as source evidence will likely differ, depending on the engagement type. For instance, in a limited assurance engagement, the audit team may find it more appropriate to put greater emphasis on enquiries of the entity's personnel and on analytical procedures, and relatively less or no emphasis on testing of controls and obtaining evidence from external sources, which may be the case for a reasonable assurance engagement.
- In a limited assurance engagement, the audit team may select fewer items for testing. Or it may conduct fewer procedures. For instance, in a limited assurance engagement, the audit team may carry out only analytical procedures in a particular area, whereas a reasonable assurance engagement audit team would carry out both analytical review and other detailed testing in that area.
- In a limited assurance engagement, the main purpose of the analytical procedures is to support potential trends or relationships rather than to identify actual instances of non-compliance expected in a reasonable assurance engagement in respondse to the risk assessment.
- When significant fluctuations, trend differences or relationships are identified in a limited assurance engagement, appropriate evidence is gathered through enquiries and analyzing the responses received in light of the circumstances.

The auditor needs to be aware that an assurance engagement is an iterative process. Sometimes the auditors may come across information that significantly differs from the information they initially had, which may require the auditor to perform additional procedures.

5.6.2 Providing a level of assurance that is meaningful

The audit team has to plan the audit and exercise professional judgment to ensure that the level of assurance given in a limited assurance engagement is meaningful enough to serve the purpose of the intended user, given the circumstance of the engagement. A meaningful level of assurance in a particular engagement represents a judgment that depends on the engagement circumstances, including the information needs of intended users as a group, the criteria, and the nature of the subject matter of the engagement.

Since the level of assurance obtained in a limited assurance engagement might vary, the executive summary of the audit report should contain the procedures performed, recognizing the appropriateness of the nature, timing and extent of the procedures to the engagement circumstances, to provide for better understanding of the conclusions reached.

Some of the factors that may be relevant in determining what constitutes meaningful assurance in a specific engagement include, for example:

- The characteristics of the underlying subject matter and the criteria, and whether there are any relevant subject-matter-specific CSAEs.
- Instructions or other indications from the engaging party, for example from the parliament, about the nature of the assurance the engaging party is seeking from the SAI. For example, the parliament's request may specifically mention the particular procedures or issues that it considers necessary, or particular aspects of the subject matter on which it would like the SAI to focus the audit procedures. However, the SAI may decide that other procedures are also required in order to obtain sufficient appropriate evidence for a meaningful level of assurance.

- The information needs of intended users as a group. Generally, the greater the consequences to the intended users of receiving an inappropriate conclusion when there is a significant deviation in the underlying subject matter, the greater the assurance that would be needed in order to be meaningful to them. For example, in some cases the consequence of receiving an inappropriate conclusion may be so great that a reasonable assurance engagement is needed for the audit team to obtain assurance that is meaningful to users in the circumstances.
- The expectation by intended users that the audit team will form the limited assurance conclusion on the underlying subject matter within a short timeframe and at a low cost.

5.6.3 Suitability of audit criteria

The suitability of audit criteria is not affected by the level of assurance; that is, if criteria are unsuitable for a reasonable assurance engagement, they are also unsuitable for a limited assurance engagement, and vice versa. Suitable audit criteria for either regularity or propriety should have the characteristics mentioned in 118 of ISSAI 4000.

5.6.4 Engagement risk assessment

The degree to which risk assessment is relevant to the engagement is affected by the engagement circumstances and the level of assurance to be provided.

For example, in limited assurance engagements the audit team may often decide to obtain evidence by means other than testing of controls, in which case consideration of control risk may be less relevant than in a reasonable assurance engagement on the same underlying subject matter.

5.6.5 Appropriateness of the subject matter

The appropriateness of an underlying subject matter is not affected by the level of assurance; that is, if an underlying subject matter is not appropriate for a reasonable assurance engagement, it is also not appropriate for a limited assurance engagement, and vice versa.

5.6.6 Use of professional judgment

Professional judgment is necessary in deciding the relevant ethical requirements, and the auditors need to make informed decisions throughout the audit process; this is not possible without applying the relevant training, knowledge and experience in the given circumstances. The exercise of professional judgment is especially important in evaluating whether sufficient and appropriate evidence has been obtained or whether further procedures need to be performed to gather more evidence. Especially in the case of a limited assurance engagement, professional judgment is necessary in evaluating whether a meaningful level of assurance that would meet the needs of the intended users has been obtained.

5.6.7 Understanding the entity and the engagement circumstances

The auditors usually have a lesser understanding of the entity, the subject matter and the engagement circumstances than does the entity or the responsible party. This requires that auditors gain a sufficient level of understanding of the subject matter and the engagement circumstances. Similarly, auditors' understanding of the entity and the subject matter in a limited assurance will be less in-depth than in a reasonable assurance engagement.

In limited assurance engagements, gaining an understanding of the internal control or carrying out internal control tests is seldom needed. However, in some limited assurance engagements the auditor may need to understand the internal control, depending on the engagement circumstance and the nature of the subject matter.

Identifying the possible areas of significant non-compliance enables the auditor to focus on those areas alone in a limited assurance engagement. For instance, where the subject matter deals with procurement, the auditor may focus on certain stages in the procurement process that are most susceptible to non-compliance. The auditors may design and perform procedures over the entire subject matter when it consists of only one area or when assurance over all the areas of the subject matter are necessary to obtain a meaningful level of assurance.

In both types of engagements, (reasonable assurance and limited assurance) the entity's risk assessment process also assists the auditor in obtaining an understanding of the subject matter and the engagement circumstances.

5.6.8 Determining whether additional procedures are necessary in a limited assurance engagement

Sometimes during the course of the engagement, auditors may become aware of non-compliance that may or may not be significant. In such circumstances the auditors need to make a professional judgment and determine whether additional procedures are required. If the auditors believe that the existing non-compliance will not cause the total non-compliance in the area to exceed the threshold level set (tolerable level of noncompliance), then they may decide not to perform additional procedures.

Example:

If the threshold level set for the area is 10% and the potential non-compliance will only raise the actual noncompliance to 6%, additional procedures may not be required, unless the auditor believes that there are other qualitative factors that need to be considered.

Circumstances where additional procedures are required include the following:

- When performing analytical procedures, the practitioner may identify a fluctuation or relationship that is inconsistent with other relevant information or that differs significantly from expected amounts or ratios.
- If the results of analytical procedures are within expectations but are, nevertheless, close to exceeding the expected value, then additional procedures may be needed because the risk of material non-compliance may not be acceptable in the engagement circumstances.
- If the auditor become aware of a potential material non-compliance by reviewing external sources, then additional procedures may be required.
- If the threshold level for the area is 10% and the initially planned procedures discovered a 9% actual non-compliance rate, additional procedures may be needed because the risk of material non-compliance may not be acceptable in the engagement circumstances.

If, in a limited assurance engagement, a matter comes to the auditor's attention that causes the auditor to believe that material non-compliance exists, the auditor is to design and perform additional procedures.

5.7 Conclusion

Auditors exercise professional judgment and skepticism throughout the audit in determining whether audit evidence is sufficient and appropriate. This chapter discussed factors that the auditors have to consider to evaluate audit evidence and form conclusions. Chapter 6 will discuss how the results of evaluation of evidence and the conclusion formed are reflected in compliance audit reports.

Annex 5.1: Testing operating effectiveness of controls

ISSAI requirement covered: ISSAI 4000.144-149

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Step 1: Link from planning to risk, control activities, test procedures

1	2	3	4	5	6
Control reference number	Risk	Risk reference	Control activity for the risk	Control testing procedures performed	Comments
Link to…	Link to…			Link to…	

Step 2: Test of control procedures performed

1	2	3					4
Sample	Sample Reference no.	Item tested in sample					Conclusion
		Item 1	Item 2	Item 3	Item 4	Item 5	
1							
2							
3							
4							

Overall conclusion on control testing

Completing the template for testing operating effectiveness of controls: Suggested process guide

<table>
<tr><td>Objective of completing the template</td><td>The objective of this working paper template is to document the control testing procedures performed by the auditor in the audit execution phase to ensure that the work performed by the auditor is documented accordingly. Test objective is linked to identified risk; the audit procedure is performed on the samples selected.</td></tr>
<tr><td>ISSAI requirement covered</td><td>ISSAI 4000.144-149</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Guide</td><td>There are two steps to completing this working paper template, as explained below.

Step 1:
Link the risks from the planning document that were considered for testing, and record in the field provided above. Against this, trace the risks, control activities, control testing procedures identified from the planning document.

Step 2:
Select samples to be tested for one control activity at a time. First record the control reference number and risk reference number, to confirm which control was tested. Record this in the field provided in the template, and then record the details of samples in the given table. The particulars or items to be tested in the given sample will depend on the test objective; what needs to be tested should be drawn from audit procedures.

Step 1: Link from planning to risk, control activities, test procedures
<table>
<tr><td>Column 1</td><td>In this column, trace the control activity reference number from the Log of Control Activity or from the RMNC (risk of material non-compliance)/risk register table completed at the planning stage of the audit. Column 1 records the control reference number and thus provides a status of controls being tested.</td></tr>
<tr><td>Column 2</td><td>Trace risks identified in the RMNC/risk register table and record them in this column. First trace the risks assessed as significant.</td></tr>
<tr><td>Column 3</td><td>It is optional whether to trace the name of the risk or the risk reference in this documentation. The risk reference number can be traced from the RMNC/risk register table and recorded in this column.</td></tr>
<tr><td>Column 4</td><td>Trace the name of the control activity from RMNC/risk register table and record it in this column. It should correspond to the control activity reference number recorded in column 1 and also the risks traced from the RMNC/risk register.</td></tr>
<tr><td>Column 5</td><td>In this column, add a comment on control testing procedures designed at the planning stage from the RMNC/risk register table. This is the work that needs to be performed by the auditor.</td></tr>
</table>
</td></tr>
<tr><td></td><td>Step 2: Test of control procedures performed</td></tr>
</table>

<table>
<tr>
<td></td>
<td>
<table>
<tr><td>Column 1</td><td>In this column, record the sample numbers. This indicates how many samples were tested.</td></tr>
<tr><td>Column 2</td><td>Document sample reference no. in this column. Typically, it could be payment voucher or receipt voucher no. and date, or similar in nature.</td></tr>
<tr><td>Column 3</td><td>In this column, record the details of items tested in that particular sample against the control. Items to be tested in a particular sample will be determined by the control testing procedures designed at the planning stage, and by the test objective.</td></tr>
<tr><td>Column 4</td><td>Arrive at a conclusion on every sample tested, and record it in this column. This will form the basis to arrive at an overall conclusion.</td></tr>
</table>
</td>
</tr>
<tr><td></td><td></td></tr>
<tr>
<td>Conclusion on control testing</td>
<td>Based on controls identified against each risk tested, conclude as to whether the controls put in place are operating effectively. To do so, first record the basis for conclusion, and then conclude with either of the following statements.
1. The controls were operating effectively.
2. The controls were not operating effectively.

