

**CAG's**  
**Auditing Standards**

**Third Edition, 2017**

**Comptroller and Auditor General of India**

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## Preface

The Indian Audit and Accounts Department has been continuously striving to upgrade and update its auditing practice as part of its overall endeavour to achieve professional excellence. The Auditing Standards were first brought out by the Department in 1994 and were subsequently revised in 2002.

I am pleased to release the third edition of the Auditing Standards, which is the result of a structured and diligent process of internal consultation at various levels. This edition takes into account the prerequisites for functioning of the Supreme Audit Institution and is suitably aligned with existing fundamental auditing principles of the framework of International Standards of Supreme Audit Institutions.

I trust that all officers and staff of the Department would abide by these Auditing Standards and apply them conscientiously in auditing for achieving the mission of promoting accountability, transparency and good governance.



**Shashi Kant Sharma**  
Comptroller and Auditor General of India  
March 2017



# 1. Basic Postulates

## 1.1 Introduction

The Comptroller and Auditor General of India (CAG) who is the head of Supreme Audit Institution of India (SAI India) discharges his constitutional functions through the Indian Audit and Accounts Department. The Constitution of India provides for the Comptroller and Auditor General of India who is appointed by the President of India by warrant under his hand and seal. The Constitution provides that the salary and other conditions of service as well as the duties and powers of CAG may be determined by Parliament by law. In pursuance of these provisions, the Parliament enacted the CAG's (Duties, Powers and Conditions of Service) Act, 1971 (DPC Act) to determine the conditions of service of the CAG and to prescribe his duties and powers. In exercise of powers conferred by the DPC Act, as amended from time to time, the CAG framed the Regulations on Audit and Accounts, 2007, which provide the overarching governance framework for both accounting and auditing functions. The CAG's Auditing Standards constitute the next layer of the audit governance framework and set out the professional standards of auditing for the organisation as well as for its personnel - the individual auditors. As an ongoing initiative for continuous improvement and benchmarking, these standards are periodically reviewed, restructured and updated.

## 1.2 Purpose and Authority of the Standards

These standards establish the norms which are applicable to all public sector audit engagements, irrespective of their form or context. These standards incorporate the Prerequisites for the functioning of Supreme Audit Institutions and Fundamental Auditing Principles of the International Standards of Supreme Audit Institutions, which have been suitably adapted with due consideration of the audit mandate and rules applicable to SAI India. These standards determine the audit procedures that shall be applied in audit and constitute the criteria or benchmark against which the quality of audit results is evaluated. These Auditing Standards are effective from 1 April 2017. All audit engagements as per the audit mandate of SAI India on or after this date shall be conducted in accordance with these standards.

## 1.3 Audit Mandate

**The audit mandate is laid down in the Constitution of India, DPC Act and specific legislations enacted over time by the Parliament and State Legislatures.**

- 1.3.1 Article 149 of the Constitution of India envisages that CAG shall perform such duties and exercise such powers in relation to the accounts of the Union and of the States and of any other authority or body as may be prescribed by or under any law made by Parliament. Article 151 envisages that the reports of the CAG relating to the accounts of the Union shall be submitted to the President, who shall cause them to be laid before each House of Parliament and that the reports relating to the accounts of a State shall be submitted to the Governor, who shall cause them to be laid before the Legislature of the State. Additionally, Article 279 envisages that 'net proceeds' in relation to any tax or duty means the proceeds thereof

reduced by the cost of collection and that the net proceeds of any tax or duty, or of any part of any tax or duty, in or attributable to any area shall be ascertained and certified by the CAG, whose certificate shall be final. Further, the Sixth Schedule of the Constitution of India also envisages audit of accounts of District and Regional Councils of autonomous regions.

1.3.2 The general provisions relating to audit are elaborated in Sections 13 to 21 and 24 of the DPC Act. There are also other legislations providing for audit of specific entities by the CAG. The audit mandate of CAG extends to bodies or authorities such as statutory corporations, government companies, autonomous bodies constituted as societies, trusts or not for profit companies, urban and rural local bodies and also to any other body or authority whose audit may be entrusted to CAG under law. To fulfil its mandate, SAI India undertakes financial audit, compliance audit, performance audit and combination of such audits.

#### **1.4 Prerequisites for functioning**

The pre-requisites constitute the principles that are essential for the functioning of SAI, India and for proper practice of public sector auditing within the SAI.

- Independence
- Accountability and Transparency
- Ethics
- Quality assurance

##### **1.4.1 Independence**

An adequate degree of independence from both the Legislative and Executive branch of the Government is essential for the conduct of audit and for the credibility of its results. Independence of a Supreme Audit Institution (SAI) is secured through certain principles and conditions that are institutionalised through established mechanisms and processes. The principles and conditions that define an independent SAI are elaborated below.

