Compliance audit

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28-29 Oct 2014
1) What do we have?

2) A new horizon

3) New standard for compliance audit
The Compliance Audit Guidelines
- endorsed by INCOSAI in South Africa 2010

- **ISSAI 4000** - General introduction to compliance audit

- **ISSAI 4100** - deals with compliance audit performed separately from the audit of financial statements, for example as a separate audit task or related to performance audit

- **ISSAI 4200** - deals with compliance audit related to the audit of financial statements

Written as consistent, stand-alone documents
Compliance Audit Process

1. Initial considerations
2. Planning the audit
3. Performing the audit and gather evidence
4. Evaluating evidence & forming Conclusions
5. Reporting
2) A new horizon
Public sector auditing telling its own story
Fundamental elements in level 3 of the ISSAI framework

• Three part relationship
• Generic definition of an audit
• Common features for all audit types
  – Subject matter and criteria
• Attestation engagement and direct reporting
• Principles to be applied in all audits
• The tree audit types
Three part relationship

- THE LEGISLATURE
- INTENDED USER
  - THE THREE PARTIES OF AN AUDIT
  - AUDITOR
  - RESPONSIBLE PARTY
- THE SAI
- THE GOVERNMENT
An audit

A *systematic process* of objectively obtaining and evaluating *evidence* to determine whether *the subject matter* (information or actual conditions) conform to established *criteria*.

ISSAI 100 paragraph 18
Subject matter

«Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria.»

ISSAI 100 paragraph 26
<table>
<thead>
<tr>
<th>Audit type</th>
<th>Subject matter</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial audit:</td>
<td>A financial statement</td>
</tr>
<tr>
<td>Compliance audit:</td>
<td>A tendering process</td>
</tr>
<tr>
<td>Performance audit:</td>
<td>Effectiveness in heart operations at a hospital</td>
</tr>
</tbody>
</table>
«The criteria are the benchmarks used to evaluate the subject matter»

ISSAI 100 para. 27
# Criteria - example

<table>
<thead>
<tr>
<th>Subject matter</th>
<th>Criteria</th>
</tr>
</thead>
<tbody>
<tr>
<td>A financial statement</td>
<td>A recognized financial reporting framework</td>
</tr>
<tr>
<td>A tendering process</td>
<td>National laws and regulations for tendering processes</td>
</tr>
<tr>
<td>Effectiveness in heart operations at a hospital</td>
<td>Number of operations</td>
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<tr>
<td></td>
<td>Cost per operation</td>
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<tr>
<td></td>
<td>Survival rates</td>
</tr>
<tr>
<td></td>
<td>Patient satisfaction ratings</td>
</tr>
</tbody>
</table>
Attestation engagement and direct reporting

The auditor defines the subject matter, the criteria and gather information.

The responsible party provides information that the auditor verifies.
Figure 3: Principles to be applied in conducting an audit

- **General Principles**
  - Ethics & Independence
  - Quality control
  - Engagement team management & skills
  - Audit / engagement risk
  - Materiality
  - Professional scepticism and judgement
  - Documentation
  - Communication with auditees and other stakeholders

- **Principles related to the audit process**
  - Activities related to planning the audit:
    - Establish the terms of the engagement
    - Obtain an understanding
    - Conduct risk assessment or problem analysis
    - Consider risk of fraud
    - Develop an audit plan
  - Activities related to performing the audit:
    - Perform the planned audit procedures to obtain audit evidence
  - Activities related to evaluating audit evidence, concluding and reporting:
    - Evaluate audit evidence
    - Prepare report
Three Audit types of INTOSAI

Financial audit
The reliability of financial reporting

Compliance audit
Compliance with authorities

Performance audit
Economy Efficiency Effectiveness
Financial Audit

Determining whether an entity’s financial information is presented in accordance with the applicable financial reporting and regulatory framework.

ISSAI 200 para. 4
Performance auditing is an examination of whether government undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement.