This conclusion should then be traced back to the RMNC/risk register table under the column specified as ‘Conclusion of control testing procedure’ and recorded as either ‘Effective’ or ‘Not Effective’ against each control testing procedure.</td>
</tr>
<tr>
<td>Evidence from preparer and reviewer</td>
<td>The Table indicating the names of a person who prepared and completed this working paper and the reviewer needs to be completed at the end. The preparer could be a team leader or one of the team members who could then sign off accordingly.

The reviewer, usually the audit supervisor, should sign off this document to ensure that the work done by the team has been reviewed accordingly.</td>
</tr>
</table>

Annex 5.2: Performing substantive audit procedures

ISSAI requirement covered: ISSAI 4000.144-149

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Step 1: Link from planning to risk and substantive audit procedures

1 Risk	2 Risk reference	3 Substantive audit procedures performed	4 Comments
Link to…		Link to…	

Step 2: Substantive audit procedures performed

1 Sample	2 Sample Reference no.	3 Item tested in sample					4 Conclusion
		Item 1	Item 2	Item 3	Item 4	Item 5	
1							
2							
3							
4							

Overall conclusion on the substantive audit procedures

Completing the template for substantive audit procedures: Suggested process guide

<table>
<tr><td>Objective of completing the template</td><td>The objective of this audit working paper template is to document the substantive audit procedures performed by the auditor in the execution phase of the audit to ensure that the work performed by the auditor is documented accordingly. Test objective is linked to identified risk; the audit procedure is performed on the samples selected.</td></tr>
<tr><td>ISSAI requirement covered</td><td>ISSAI 4000.144-149</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Guide</td><td>The auditor needs to follow two steps in completing this working paper template, as explained below:

Step 1:
Link the risks from the planning document that were considered for testing, and record in the field provided above. Against this, link the risks and the substantive audit procedures identified from the planning document.

Step 2:
Select samples for testing. Usually the samples selected for substantive testing are larger than for control testing. Therefore, the auditor needs to first record risk reference number, so that it is quite clear as which risk will be addressed by performing substantive audit procedure. The particulars or items to be tested in the given sample would depend on the test objective, and what needs to be tested should be drawn from the substantive audit procedures.

Step 1: Link to risk and substantive audit procedures from planning

After recording the risks to be tested, proceed to complete the table having four elements. The auditor should first focus on significant risk, and design and perform substantive audit procedures that are responsive to such risks.

<table>
<tr><td>Column 1</td><td>Link risks identified from the RMNC/risk register table and record in this column. First link the risks assessed as significant.</td></tr>
<tr><td>Column 2</td><td>The risk reference number can be linked from the RMNC/risk register table and recorded in this column for ease of reference while documenting substantive audit procedures performed.</td></tr>
<tr><td>Column 3</td><td>In this column, link the substantive audit procedures designed at the planning stage from the RMNC/risk register table. This is the work that needs to be performed by the auditor.</td></tr>
<tr><td>Column 4</td><td>Add a comment here on the process and the outcome. The purpose is to ensure that the test objective is maintained consistently to arrive at an appropriate conclusion based on substantive audit procedures performed.</td></tr>
</table></td></tr>
<tr><td></td><td>Step 2: Substantive audit procedures performed

Document the substantive audit procedures performed that are responsive to assessed risks of material non-compliance. Link risk reference and record in the given field.</td></tr>
</table>

<table>
<tr><td></td><td>
<table>
<tr><td>Column 1</td><td>In this column, record the sample numbers. This indicates how many samples were tested.</td></tr>
<tr><td>Column 2</td><td>Document sample reference no. in this column. Typically, it could be a payment voucher or receipt voucher no. and date.</td></tr>
<tr><td>Column 3</td><td>In this column, record the particulars or items tested in that particular sample. Items to be tested in a particular sample will be determined by the substantive audit procedures designed and the test objectives determined in the planning stage.</td></tr>
<tr><td>Column 4</td><td>In this column record the conclusion arrived at on every sample tested. This will form the basis to arrive at an overall conclusion.</td></tr>
</table>
</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Conclusion on substantive audit procedures</td><td>To arrive at an overall conclusion, first establish the basis of the conclusion. This can be derived by summarizing the conclusion for each sample under column 4.

The overall conclusion should then be linked back to the specific risks in the risk register so that auditors will know which risks have actually resulted in non-compliances. From that constructive recommendations can be suggested.

Any exceptions observed while performing the substantive audit procedures on each sample selected for testing should be linked to the observation list in the completion and review stage of the audit to deal appropriately with the management and to evaluate the impact on the objective and subject matter.</td></tr>
<tr><td>Evidence from preparer and reviewer</td><td>The Table indicating the names of a person who prepared and completed this working paper and the reviewer needs to be completed at the end. The preparer could be a team leader or one of the team members who could then sign off accordingly.

The reviewer, usually the audit supervisor, should sign off this document to ensure that the work done by the team has been reviewed accordingly.</td></tr>
</table>

Annex 5.3: Finding form for compliance substantive testing

ISSAI requirement covered: ISSAI 4000.144-149

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved	Signature
Name:				
Designation:				
Date:				

Finding title

Background	
Criteria	
Condition or fact	
Impact	
Non-compliance	
Characteristics of the non-compliance	
Detectable?	
Non-compliance classification	
Nature of the non-compliance	
Quantification of the non-compliance	
Level of non-compliance	
Cause of non-compliance	
Finding description	

Completing the finding form for compliance substantive testing: Suggested process guide

<table>
<tr><td>Objective of completing the template</td><td>The objective of completing this working paper template is to record findings from the substantive testing procedures. This will help the auditor to narrate the findings with adequate references.</td></tr>
<tr><td>ISSAI requirement covered</td><td>ISSAI 4000.144-149</td></tr>
<tr><td></td><td></td></tr>
<tr><td>Guide</td><td>For each risk the procedure should be repeated for the samples identified.

<table>
<tr><td>Row 1</td><td>Finding title is a short statement explaining the key message of the finding. It can mention the particular non-compliance observed by the audit, which is then further explained in the following sections of the form.</td></tr>
<tr><td>Row 2</td><td>Background of the audited transaction, operation, etc. For example, an amount, when paid and by whom, what it concerned, etc.</td></tr>
<tr><td>Row 3</td><td>Criteria: Normally in compliance audit the criteria stem from legal requirements. The essential elements for the finding can be quoted or referred to. Here the question is asked, “what should be” the situation as stated in the criteria.</td></tr>
<tr><td>Row 4</td><td>Condition or fact: Write what the auditor found against the criteria in the entity under audit. It basically answers “what did you find?”</td></tr>
<tr><td>Row 5</td><td>Impact: The analysis when comparing criteria with condition or facts. What effect has the non-compliance created?</td></tr>
<tr><td>Row 6</td><td>Non-compliance: Here write the details of the non-compliance—if it is detectable or not; classification of the non-compliance; nature of the non-compliance; if possible, quantification of the non-compliance, which is often required to substantiate the findings; the level of non-compliance; cause of non-compliance, etc. Based on all this information, write a narrative description of the finding.</td></tr>
</table></td></tr>
<tr><td></td><td></td></tr>
<tr><td>Evidence from preparer and reviewer</td><td>The Table indicating the names of a person who prepared and completed this working paper and the reviewer needs to be completed at the end. The preparer could be a team leader or one of the team members who could then sign off accordingly.

The reviewer, usually the audit supervisor, should sign off this document to ensure that the work done by the team has been reviewed accordingly.</td></tr>
</table>

Annex 5.4: Audit Findings Matrix

ISSAI requirement covered: ISSAI 4000.179

Entity Name	
Audit Period	

Prepared by		Signature	Reviewed & approved by	Signature
Name:				
Designation:				
Date:				

Audit risk						
Findings						
1	2	3	4	5	6	7
Audit risk/question	Criteria	Condition/ evidence	Finding	Cause and effect of finding	Conclusion	Recommendation

Completing the template for audit finding matrix: Suggested process guide

Objective of completing the template	The objective of completing this working paper template is to facilitate preparing audit findings in a systematic manner. The auditor needs to fill this template for each risk and create a memo, according to the SAI's format for the finding. It will have the required documentation reference for each finding and this will ensure that evidence and documentation will be covered.
ISSAI requirement covered	ISSAI 4000.179
Guide	Audit risk: This is same as stated in the audit plan, which has reference to the risk register. For each audit risk or question, the items in the table below should be repeated. **Column 1**: Risks identified at the planning phase, with the process explained: What could go wrong. **Column 2**: Authorities, rules or regulations governing the particular entity/events/situation used to determine the answer to the risk, that is, whether it is compliant. **Column 3**: What the auditor found in the audit, the existing situation in the entity, whether it deviates from set criteria, results of the collection of evidence using different methods/techniques/procedures. The evidence is linked to the criteria. **Column 4**: This is the difference between the criteria (what should be) and the condition (what is there), by assessing the evidence of the condition found against the criteria. Often there are several items of evidence that form a finding. **Column 5**: If there is non-compliance, what is the cause? It could be ignorance of the rules in force or overriding of a management decision. Here the auditor needs to identify the root cause of the non-compliance rather than writing the obvious. What is the effect or consequence of the non-compliance or deviation with regard to loss or other damage to the entity? **Column 6**: Based on the findings, whether the risk under audit is or is not compliant with the respective criteria. **Column 7**: Proposals to address the main problems or root cause identified in column 5. Recommendations should come from the root cause determined. It may be that not all findings have recommendations. When suggesting a recommendation, it is good practice to discuss with the entity the logic and probability of its implementation. This will enhance the recommendation's prospects for implementation.
	Documentation: All the columns will have statements from the auditor. All these statements need to be substantiated with sufficient and appropriate evidence and required documentation. For any decision made by the auditor, the decision-making process needs to be documented. Work performed in coming to a conclusion and analysis made of the data or information gathered to formulate a decision also need to be documented appropriately.
Evidence from preparer and reviewer	The Table indicating the names of a person who completed the template and who reviewed it is completed at the end. It is usually the team leader who would sign off as part of quality control. The reviewer, usually the audit supervisor, should sign off this document to ensure that it has been reviewed.

Chapter 6

Reporting Compliance Audit

Contents

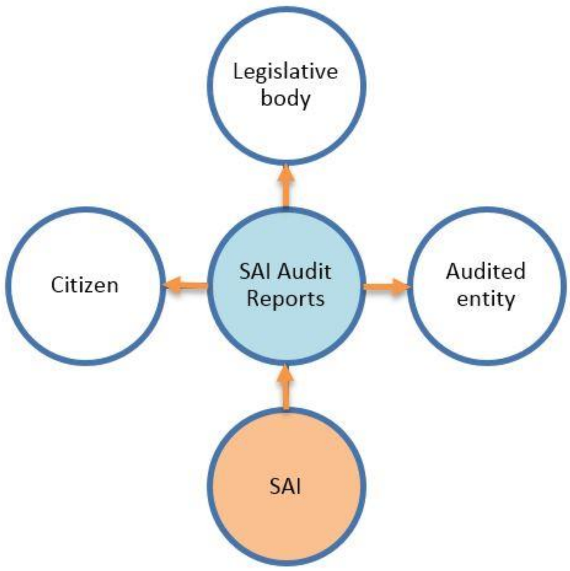
6.1 Introduction

ISSAI 4000.191: The auditor shall communicate the conclusion in an audit report. The conclusion can be expressed as either an opinion, conclusion, answer to specific audit questions or recommendations.

This chapter covers the reporting phase of the audit process and describes the form and content of reports for different compliance audit engagements. Chapter 5 expanded on the audit procedures performed, techniques and methods of gathering and evaluating the audit evidence, and forming conclusions. The auditor performs the audit procedures to reduce the audit risk and to ensure that the conclusion or opinion provided is appropriate in the circumstances of the audit. This assurance in effect forms the basis for the compliance audit report.

The purpose of an audit report is to communicate the results of the SAI’s work to the respective users, the auditee, and the general public. Reporting is an essential part of audit. It involves recording non-compliance with and violations of the applicable authorities, and following up to determine whether the entity takes corrective action and those responsible for the non-compliance or violations are held accountable for their actions. The SAI provides information to the intended users, through its published reports, on whether the audited entities followed the parliamentary decisions, laws, legislative acts, policies, established codes and agreed-upon terms. This information can be used to ensure compliance with authorities within a specific subject matter. With its reports, the SAI assists the intended users in exercising its power of control over the implementation of the budget, laws and regulations by an entity.

A report is the final product of an audit, in which the SAI formally presents the results of its audit of the responsible party’s compliance with the stated criteria. The key to a good report is effective communication, with clear and objective findings and conclusions on the audit objectives. It allows the reader to understand what was done, why and how; and provides practical recommendations, without impairing the objectivity of the auditor. Proper planning and execution provides the basis for a good compliance audit report. Such a report provides an avenue for the responsible party to take corrective actions towards addressing the instances of non-compliance and for the auditor to plan for following up on its findings.



Users of the SAI audit reports

The reporting phase begins with the drafting of preliminary observations and ends with the publication of the report. It thus includes drafting, approval of the preliminary observations by the SAI, completing contradiction procedures with the audited entity, adoption of the final report by the SAI, its presentation/submission to the respective users, and publication.

6.2 Principles of reporting

ISSAI 4000.202: The auditor shall prepare an audit report based on the principles of completeness, objectivity, timeliness, accuracy and contradiction.

The ISSAIs on compliance audit require that a written report, setting out findings in an appropriate form, is prepared at the end of each audit. The law or the mandate of the SAI defines the form of reporting. The opinion/conclusion made in an attestation engagement or in a direct reporting engagement should be clear enough to eliminate any risk of misinterpretation. To ensure that the report is made in accordance with the standards of quality and is relevant for all of its users, it should conform to the five principles of reporting, in both its form and content. These are completeness, objectivity, timeliness, accuracy and contradiction.[63]

- ***Objectivity*** requires the auditor to apply professional judgment and scepticism to ensure that the report is factually correct and that findings and conclusions are presented in a relevant, fair and balanced manner.
- ***Completeness*** requires the auditor to consider all relevant audit findings before issuing the report. The relationship between audit objectives, findings and conclusions needs to be completely and clearly stated.
- ***Timeliness*** requires the auditor to prepare the report in due time when the findings are applicable and relevant for the intended users.

- The principle of ***accuracy*** and consultation require the auditor to check the accuracy of facts with the audited entity, and to ensure that the findings portray a correct and logical picture.
- The principle of ***contradiction*** requires that the auditor incorporate responses from the responsible party as appropriate and give answers to and assessments of the responses.

Additionally, reports should be clear with simple language and easy to understand, free from vagueness or ambiguity, concise and balanced. In the report the auditor should present persuasive arguments, with illustrative examples. Based on the audit plan, the audit team has a number of options for how to report on compliance audit findings. However, in arriving at a decision on how to report, the auditor should consider the following factors:

- User's needs
- SAI mandate
- Relevant legislation and regulation
- The level of assurance provided
- Type of engagement
- Customary reporting practice
- Complexity of the reported issues

This list is not exhaustive, so in deciding on the length and structure of its compliance audit reports the SAI needs to consider its mandate and legal framework along with the requirements of the

[63] ISSAI 4000/202.

ISSAIs. Considering the types of engagement and the degree of assurance provided, compliance audit reports can be one of the following four types:

- Direct reporting–reasonable assurance
- Direct reporting–limited assurance
- Attestation engagement–reasonable assurance
- Attestation engagement–limited assurance

In this chapter we will cover in detail the reporting for direct reporting–reasonable assurance (and limited assurance) and attestation engagement–reasonable assurance (and limited assurance), with the formats of these reports and conclusion or opinion as explained below.

6.3 Reporting on direct reporting engagements

Direct reporting engagement reports differ from attestation engagement reports in the requirement regarding conveying assurance. In an attestation engagement report, opinions and conclusions should explicitly convey the level of assurance, while this is not required in a direct reporting engagement report. In direct reporting engagements the auditor might not give an explicit statement of assurance on the subject matter but must provide the users with the necessary degree of confidence by explicitly explaining how the findings, criteria and conclusions were developed in a balanced and reasoned manner, and why the combinations of findings and criteria result in a certain overall conclusion or recommendation.

6.3.1 Direct reporting–reasonable assurance

In a direct reporting–reasonable assurance engagement, the auditor provides assurance by measuring the subject matter against the criteria, and forms a conclusion. The audit conclusion expresses the auditor's view that the subject matter is or is not compliant in all material respects with the applicable criteria. The conclusion is expressed in the form of findings, answers to specific audit questions, recommendations or an opinion.

Elements of the report

ISSAI 4000.210: Elements of the audit report structure for direct reporting engagement

The audit report of a direct reporting–reasonable assurance engagement shall include the elements described below.

Title. The title of the report should briefly mention the audit subject matter in a way that can be clearly understood by readers.

Identification of the auditing standards applied and level of assurance. In its audit reports the SAI declares which standards it follows when conducting audits; this declaration should be accessible to the users of the reports. Also, the SAI should make reference to the auditing standards it followed in conducting the particular audit in the report. It does not need to mention each separate standard it applied in the audit. To refer to the compliance audit ISSAIs, the SAI has two options:

Option 1: Developing a national authoritative standard that is consistent with the Fundamental Principles of Public Sector Auditing (ISSAI 100) and with the Fundamental Principles of Compliance Auditing (ISSAI 400); or

Option 2: Referring directly to the International Standards of Supreme Audit Institutions for Compliance Auditing, (ISSAI 4000).

In option 1, where an SAI's auditing standards are based on or consistent with the Fundamental Principles of Public Sector Auditing, reference may be made in audit reports by stating,

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

In option 2, SAIs in some jurisdictions may choose to adopt the Compliance Audit Guidelines 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].

Executive summary (as appropriate). The executive summary of the work performed and methods used helps the intended users understand the auditor's conclusion. Hence, the executive summary needs to give an outside reader a brief explanation of how the audit was performed.

The executive summary explains what the audit questions were, how the audit was done, and the main findings, conclusions and recommendations. It gives the information is in a summary form and contains only the most important information of the report. The executive summary typically ranges from 2 to 3 pages but can be shorter, depending on the particular audit.

The executive summary includes a paragraph on the background of the entity, where the main topic has come from, and its importance. It also includes the objective, the audit questions, the audit approach, and describes the key audit findings and conclusions in a summary form, easy to read and understand. From this, the reader gets a quick overview of the most critical issues of the topic. The executive summary includes the main recommendations of the audit and a statement that confirms that the audited entity had the opportunity to comment on the report.

Description of the subject matter and the scope. Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. This should be clearly described in the audit report. The introduction of the report sets out the audit scope in the form of a clear statement of the focus, extent and limits of the audit in terms of the subject matter's compliance with the criteria. It also includes the time period covered by the audit.

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

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

It may be relevant in the circumstances to disclose the following:

- The source of the applicable criteria, and whether or not they are embodied in law or regulation or are issued by authorized or recognized bodies of experts that follow a transparent due process—that is, whether they are established criteria in the context of the underlying subject matter (and if they are not, a description of why they are considered suitable).
- Measurement or evaluation methods used when the applicable criteria allow for choice among a number of methods.
- Any significant interpretations made in applying the applicable criteria in the engagement circumstances.

Explanation and reasoning for the methods used. The auditor should make a clear statement of the procedures performed to gather evidence in answering the audit questions. This will enable a user to read and follow the report and have confidence that the conclusions made are correct. The details of the work performed have the following aspects:

- Circumstances specific to the entity (e.g. the differing nature of the entity's activities compared to those typical in the sector).
- Specific audit circumstances affecting the nature and extent of the procedures performed.
- The intended users' expectations of the level of detail to be provided in the report, based on market practice or applicable law or regulation.

It is important to write the methodological summary in an objective way that allows intended users to understand the work done as the basis for the auditor's conclusion. However, the summary should not be so brief as to make it difficult to understand the work of the auditors, especially how they arrived at the conclusion or opinion.

Findings. The findings section comprises the auditor's description of the gathered evidence compared with the criteria. It is structured in a logical manner, based on the identified criteria in a way that assists the reader in following the logical flow of a particular argument. When significant amounts of data are included to support audit findings, such data may be included in appendices.

Conclusion(s) or opinion based on answers to specific audit questions. The auditor's report on compliance subject matters contains a conclusion or an opinion based on the audit work performed. The conclusion or opinion is expressed as an 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.