ISSAI 300 para. 9
The independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. ISSAI 400 paragraph 12

**Meaning:**

Compliance auditing is performed by assessing whether activities, financial transactions and information are in all material respect, in compliance with the authorities which govern the audited entity. ISSAI 400 paragraph 12
Three perspectives on risk

- Risk of error in the financial statement
- Risk of non-compliance with authorities
- Risks related to economy, efficiency, effectiveness
Some challenges

• Many SAIs continue its current practices of gathering evidence and reporting issues with no clear reference to the standards

• Many countries have no clear financial reporting framework, and do not financial audit according to ISSAI 1000

• Many SAIs find it difficult to undertake risk based approaches using professional judgment, preferring instead checklists and standard procedures

• It takes time to digest the huge amount of new concepts and approaches
3) New standard for compliance audit
New ISSAI 4000:

One, common authoritative standard for compliance auditing directly applicable to all SAIs.
Priorities in developing new ISSAI 4000

1. Align with the concepts and structure of level 3
2. Adapt to new writing conventions
   1. Shall requirements
   2. Explanations
3. Expand on concepts that are crucial for compliance audit
   1. Assurance
   2. Authorities
   3. Reporting formats
4. Additional requirements for courts
Align with the concepts and structure of level 3

Figure 3: Principles to be applied in conducting an audit

GENERAL PRINCIPLES

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- Quality control
- Engagement team management & skills
- Audit / engagement risk
- Materiality
- Professional scepticism and judgement
- Documentation
- Communication with auditees and other stakeholders

PRINCIPLES RELATED TO THE AUDIT PROCESS

Activities related to planning the audit
- Establish the terms of the engagement
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- Conduct risk assessment or problem analysis
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Activities related to performing the audit
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Activities related to evaluating audit evidence, concluding and reporting
- Evaluate audit evidence
- Prepare report
GENERAL REQUIREMENTS OF COMPLIANCE AUDITING

Professional judgment and skepticism

Requirement

1. Auditors shall plan and conduct the audit with professional skepticism and exercise professional judgment throughout the audit process.

Explanation

2. The terms "professional skepticism" and "professional judgment" are relevant when formulating requirements regarding the auditor's decisions about the appropriate course of action for the audit to provide the users with the necessary assurance about information provided by the auditor or another party.
## Reasonable assurance

Positive assurance – the tendering process is in all material respect performed in accordance with national laws and regulations

<table>
<thead>
<tr>
<th>Understand the internal control</th>
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<tbody>
<tr>
<td>Test the internal control</td>
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<tr>
<td>Assess risk of fraud</td>
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<tr>
<td>Substantive tests</td>
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<table>
<thead>
<tr>
<th>Physical examination</th>
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<tr>
<td>Confirmation</td>
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<tr>
<td>Inspection</td>
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<td>Analytical procedures</td>
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<tr>
<td>Inquiries of the client</td>
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<tr>
<td>Recalculation</td>
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<tr>
<td>Reperformance</td>
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<tr>
<td>Observation</td>
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**Limited assurance**

<table>
<thead>
<tr>
<th>Negative assurance – nothing has come to the auditors attention that indicates non compliance with significant laws and regulations</th>
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<tbody>
<tr>
<td>Identify significant laws and regulation, and evaluate non compliance along e.g. with the audit of the financial statement</td>
</tr>
</tbody>
</table>
| Analytical procedures  
Inquiries of the client |

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What do we mean by *compliance with authorities*

Legal and regulatory environment, which a public sector body and a civil servant must comply with, to obtain public trust
Authorities in two forms

What is written down in laws, regulations and statements from the Parliament and government

What the auditor should expect to find, even if is not written down in laws, regulations and statements from the Parliament and government

Authority

Regularity

Propriety
Different reporting formats

The *conclusion* is a broader statement of the findings assessed against the criteria, often long form reporting.

An *opinion* is a statement of the auditor expressed in a standardized form.
Court of Accounts

Add requirements related to personal responsibility and prosecution:

Some examples of additional requirements:

Planning: Consider the persons responsible for serious breaches of rules, regulations and budget authorities to be able to enforce sanctions.

Documentation: The documentation should be sufficiently detailed to enable the auditor to provide proposals of personal responsibility and sanctions.
Milestones new ISSAI 4000

1. Nov 2014: Draft circulated to the CAS members
2. Feb. 2015: Draft circulated to the PSC members
3. June 2015: Exposure draft approved by the PSC
4. Jun-Sep: Comments from INTOSAI members
5. Fall 2016 Endorsment INCOSAI
Thank you