Replies from the audited entity (as appropriate). Incorporating responses from the audited entity by reporting the views of the responsible party is part of 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. This involves agreeing on the facts with the audited entity to help ensure that they are complete, accurate and fairly presented. It also involves, as appropriate, incorporating the audited entity's response to matters raised, whether verbatim or in summary.

Recommendations (as appropriate). The auditor's report includes, as appropriate, recommendations designed to result in improvements. While such recommendations may be constructive for the audited entity, they should not be so detailed that the public sector auditor's objectivity may be impaired in future audits. If the auditor makes a specific recommendation and the responsible party does not implement that particular recommendation but considers another option, the auditor may in subsequent audits be tempted to judge this as non-compliance. In such instances, the key is to determine whether recommendations leave room for the entity to use whatever mechanism it considers suitable in the circumstances to achieve compliance.

Conclusions in direct reporting–reasonable assurance engagements

Compliance audit reporting may vary depending on the various forms of *conclusions or opinions* (provided in direct reporting and sometime attestation engagements) and brief standardized opinions (provided in attestation engagements). Depending on the type of engagement (direct or attestation) or the level of assurance given, the auditor can decide whether to issue a conclusion or an opinion, and this should be clearly and explicitly stated.

The conclusions provided in the direct reporting reasonable assurance engagement should have a direct link to the subject matter and the evidence gathered. They may clarify and add meaning to specific findings in the report. Non-compliance with criteria should logically flow from the findings. Conclusions go beyond merely restating the evidence. The audit findings are identified by comparing what should be (assessment criteria) to what actually is happening (conditions based on audit evidence). The conclusions reflect the report summary based on these findings. Conclusions might include identifying a general topic or a certain pattern in the findings.

Conclusions may also be expressed as a more detailed 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.

6.3.2 Direct reporting–limited assurance

Summary of the report

Since the extent of work carried out in a limited assurance engagement is less than in a reasonable assurance engagement and limited in nature, it is important to present the summary of the work performed to help the intended users understand the extent of work performed and the auditor's conclusion.

The summary of the limited assurance engagement report is more detailed and should identify the limitations on the nature, timing and extent of audit procedures carried out, so that the readers will have a better appreciation of the conclusion reached. In the summary of work done It may also be important to mention any procedures that were not performed but ordinarily would have been in a reasonable assurance engagement. Since the risk assessment carried out in a reasonable assurance engagement is more than in a limited assurance engagement, identification of all such procedures may not be possible.

Conclusions/opinions

The wording of the opinion or conclusion should reflect the mandate of the SAI. The auditor may therefore use terms such as “is legal and regular”, “is regular” or “has been applied for the purposes intended by Parliament.”

Unmodified conclusion/opinion

In a limited assurance engagement an example of an unmodified opinion can state, “Based on the work performed described in this report, nothing has come to our attention that causes us to believe that the subject matter is not in compliance, in all material respects with the [applied criteria].”

Modified conclusion/opinion

A modified opinion can state, “Based on the work performed described in this report, except for [describe exception] nothing has come to our attention that causes us to believe that the subject matter is not in compliance, in all material respects with the [applied criteria].”

Phrasing for other types of audit conclusions such as the adverse conclusion and disclaimer of conclusion are similar for both limited assurance engagements and reasonable assurance engagements.

6.4 Reporting on attestation engagements

6.4.1 Attestation engagement–reasonable assurance

In an attestation engagement it is the responsible party who measures the subject matter against the criteria and presents the subject matter information to the auditor. The auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for forming an opinion or conclusion. The conclusion is expressed in the form of findings, conclusions, recommendations or an opinion.

In an attestation engagement with reasonable assurance, the auditor's conclusion expresses the auditor's view that the subject matter information is or is not in accordance with the applicable criteria.

Elements of the report

ISSAI 4000.218: Elements of the audit report structure for attestation engagement

The audit report on attestation engagement reasonable assurance shall include the elements described below.

Title. The title of the report should briefly mention the audit subject matter which is clear to understand for a reader.

Addressee. An addressee identifies the party or parties to whom the audit report is directed. The audit report is ordinarily addressed to the responsible party, but in some cases there may be other intended users. The intended users are the persons for whom the auditor prepares the compliance audit report. The intended users may be legislative or oversight bodies, those charged with governance, the public prosecutor or the general public.

Description of the subject matter information, and when appropriate the underlying subject matter. Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. This should be clearly described in the audit report.

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

Responsibilities of the responsible party and the auditor. Identifying relative responsibilities informs the intended users that the responsible party is responsible for the underlying subject matter, that the measurer or evaluator is responsible for the measurement or evaluation of the underlying subject matter against the applicable criteria, and that the auditor's role is to independently express an opinion/conclusion about the subject matter information. These responsibilities can be expressed as follows:

> **Responsibility of the responsible party**
> According to [the terms of the agreement with the organisation XYZ dated xx.xx.20XX], management of government agency ABC is responsible for [preparing complete accounts in compliance with the terms of the agreement].
>
> **Responsibility of the auditor**
> 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 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 and appropriate evidence to support our conclusion. The procedures performed depend on the auditor's professional judgment, including assessing the risk of material non-compliance, whether due to fraud or error. The audit procedures we 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.

Audit criteria. The criteria against which the subject matter is assessed should be identified in the auditor's report. Clear identification of the criteria in the report is therefore important so that the users of the report can understand the basis for the 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 are otherwise available from a readily accessible and reliable source.

Identification of the auditing standards and level of assurance. Where an SAI's auditing standards are based on or consistent with the INTOSAI Fundamental Auditing Principles, these may be referred to in audit reports by stating:

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

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

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

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

Factors to consider in determining the level of detail to be provided in the summary of the work performed may include:

- Circumstances specific to the entity (e.g. the differing nature of the entity's activities compared to those typical in the sector).
- Specific audit circumstances affecting the nature and extent of the procedures performed.
- The intended users' expectations of the level of detail to be provided in the report, based on market practice, or applicable law or regulation.

It is important that the summary be written in an objective way that allows intended users to understand the work done as the basis for the auditor's conclusion. However, it needs to be ensured that the summary is not so brief that it makes it difficult to understand the work of auditors especially how they have arrived at a conclusion or opinion.

Opinion/conclusion. For attestation engagements, the level of assurance will be conveyed by the appropriate use of standardized audit opinions. For combined audits, the auditor assesses which standard to reference. When a compliance audit is combined with a financial audit, the conclusion/opinion on the aspect of compliance should be clearly separated from the opinion on the financial statements.

Replies from the audited entity (as appropriate). Incorporating responses from the audited entity by reporting the views of officials of the responsible party is part of 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. This involves agreeing on 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.

Report date. The compliance audit report should be dated and signed. The auditor should ensure that the report is not to be dated before he or she has obtained sufficient and appropriate audit evidence to support the opinion/conclusion.

Signature. The compliance audit report should be signed by someone with appropriate authority to do so, namely the Head of the SAI, or someone to whom authority has been delegated.

6.4.2 Opinion in an attestation engagement

In an attestation engagement, the auditor provides assurance by making a clear statement of the level of assurance, through either standardized opinions or conclusions. In forming the opinion, the auditor considers the level of assurance provided. This section describes the opinion provided for attestation engagement–reasonable assurance and –limited assurance.

Opinion in reasonable assurance attestation engagements

Here the audit opinion is expressed positively, conveying that, in the auditor's opinion, the subject matter is or is not compliant in all material respects, or, where relevant, that the subject matter information provides a true and fair view in accordance with the applicable criteria.

Unmodified opinion

When no instances of material non-compliance have been found in a reasonable assurance engagement, the auditor expresses an unmodified opinion that:

> *the subject matter information is prepared, in all material respects, in accordance with the applicable criteria.*

Example of unmodified opinion:
In this example, the compliance subject matter relates to the National Tax Office, and the audit revealed no instances of non-compliance with the relevant Act.

.... [appropriate introductory sections of the report] ......
[We have audited National Tax Office's compliance with the Value Added Tax Act CAP 223A dated xx.xx.20XX.]

Unmodified Opinion
Based on the audit work performed, we found that the National Tax Office is in compliance, in all material respects, with the Value Added Tax Act CAP 223A.

Modified opinion

Public sector auditors modify their opinion appropriately where there are cases of material non-compliance. Depending on the extent of the non-compliance, this may result in:

- A qualified opinion (if non-compliance instances are material, but not pervasive)— *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

- An adverse opinion if non-compliance instances are material and pervasive)—
  In our opinion, [the subject matter] is not in compliance, in all material respects, with (the applied criteria, and non-compliance is pervasive.

Scope limitation

Depending on the extent of the limitation, this may result in:

A qualified opinion (if the auditor is unable to obtain sufficient and appropriate audit evidence, and the possible effects are material, but not pervasive)—

In our opinion, except for [describe exception], the auditor was unable to obtain sufficient and appropriate audit evidence, and the possible effects are material, but not pervasive, or

A disclaimer (if the auditor is unable to obtain sufficient and appropriate audit evidence on compliance with authorities, and the possible effects are material and pervasive)—

We do not express an opinion on the subject matter. We have been unable to obtain sufficient and appropriate audit evidence to provide a basis for an opinion.

Example of a qualified compliance audit opinion:
In this example, the compliance subject matter relates to the national tax office, and the audit revealed an instance of non-compliance that resulted in additional charges and penalties to the audited entity. The compliance deviation is not so material as to warrant an adverse conclusion.

.... [appropriate introductory sections of the report]......
[We have audited National Tax Office's compliance with the Value Added Tax Act CAP 223A dated xx.xx.20XX.]

Basis for the Qualified Opinion
The VAT legislation requires that the National Tax Office send quarterly reports to Parliament. Reports were not prepared for the period April 1 – June 30 2013.

Qualified opinion
Based on the audit performed, we found that, except for the instance of non-compliance noted in the Basis for the Qualified Opinion paragraph, the National Tax Office is in compliance, in all material respects, with the Value Added Tax Act CAP 223A.

Adverse opinion

Example of an adverse opinion:
In this example, the compliance subject matter relates to the National Tax Office, and the audit revealed that measures were not implemented for the delinquent taxpayers by the tax office as stipulated in the Act.

.... [appropriate introductory sections of the report]......
[We have audited the National Tax Office's compliance with the Value Added Tax Act CAP 223A dated xx.xx.20XX.]

Basis for the Adverse Opinion
The VAT legislation states that seizures and garnishing for non-compliance should be applied to delinquent taxpayers who owe more than $10,000.00 in arrears. Although there were instances of delinquent taxpayers in that category, these measures were not implemented as stipulated in the Act.

Adverse opinion
Based on the audit work performed, we found that, because of the significance of the matter noted in the Basis for the Adverse Opinion paragraph above, the National Tax Office is not in compliance, in all material respects, with the Value Added Tax Act CAP 223A.

Disclaimer

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 the National Tax Office's compliance with the Value Added Tax Act CAP 223A.

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

[We have audited National Tax Office's compliance with the Value Added Tax Act CAP 223A dated xx.xx.20XX.]

Basis for the Disclaimer

The individual taxpayers' files containing information on assessment for Value Added Tax were not properly maintained by the National Tax Office. Only 20 of the 200 registered taxpayers had complete files containing assessments. There were no other reliable procedures we could conduct to determine if the National Tax Office was in compliance with the VAT Act with regard to assessing taxpayers.

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 an opinion on the National Tax Office's compliance with the stipulations of the VAT Act.

Emphasis of matters or other matters paragraphs

In some situations, there may be a need to elaborate on particular matters that do not affect the compliance opinion but it is important to mention as it came to auditor's attention. In such circumstances the auditor uses an Emphasis of Matters or an Other Matters paragraph. Also, findings that are not deemed material or do not warrant inclusion in the auditor's report may be communicated to management during the audit. Communicating such findings may help the audited entity to remedy instances of non-compliance and avoid similar instances in the future.

The decision whether to include an Emphasis of Matters or Other Matters paragraph is dependent on whether the particular matter is presented or disclosed in the subject matter information or not.

Emphasis of Matter paragraph. If the auditor considers it necessary to draw intended users' attention to a matter presented or disclosed in the subject matter information that, in the auditor's judgment, is of such importance that it is fundamental to intended users' understanding of the subject matter information, the auditor adds an Emphasis of Matter paragraph.

Other Matter paragraph. If the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the subject matter information that, in the auditor's judgment, is relevant to intended users' understanding of the audit, the auditor's responsibilities, or the audit report, the auditor adds an Other Matter paragraph.

In the case of an other matter, the auditor needs to indicate in an appropriately headed paragraph of the report that the auditor's opinion is not modified in respect of the matter. In the case of an Emphasis of Matter paragraph, such a paragraph shall refer only to information presented or disclosed in the subject matter information. The example below illustrates.

Example of an Emphasis of Matter and Other Matter paragraph

Opinion

Based on the audit work performed, we found that the National Tax Office is in compliance, in all material respects, with the Value Added Tax Act CAP 223A.

Emphasis of Matter

We draw attention to Note xx to the 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 Opinion 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.

6.4.3 Attestation engagement–limited assurance

In an attestation engagement with limited assurance the auditor states that, based on the procedures performed, nothing has come to the auditor's attention to cause the auditor to believe that the subject matter is or is not in compliance, in all material respects, with the applicable criteria. The procedures performed are limited compared with what is necessary to obtain reasonable assurance. A limited assurance report conveys the limited nature of the assurance provided.

An **unmodified** opinion in a limited assurance engagement can state,

> *Based on the work performed described in this report, nothing has come to our attention that causes us to believe that the subject matter is not in compliance, in all material respects, with the [applied criteria].*

A **modified** opinion in a limited assurance engagement can state,

> *Based on the work performed described in this report, except for [describe exception] nothing has come to our attention that causes us to believe that the subject matter is not in compliance, in all material respects with the [applied criteria].*

6.4.4 Conclusion in an attestation engagement

Conclusions in the attestation engagement are presented in the same manner as in a direct reporting engagement. Conclusions expressed in a form appropriate to a reasonable assurance engagement include the following:

- When expressed in terms of the underlying subject matter and the applicable criteria, “In our opinion, the entity has complied, in all material respects, with criteria.”
- When expressed in terms of the subject matter information and the applicable criteria, “In our opinion, the forecast of the entity’s activity is properly prepared, in all material respects, based on criteria.”

6.5 Reporting by SAIs with jurisdictional powers

ISSAI 4000.221: In the SAIs with jurisdictional powers, the auditor shall consider the role of the prosecutor or those responsible for dealing with judgment issues within the SAI, and shall also include as appropriate, the elements in both direct reporting and attestation engagements.

In the SAIs with jurisdictional powers, the auditor shall consider the role of the prosecutor or those responsible for dealing with judgment issues within the SAI, and shall also, where appropriate, include in the report the following elements in both direct reporting and attestation engagements:

- Identification of the responsible parties and the audited entity.
- The responsible person(s) involved and their responsibilities.
- Identification of the auditing standards applied in performing the work.
- Responsibilities of the auditor.
- A summary of the work performed.
- Operations and procedures, etc. that are affected by non-compliance acts and/or possible unlawful acts. This needs to include, as appropriate,
    - A description of the finding and of its cause;
    - The legal act which has been infringed (the audit criteria);
    - The consequences of the non-compliance acts and/or possible unlawful acts.
- The responsible persons and their explanations regarding their non-compliance acts and /or possible unlawful acts, when appropriate.
- The auditor's professional judgment that determines whether there is personal liability for non-compliance acts.
- The value of the loss/misuse/waste created and the amount to be paid due to personal liability.
- Any measures taken by responsible persons during the audit to repair the loss/misuse/waste created.
- Management's arguments on the non-compliance/unlawful acts.

In audits conducted by SAIs with jurisdictional powers, the users of compliance audit reports include the prosecutor or those responsible for dealing with judgment issues within the SAI.

SAIs with jurisdictional powers may conclude those of discharge or personal liability for non-compliance acts. These are normally proposals and final decisions on personal liability and sanctions are taken in a jurisdictional process. Personal liability can be measured by the extent of the participation of the person in a non-compliant (illegal, unnecessary, excessive, extravagant, unconscionable) transaction as indicated in the transactions documents that s/he signed.

In the report the auditor needs to explain the methods used to determine whether each responsible person involved in administering, managing, using or controlling public funds or assets is liable for the acts of non-compliance or not.

6.6 Reporting suspected fraud and unlawful acts

ISSAI 4000.225: In conducting compliance audits, if the auditor comes across instances of non-compliance, which may be indicative of unlawful acts or fraud, s/he shall exercise due professional care and caution and communicate those instances to the responsible body. The auditor shall exercise due care not to interfere with potential future legal proceedings or investigations.

6.6.1 Reporting suspected unlawful acts

While detecting potential unlawful acts, including fraud, is not the main objective of conducting a compliance audit, the auditor does include fraud risk factors in his/her risk assessments, and remains alert to indications of unlawful acts, including fraud, in carrying out his/her work.

Auditors may consider consulting with legal counsel or appropriate regulatory authorities. Furthermore, they may communicate their suspicions to the appropriate levels of management or to those charged with governance, and then follow up to ascertain that appropriate action has been taken. Because of the different mandates and organizational structures that exist internationally, it is up to the SAI to determine the appropriate action to be taken regarding instances of non-compliance related to fraud or serious irregularities.

A court of law can determine whether a particular transaction is illegal and constitutes a criminal offence. But SAIs with jurisdictional powers may also conclude that a particular transaction is illegal, and may justify imposing sanctions on the responsible person and determining the reimbursements of funds, misappropriated assets, and undue or improper payments.

Although auditors do not determine if an illegal act constitutes a criminal offense or if civil liability has occurred, they do have a responsibility to assess whether the transactions concerned are in compliance with applicable laws and regulations and whether they constitute infringements that will lead the court to impose sanctions or reimbursement of undue or improper payments or of misappropriated assets.

Fraudulent acts are, by their nature, not in compliance with relevant regulations. The auditor may also determine that transactions where fraud is suspected, but not yet proven, are not in compliance with authorities. Fraud normally results in qualification of the compliance opinion in the auditor's report.

SAIs with jurisdictional powers

SAIs may communicate unlawful acts to the prosecution body, who decides whether or not the case needs to be treated in a court of justice.

If suspicion of unlawful acts arises during the audit, the auditor may communicate this to the appropriate levels of management and those charged with governance. Those charged with governance are likely to be ministerial or administrative bodies higher up in the reporting hierarchy. Where appropriate and reasonable, the auditor may 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. The auditor may also report such incidents directly to the relevant law enforcement authorities.

6.7 Incorporating responses from the entity

When the draft report is ready, it is sent to the audited entity for comment. Earlier, in the conducting stage of the audit, individual observations or findings are discussed with the entity; this has kept the entity updated on the progress of the audit. Timely clearing of the facts creates the basis for a sound report, reducing the time it takes to agree on the final report with the auditee.

The medium used to present findings to the auditee can be based on the SAI's regular forms, e.g. a management letter or draft findings. The auditee is required to respond to the draft report. Once the comments are received from the entity, the auditor should analyse this response, ensuring that valid issues raised by the auditee are taken into account when drafting the final report.

It is a good practice that the auditor discusses the report recommendations with the entity, because the auditor might think s/he is providing useful recommendation(s). But during the discussion, the entity can comment on the practicality of implementing the recommendations, or explain difficulties of doing so. Based on the discussion, the auditor can modify and finalize the recommendations if appropriate. While conducting the audit, the auditor can discuss the possible recommendations if s/he has a clear idea, at that stage, what they could be, based on the evidence gathered and probable conclusions. This will help the auditor to draft a report with effective recommendations.

Based on the SAI's legal framework, the auditor will publish the report with the comments in full, or in a summary or an edited version, or not publish the comments.

6.8 Communicating the report to the stakeholders

Good communication with the audited entity and experts is important during the entire audit process. It is a good practice for the SAI to develop a communication strategy or policy to provide guidance on how to relate to the audited entity and relevant stakeholders during the reporting process. This policy could address communication with the key stakeholders, discussed below.

The audited entity. The communication process between the auditor and the audited entity begins at the planning stage of the audit and continues throughout the audit process. The SAI must always provide the audited entities with an opportunity to comment on the audit findings, conclusions and recommendations. After issuing the draft report, the SAI should ask the entity management to provide, within a specified time frame, comments on agreement or disagreement with the validity and completeness of the content of the draft report.

The audit team may meet with entity officials to discuss the entity's comments, to gain a full understanding of the comments, and/or to obtain any additional significant information related to the comments. If conflicts occur, efforts must be made to solve contradictory opinions with a view to making the final picture as true and fair as possible. Such meetings are normally limited in number and should be scheduled within a period that meets the SAI's report production schedule.

Parliament. Communication with parliament is equally important as it is the Parliament that will use the SAI's reports to improve government management and accountability. If reports are ignored or messages are misunderstood, audit resources could be wasted and the SAI's credibility could be called into question.

SAIs assist the legislative bodies such as the Public Accounts Committees (PAC) by debriefing the parliament members and providing relevant information regarding reported audit findings. In addition to prior communication, it is vital that representative(s) of the SAIs attend the PAC hearings where audit reports are discussed. The legislature should be aware of the fact that compliance auditing is about identifying instances of non-compliance against the authorities.

The media. As soon as the report is tabled in Parliament, it becomes public. The report and news releases are posted in the media. The SAI must ensure that the information provided to the media is timely, accurate, and clear. In providing the information, the SAI should be responsive, helpful, and informative, without compromising its independence or political neutrality, or offending parliamentary privilege. Some points to consider in ensuring proper communication with the media as it relates to the audit report are as follows:

- Responding to media inquiries.
- Developing news releases in conjunction with audit teams.
- Organizing and managing media events such as news conferences and interviews.
- Assisting staff in developing questions and answers in media lines.
- Providing staff with media training.
- Monitoring news and public discussions about the SAI.
- Informing senior management about emerging issues in the media.
- Conducting media analyses to assist in improving message development.

Citizens and other stakeholders. Citizens are a source of ideas for public sector auditing, a source of demand for auditing, and users of the audit reports. They may be contacted directly or through non-government organisations that represent them. Depending on the circumstances in the SAI's country, this communication could include a mix of television interviews, articles, leaflets and use of the SAI's website.

Other important stakeholders are representatives of the academic community. They have expert knowledge in specific audit areas, and may provide a more objective view, less restricted by personal interest. Non-government organisations can be a useful source of ideas. They may have conducted their own research through surveys and case studies, and may have a range of relevant contacts. Civil society can be motivated to put pressure on the legislature to act, particularly if the SAI is providing high-profile material that is of interest to it.

6.9 Audit follow up

ISSAI 4000.232: The auditor shall decide follow up on opinions/conclusions/recommendations of instances of non-compliance in the audit report when appropriate.

Compliance auditing guidelines recommend that auditors should follow-up instances of non-compliance when appropriate. The follow-up process is one in which the compliance auditor monitors, to ascertain whether and what corrective actions have been undertaken by the responsible party in addressing instances of non-compliance identified in a previous audit report/s. In instances where this is necessary, the SAI should follow-up on its recommendations to be able to provide the intended user with an update on the responsible party's actions and initiatives taken towards compliance. It should be noted that the follow-up process may not be applicable in all instances and in all SAIs. The mandate of the SAI along with the nature of the audit will determine if follow-up is applicable.

Why to follow-up

The SAI has a role in monitoring actions taken by the responsible party in response to matters raised in an audit report. The need to follow-up previously reported instances of non-compliance would vary with the nature of the subject matter, the non-compliance identified and the particular circumstances of the audit. The follow-up process facilitates the effective implementation of corrective actions and provides useful feedback to the audited entity, the users of the report and the auditors in planning future audits. Follow-up serves many purposes for the three parties. These include:

- For the responsible party: Demonstrates the audited entity's effectiveness in addressing the issues.
- For the intended user: Provides an update on what has been achieved by the responsible party and the existing gaps if any
- For the auditor: To assess the effectiveness of its work

What to follow-up

Follow up focuses on whether the audited entity has adequately addressed the matters raised, in a specific audit report.
Here are some examples of what to follow-up:

- Recommendations in the audit report
- Issues raised by intended users', example, Parliament, Public Accounts Committee or the Public.

It is important to note that the auditor may expand the scope to include other relevant aspects outside of its recommendations. The key here is to determine whether the entity complied with all the necessary directives.

When to follow-up

The decision as to when to follow up would be based on a number of factors. If the audit was a one off attestation engagement, then follow-up may not be necessary. However, if auditors come out with significant deviation having implications for the citizens, even the audit engagement is one off, its results should be followed up. If the engagement is a direct engagement and is conducted at specific periods, then follow-up may be necessary.
The auditor should allow the responsible party sufficient time to implement the recommendations yet still ensure that the follow-up is relevant to the intended users. As a result, the auditor would

exercise professional judgment in this regard. Some SAIs may, depending on the frequency of an audit engagement, conduct follow-up procedures while performing current audits.

How to follow-up

SAIs may have established policies and procedures for conducting follow-up. The auditor may prepare an audit plan identifying the resources to be used, the recommendations and audit findings to be examined and timeframe in which to complete.

Some audit procedures that were used during the initial audit engagement may be applicable during the follow-up. The auditor should access to determine adequacy of these procedures. Other follow-up processes may include internal reviews and evaluations prepared by the audited entity or others. Regardless of the form, the auditor should obtain sufficient and appropriate audit evidence to support the findings and conclusions. The follow-up report could follow the same reporting lines as the audit engagement including submission to relevant intended users.

The SAI may decide, based on the results of the follow-up, to continue monitoring the implementation measures of the audited entity or it may take the decision to undertake an entirely new audit engagement. In audits carried out on a regular basis, the follow-up procedures may form part of the subsequent year's risk assessment.

6.10 Conclusion

After completing the audit, the auditor writes the report. This chapter explained the initial considerations, i.e. the principles of reporting that the auditor needs to take into consideration while drafting a report. It then explained different reporting requirements from the ISSAI on direct reporting and attestation engagements in a compliance audit. It also explained how the SAIs with jurisdictional powers can report a compliance audit following the ISSAI. Communicating the report with the stakeholders is the ultimate objective of conducting the audit, by which the auditor informs the users about the situation of the subject matter under audit. It is important to communicate in a manner that is easy for readers to understand. With this in mind, the last part of the chapter covered how to write a good audit report. Chapter 7 covers organizing the audit working papers and documenting the audit work.

Chapter 7

Documentation: Working Papers and Communication

Contents

7.1 Introduction

This chapter aims to provide the auditors with required information on documentation and working papers while conducting the audit in compliance with the respective ISSAIs. The credibility and impact of audit invariably depend on the quality of the work that SAIs do. Proper documentation throughout an audit (from planning to reporting stages) helps SAIs to produce high-quality audit reports. This chapter explains how auditors can make use of documentation in a compliance audit to improve the quality of their work. ISSAIs and relevant good practices have been adapted to provide guidance on documentation.

Auditors often need to be creative in documentation to support their audit conclusions. In the audit process they gather items of evidence, put them in order, and organize them in folders in paper or electronic form. But often the auditor asks, *"Exactly what do I have to document?"* The standards answer this while providing guidance to come up with the required working papers. Standards make suggestions regarding the contents, sequence, or format of the audit documentation and leave the form of the documentation up to professional judgment of the auditors.

This chapter elaborates the distinctions between the elements of a working paper. It also identifies the criteria for working paper documentation and how to review the working papers.

7.2 What the ISSAIs require for documentation

ISSAI 4000.89: The auditor shall prepare audit documentation that is sufficiently detailed to provide a clear understanding of the work performed, evidence obtained and conclusions reached. The auditor shall prepare the audit documentation in a timely manner, keep it up to date throughout the audit, and complete the documentation of the evidence supporting the audit findings before the audit report is issued.

ISSAI 4000 explains this as follows:

90. The purpose of documenting the audit work performed is both to enhance transparency about the work performed, and to enable an experienced auditor having no previous connection with the audit, to understand significant matters arising during the audit, the conclusion(s)/ opinion(s) reached thereon, and significant professional judgments made in reaching those conclusion(s)/opinion(s). The documentation includes as appropriate:

a) An explanation of the subject matter of the audit.
b) Risk assessment, audit strategy and plan, and related documents.
c) The methods applied and the scope and time period covered by the audit.
d) The nature, the time and extent of the audit procedures performed.
e) The results of the audit procedures performed, and the audit evidence obtained.
f) The evaluation of the audit evidence forming the finding(s), conclusion(s) opinion(s) and recommendation(s).
g) Judgments done in the audit process, including professional consultations and the reasoning behind them.
h) Communication with and feedback from the audited entity.
i) Supervisory reviews and other quality control safeguards undertaken.

91. *<u>Documentation needs to be sufficient</u> to demonstrate how the auditor defined the audit objective, subject matter, the criteria and the scope, as well as the reasons why a specific method of analysis was chosen. For this purpose, <u>documentation needs to be organized</u> in order to provide a clear and direct link between the findings and the evidence that support them.*
92. *Specifically related to the <u>audit planning stage</u>, the documentation kept by the auditor needs to contain:*
    a) *The information needed to understand the entity being audited and its environment which enable the assessment of the risk.*
    b) *The assessment of the materiality of the subject matter.*
    c) *The identification of possible sources of evidence.*
93. *The auditor needs to adopt appropriate procedures to <u>maintain the confidentiality</u> and safe custody of the audit documentation, and retain it for a period sufficient to meet the needs of the legal, regulatory, administrative and professional requirements of record retention and to enable the conduct of audit follow-up activities.*
94. *<u>Documenting the key decisions made</u> is important to demonstrate the independence and impartiality of the auditor in his/her analysis. The existence of sensitive issues demands the documentation of the relevant facts considered by the auditor in choosing a particular course of action or in taking a certain decision. In this way, the actions and decisions are explained and transparent.*
95. *In the context of SAIs with jurisdictional powers, documentation needed to provide proposals of personal liability is outside the scope of this professional standard.*

ISSAI 4000.90 to ISSAI 4000.95 explains the different aspects of documentation and working papers, which are as follows:

- Purpose of documentation
- Elements of documentation
    - Sufficient documentation
    - Documenting the key decisions made
- Organization of audit documentation
- Documentation at audit planning stage
- Maintaining confidentiality

All of these aspects are described in the following sections of this chapter.

7.3 Purpose of documentation and working papers

Clear working paper documentation is an essential part of audit and forms an important element of audit quality. According to ISSAI, the purpose of documentation is to enhance the transparency of the work performed, and to enable an experienced auditor with no previous connection to the audit to understand matters arising from audit. It makes significant audit tasks easier and helps the audit supervisor and peer reviewer to provide their review comments.

The process of preparing and reviewing audit documentation contributes to the quality of an audit. Audit documentation serves to:

- Provide support for the auditors' report.

- Aid auditors in conducting and supervising the audit.
- Allow for the review of audit quality.

Proper working papers make review easier

Auditors consider their supervisors, managers, audit quality reviewers, and peer reviewers to be the primary users of the working papers. Looking at from a user's point of view, the auditor needs to think about what the reviewers want to see and what rules they want followed. For a compliance audit, the benchmark is the ISSAI 4000 and its requirements are those mentioned above. If this is not done properly, working paper review is a struggle for the reviewer. As auditors, our job is to make this task as easy as possible for a supervisor or reviewer.

The standard requires auditors to create audit documentation that an "experienced auditor" will be able to follow. An experienced auditor means an individual (whether internal or external to the audit organization) who possesses the competencies and skills that would have enabled him or her to conduct the audit. These competencies and skills include an understanding of

- the audit processes.
- standards and applicable legal and regulatory requirements.
- the subject matter associated with achieving the audit objectives.
- issues related to the audited entity's environment.

Proper documentation helps reviewers of audit work to understand what was done, how it was done, and why it was done. Auditors need to do proper documentation at every stage of the audit process.

Generally, the SAI should come up with a standardized set of working papers and ascertain what makes them compliant and satisfactory to the supervisor. And supervisors and managers should make clear what they want from the audit teams. If the expectations are set and it is clear to all parties, auditors and reviewers will have no difficulty in this.

7.4 Elements of documentation

The documentation includes as appropriate:

- An explanation of the subject matter of the audit.
- A risk assessment, audit strategy and plan, and related documents.
- The methods applied and the scope and time period covered by the audit.
- The nature, the time and extent of the audit procedures performed.
- The results of the audit procedures performed, and the audit evidence obtained.
- The evaluation of the audit evidence forming the findings, conclusions, opinion and recommendations.
- Judgments made in the audit process, including professional consultations and the reasoning behind them.
- Communication with and feedback from the audited entity.
- Supervisory reviews and other quality control safeguards undertaken.

The auditor's documentation of evidence regarding identified or suspected non-compliance with authorities may include, for example:

- Copies of records or documents.
- Minutes of discussions held with management, those charged with governance, or other parties inside or outside the entity.

Auditors are required to document the audit procedures performed, evidence obtained, and conclusions reached with respect to compliance audit criteria used in the audit. Auditors will develop/maintain documents that will clearly show that the work was in fact performed.

In determining the nature and extent of the documentation for a typical compliance audit, auditors may consider the following:

- Nature of the auditing procedures performed;
- Risk of material non-compliance with the applicable criteria, and auditors' response to the assessed risks;
- Extent to which professional judgment was applied (in making decisions), especially in considering materiality;
- Materiality of the evidence obtained against criteria.

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 judgment; and the related conclusions .

7.5 How to document: Components of working papers

Based on the standards and best practices, following are some common components of working papers that most audit documentation follows:

- The working paper has:
  - Name of audit
  - Title
  - Auditor's initials
  - Date completed
  - Page number and reference
  - Source, purpose, procedures, results, conclusions
  - Two-way cross-references
- The working paper is:
  - Neat and legible
  - Referenced to the programme
  - Understandable without further explanation

- Important calculations are verified
- Source documents are included as necessary
- If a document was produced by the entity, it is written on the working paper
- A review has been indicated and all points were cleared

These requirements are explained more in-depth below:

The working paper is titled, signed, and dated

Each working paper includes:

- Name of audit
- A unique title of the working paper
- Auditor's initials
- Date completed
- Page number and reference

Source, purpose, procedures, results, and conclusions

Source, purpose, procedures, results, and conclusions should be included on the first page of each unique working paper. Each element should answer the following:

Source: Where did the auditor get the evidence on the working paper? Who gave it to the auditor? Which evidence did the auditor look at? Where is the evidence and how can the auditor get to it again?

Purpose: What question does this working paper seek to answer? Why was this working paper created, and why was this work done? What programme step does it satisfy?

Procedures: What did the auditor do on this working paper? What methodology did the auditor use? What were the detailed steps and procedures auditor performed?

Results: What did the procedures yield? What were the results of applying the methodologies? This should contain the same language and easily link back to the procedure element. Here auditor needs to provide adequate details.

Conclusion: What is the answer to the questions posed in the purpose? Was the programme step satisfied? What did the auditor do with any issues found? Did the auditor take the issues to a finding or a point disposition sheet?

All this information is very helpful to an audit supervisor or reviewer. Without these elements of a working paper, the supervisor or reviewer has to make assumptions throughout the working papers. The auditor needs to make the conclusions for the reviewers and guide them to follow the process smoothly.

The linkage among the elements is important. When the linkage is established properly, the purpose and conclusions match and the procedures and results also match. This demonstrates clarity of thought and supports logical conclusions made by the auditor. In most cases the audit findings matrix covers these elements in a compliance audit. However, the findings matrix elements need to be completely explained, as shown in the example below.

Working paper example
Source
Student files maintained in the Student Financial Aid Office by Ms. XYZ. Tested fall semester 2004 students.
Purpose
To determine whether students receiving federal student financial aid are eligible; to satisfy programme step 2 at the programme goals.
Procedure
Sampled 72 files out of a population of 13,500 files. Examined each file to determine whether the proper paperwork was in the file and the student met federal eligibility requirements. The attributes tested are as follows: ………. ……….
Results
Out of all attributes tested on 72 files, we noted only one error. The student had failed to initial one of the pages of the financial aid application.
Conclusion
Students receiving financial aid are eligible. The one error noted is not significant and we will not take it to the report.

Every tick mark is explained

A tick mark is a little symbol that indicates a task that auditor has completed. For instance, a ʌ may indicate that a column of numbers has been summed and a √ may indicate that attribute was verified. To explain the tick marks in the working papers, auditor may have a tick mark legend, which includes all tick marks and have the legend insider the working papers binder.

All cross references are two-way

To cross reference working papers, if the auditor got a number for working paper A from working paper B, the auditor would write B on working paper A near the number. And on working paper B, the auditor would write a reference to working paper A. Working paper review is nearly impossible without two-way cross-referencing.

Each working paper is neat and legible, referenced to the audit programme, and understandable without further explanation. These are self-explanatory requirements for a working paper.

Important calculations are verified

Verifying important calculations is crucial in an audit. Someone needs to sum or recalculate the numbers. For very significant numbers, the supervisor might even recalculate them.

Source documents are included as necessary

This explains what the reviewer actually needs to understand about what was tested. The auditor should include any source documents that will help the reviewer. The example below explains:

Source document example
If the auditor has tested 30 files to see that the programme director initialed a certain document, a copy of all 30 documents does not need to be included in the file copy. A description of the files or the forms is enough so that, if necessary, someone could replicate the work done by auditor. So the auditor might add a description of the file including the date created, name, director's initials, and the date of review. Adding one copy of the forms to the file would also help, so a reviewer or a subsequent auditor could easily find the forms again. In some cases, there might be forms without initials; the auditor could copy those and put them in the working papers with an explanation of how the issue was resolved. As an auditor you should also consider whether the issue would make it into the report. If it would, you might copy or scan the exceptions to strengthen your evidence.

If the entity produced a document, it should be written on the working paper

This indicates to the reviewer who created the working paper, which matters in determining strength of evidence. Generally, evidence directly obtained by auditor is considered stronger than evidence that the entity provides. The reason is that entities are not considered to be as objective as auditors about the information.

A review has been indicated

Following are some ways to fulfill this requirement. The reviewer might:

- Initial and date each working paper.
- Initial only significant working papers.
- Create a checklist and include it at the front of the working papers.
- Initial the binder.
- Write up review comments and include them in the working papers.

7.6 Organization of working paper documentation

According to ISSAI, documentation needs to be organized in a way that provides a clear and direct link between the findings and the evidence that supports them. Working papers can be organized in many different ways. It is the auditor who determines how to do it, sometimes with the system or practices that exist in the SAI. The auditor may have many working papers supporting the audit, but to be understandable to an outside party, they need to explained and organized. Using a summary memo facilitates this process.

The summary memo can be called a lead sheet, a conclusions form, or a top memo based on the SAI practice and norms. It might have components that differ from those described here, also based on the SAI's practice. Summary memos will make the supervisor's or reviewer's work easier. Writing these memos forces the auditor to clarify his or her thoughts and document them in writing before completing the audit, which makes it easier to understand the working papers.

What is a summary memo?

A summary memo summarizes a group of working papers. In the hierarchy of working papers, a summary memo usually comes third, even though it may be written last. The hierarchy is as follows:

- Audit objective
- Audit programme
- Summary memo
- Detailed working papers

Summary memo example

In an audit of a purchasing department, after gathering information and doing a risk assessment the auditor decides that the overarching objective is *to determine if the purchasing department complies with significant purchasing policies.* Under that overarching objectiv are three sub-objectives—to determine the following:

- Are purchases of equipment exceeding $9000 conducted in accordance with policy?
- Are purchasing procedures written in accordance with policy?
- Are professional contracts in accordance with policy?

The auditor will create a set of working papers to support each sub-objective, and will use letters to designate groups of working papers.

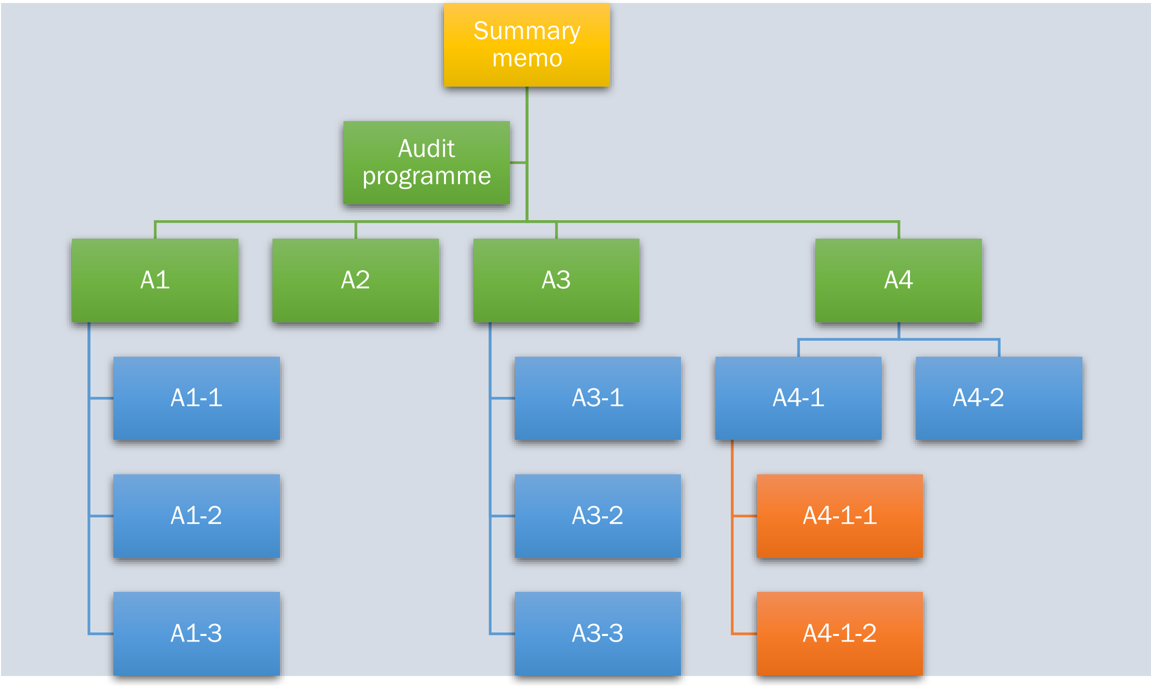
1. Working paper set A answers sub-objective 1: whether purchases of equipment exceeding $9000 were conducted in accordance with policy.

2. Working paper set B answers sub-objective 2: whether purchasing procedures are written in accordance with policy.

3. Working paper set C answers sub-objective 3: whether professional contracts are in accordance with policy.

The summary memo for sub-objective 1 summarizes what working paper series A accomplished and how the auditor answered the audit objective, with all the related evidence. Then A-1, A-2, A-3, etc. speak to the performance and results of each audit procedure.

The summary memo is a kind of narrative version of the audit programme and in the hierarchy might fall above or beneath the programme. The working paper hierarchy might look like this:



There can be a “meta” or master summary memo that summarizes working paper series A, B, and C and speaks to the overarching audit objective: “Does the purchasing department comply with significant policies?” The auditor canprepare a summary memo for each audit procedure. The working paper series A-4 above contains plenty of working papers and may warrant a summary to help the reviewer sort through the group and discern what the auditor did.

What is included in a summary memo? The summary memo includes the components of the working paper—source, purpose, procedure, results and conclusion, with a narrative description of these five components in every working paper. Below is an example of a summary memo for series A.

Summary memo
Source
Interviews, observations, and testing described in working paper series A.
Purpose
To answer the sub-objective “Are purchases of equipment exceeding $9000 conducted in accordance with state law?”
Procedure
We satisfied programme steps in the area decided, which called on us to: • Reiterate programme step 1. • Reiterate programme step 2. • Reiterate programme step 3.
Results

We noted several significant items of non-compliance:

- Summarize results of programme step 1.
- Summarize results of programme step 2.
- Summarize results of programme step 3.

Conclusion
The purchasing department did not comply with significant purchasing policies regarding purchases of equipment exceeding $9000. In particular, the department allowed the same person to initiate, approve, and receive equipment purchases over $9000. This issue has been developed into a finding for the report. We did not find any questionable purchases.

The summary memo can serve as an initial draft of the report. Instead of referring to a finding in a working paper outside of the summary memo, the auditor can include it in the summary memo, or can formalize the section where the auditor discusses the objective and conclusion and later add it to the report.

The summary memo can be very detailed or highly summarized. A summary memo can be a restatement of each supporting working paper under it, plus an overarching conclusion that sums up the whole set. Or it can be an overarching conclusion that sums up the whole set. A good way to determine how much detail the summary memo should contain is to refer to the practices set at the SAI.

Summary memos can take care of a good number of the required contents of working papers. The standard requires that the auditor document the following in the working papers:

- Objective, scope, and methodology
- Nature, timing, and extent of procedures
- Audit evidence obtained and its source and the conclusions reached
- Support for significant judgments, findings, conclusions, and recommendations
- Evidence of supervisory review

The standards are not explicit about maintaining a summary memo. But it is good to have this for the sake of the auditors' and the reviewers' jobs. Auditors could use a summary memo to do the majority of this work. Auditors could take care of only part of these requirements in the detailed, supporting working papers.

7.7 How to review the working papers

It is often very difficult by looking at a set of working papers to understand what the auditor was thinking and to retrace the thought process during an audit. It may take hours to get a sense of the overall purpose of the working papers. Two simple guiding principles of working paper review make the task an easy process:

- Check concepts before procedures.
- Review working papers beginning at the top of the working paper hierarchy.

Check concepts before procedures

Example
An audit team expressed an opinion on a university's bond issues. One of the more senior auditors took the lead in auditing bond arbitrage, a technical subject. He spent two days auditing and creating a good-looking working paper. It was a huge, foldout spreadsheet that had several columns and rows and had plenty of colored tick marks and numbers. The supervisor started her review of this spreadsheet. She re-footed and re-cross-footed the columns. She checked the meaning of all the tick marks and added one of her own. And then, after about half a day of reviewing it, she realized that the concept behind the working paper was flawed. The senior auditor had gone down a trail and tested attributes that did not pertain to the audit objective. The whole working paper was scrapped. So, time spent by the auditor—two days, and the supervisor—half-a-day, was not necessary. Had the supervisor checked the concept of the working paper before the procedure, she could have saved her time and audit resources.

So how to check the concept behind the working paper? If the audit team uses the elements of a working paper (source, purpose, procedures, results, conclusions) in the working paper, the reviewer should read that first, paying close attention to the purpose of the working paper. The purpose should correspond to a step in the audit programme.

Following the hierarchy of working papers is important to consider. Only if the top of the hierarchy works well and is understandable should the reviewer delve into the working papers at the bottom of the hierarchy. This saves time and effort.

The hierarchy of working papers is as follows:

- Audit objective
- Audit programme
- Summary memo
- Detailed working papers

The first thing the reviewer should look at is the audit objective. If the audit objective is flawed, s/he can stop right there. S/he can give the working papers back to the auditor and tell him or her to work on the objective and change the working papers accordingly.

Once satisfied with the audit objective, the reviewer can review either the summary memo or the audit programme. Because some auditors do not create summary memos, s/he may have to look at the programme. Or s/he may have to look at the audit programme if the summary memo is not useful.

If a reviewer sees that the programme is disjointed and does not help satisfy the audit objective, s/he can again stop the review of the working papers and return them to the auditor. There is no reason to proceed further until the programme is rewritten.

Assuming that the auditor's audit programme and summary memo are good, the reviewer can move on to the detailed supporting working papers. Those working papers should satisfy steps of the audit programme.

7.8 Document retention

Some SAIs may have policies and procedures consistent with their laws and auditing standards to maintain documentation of their work. Documentation retention policies ensure that relevant records are available for use for a certain number of years after an audit. These policies and procedures usually describe:

- Documents covered in their scope
- Form in which the documents would be kept/archived
- Period for which the documents would be retained
- How these documents can be accessed when needed

The SAI should see whether it has policies and procedures for documentation retention and, if so, it should see if they are adequate. In case of inadequacies, the SAI may consider strengthening its policies and procedures with adequate requirements for the retention of audit documentation.

These requirements may be due to the historical significance of certain types of documents which, for example, may require indefinite retention in the country's national archives. There may also be additional requirements related to national security classifications, including how documentation is stored. Public sector auditors should familiarize themselves with applicable legislation in regard to retention of documentation.

7.9 Confidentiality and transparency issues

SAIs need to establish, and ensure that auditors comply with, ethical requirements to observe at all times the confidentiality of information contained in audit documentation, unless specific authority has been given by the entity to disclose such information or there is a legal or professional duty to do so. There is an ongoing need in the public sector to balance confidentiality with the need for transparency and accountability. The balance between confidentiality and transparency requires professional judgment to ensure that documentation of a confidential nature is clearly identified and treated as such, while at the same time granting access as appropriate. It is therefore important to be familiar with the SAI's policies and procedures addressing confidentiality. Such procedures might include types of audit documentation to be considered confidential, types of audit documentation to be made available to the public, clearly defined lines of responsibility for authorizing disclosure of audit documentation and routines for making such information available if required.

Furthermore, public sector auditors may have additional statutory responsibilities related to confidentiality. These responsibilities may be based on the mandate of the SAI or on legislation related to official secrets or privacy. Such legislation, for example, could relate to audits of defense, health, social service or tax agencies. Public sector auditors familiarize themselves with the particular local requirements related to confidentiality by which they are bound.

Auditors also familiarize themselves with any legislation that grants public access to audit correspondence, for example where electronic or other post journals are open to public scrutiny. This type of correspondence may include letters to and from the audited entity, or other parties, related to the gathering of audit evidence, as well as considerations and judgments related to audit issues. It is not unusual in the public sector to have to respond to requests from outside parties to obtain access to audit documentation. This can be especially sensitive when the outside party attempts to obtain information indirectly from the audit organization that it is unable to obtain directly from the audited entity.

As a matter of principle, when the audited entity has a statutory obligation to gather and retain certain information, requests from outside parties for such information are normally referred to the audited entity. In situations where auditors consider granting access to audit documentation, they normally consult with relevant parties (such as the audited entity to whom the request relates) prior to disclosing the information being.

In some environments, audit work is contracted out by the SAIs to other auditors. The acceptance of such appointments normally requires the auditor performing the work to acknowledge that audit documentation may be subject to inspection by the SAI that appointed the auditor. The audit documentation may also be subject to inspection by review agencies that have statutory rights of access to information relevant to the auditor’s duties.

7.10 Communication

ISSAI 4000.96: The auditor shall communicate in an effective manner with the audited entity and those charged with governance throughout the audit process

The role of communication

Communication takes place at all audit stages: before the audit starts, during initial planning, during the audit execution, 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.

ISSAI 4000.99: Instances of material non-compliance shall be communicated with the appropriate level of management and (if applicable) those charged with governance. Other significant matters arising from the audit that are directly relevant to the entity shall also be communicated

Good communication with the audited entity throughout the audit process may help make the process more effective and constructive. Effective two-way communication is important in assisting the following:

- The auditor and those charged with governance in understanding matters related to the audit in context, and in developing a constructive working relationship. This relationship is developed while maintaining the auditor's independence and objectivity.
- Public sector auditors' sensitivity to the needs and expectations of the legislature or appropriate regulators about matters communicated to other governance levels, particularly where the matters may be of broad public interest or speculation.
- The auditor in obtaining the cooperation of those charged with governance to acquire information relevant to the audit. For example, those charged with governance may assist the auditor in understanding the entity and its environment, in identifying appropriate sources of audit evidence, and in providing information about specific transactions or events.

The communication process

SAIs need to have a system in place that requires the auditor to evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If the two-way communication is not adequate, the auditor should take appropriate action. In the public sector, appropriate action may include communicating with the legislature or the appropriate regulators, or funding agencies.

7.11 Conclusion

This chapter focused on the importance of documentation in the audit process to ensure audit quality. The auditor should always prepare relevant audit documentation for the particular audit before the audit report is issued. Determining the form and content of the documentation is a matter for the auditor's professional judgment. Written communication is preferred, as it facilitates proper documentation of the interaction.