1.4.1.1 **The existence of an appropriate and effective constitutional/statutory/legal framework and its application. This framework shall establish provisions that secure the functional independence of the Head of the SAI including security of tenure.** The Constitution of India stipulates that the CAG shall only be removed from office in like manner and on like grounds as a Judge of the Supreme Court of India. The other terms for appointment and demitting of office of the CAG are provided under the DPC Act that ensures due autonomy and security of tenure.

1.4.1.2 **SAI shall have a sufficiently broad mandate and full discretion in the discharge of its functions**

While conforming to the Constitutional provisions and laws enacted by the legislatures, SAI India has the functional and organisational autonomy required for carrying out its mandate and is free from direction or interference from the Legislature or the Executive in the:

- a) selection of audit issues;
- b) planning, programing, conduct, reporting and follow up of audits; and
- c) organisation and management of its office.

SAI India may accept specific requests for audits made by Legislature as expressed as a whole or through one of its committees or by the Government while retaining its right to decline such requests. SAI India may be consulted by the Executive in matters such as financial legislations, accounting standards and policies, public accounts, form of financial statements and for draft laws or rules affecting its competence or authority ensuring, however, that rendering such advice or assistance does not either implicitly or explicitly impair independent exercise of its audit mandate.

**1.4.1.3 SAI shall have unrestricted access to information**

The DPC Act empowers SAI India to inspect any office of accounts under the control of the Executive and to require the production of all necessary documents and information necessary for the proper discharge of its statutory responsibilities. SAI India thus shall have access to premises, operations, systems including Information Technology systems and records of auditable entities<sup>1</sup> which include the implementing arms of Government and to obtain relevant information from persons or entities possessing it.

**1.4.1.4 SAI shall have the freedom to decide the form, content and timing of audit reports, to publish and disseminate them**

SAI India shall be free to decide the form and content of its audit reports and to make observations and recommendations therein, taking into consideration, the views of the audited entity. SAI shall be free to decide the timing of its audit reports except where specific reporting requirements are prescribed by law. It is also free to disseminate its reports once they have been formally tabled in the appropriate legislature as required by law.

**1.4.1.5 There shall exist effective follow up mechanisms on SAI's recommendations**

SAI India may submit its reports to the Legislature or an audited entity's governing body as appropriate for follow up of specific recommendations for corrective action. SAI India shall have its own follow up procedures to monitor and report on the action taken by the Executive on its observations and implementation of recommendations made in its reports as well as those made by the Legislature or the audited entity's governing board, as appropriate.

**1.4.1.6 SAI shall have financial and managerial/administrative autonomy and the availability of appropriate human, material and monetary resources**

The Constitution provides that the conditions of service of persons serving in the Indian Audit and Accounts Department and the administrative powers of the CAG shall be such as may be prescribed by rules made by the President after consultation with the CAG. Thus, SAI India shall have the necessary empowerment to manage the human and budgetary resources available to it. The Legislature is responsible for ensuring that SAI India has the resources necessary to fulfil its mandate.

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<sup>1</sup> Regulation 2 of the Regulation of Audit and Accounts, 2007 defines an auditable entity as 'office, authority, body, company, corporation or any other entity subject to audit by the CAG'

SAI India's functional autonomy does not preclude arrangements with auditable entities in regard to matters such as personnel management, property management or common purchasing of equipment and stores.

#### **1.4.2 Accountability and Transparency**

Accountability and transparency are two important elements of good governance. Accountability refers to the legal and reporting framework, organisational structure, strategy, procedures and actions to ensure that the SAI meets its legal obligations with regard to its audit mandate and reporting and that the SAI and its personnel can be held responsible for their actions.

Transparency refers to the SAI's timely, reliable, clear and relevant public reporting on its status, mandate, strategy, activities and performance as also of the audit findings, conclusions and public access to information about the SAI. The principles of accountability and transparency are as under:

##### **1.4.2.1 SAI shall perform its duties under a legal framework that provides for accountability and transparency.**

SAI India shall perform its duties in accordance with the constitutional and statutory framework which cover the audit authority, jurisdiction and responsibilities, conditions for appointment and removal of the CAG, publishing of audit reports, oversight of activities and balance between public access to information and confidentiality of audit evidence and other information.

##### **1.4.2.2 SAI shall make public its mandate, mission and responsibilities.**

The mandate, mission and responsibilities of SAI India shall be in public domain.

##### **1.4.2.3 SAI shall adopt audit standards, processes and methods that are objective and transparent.**

The standards and methodologies adopted by SAI India shall be consistent with the fundamental auditing principles elaborated under the International Standards of Supreme Audit Institutions (ISSAIs) of International Organisation of Supreme Audit Institutions (INTOSAI). While conducting its audits, SAI India shall communicate the criteria on which opinions would be based to the auditable entities and keep them informed about the audit objectives, methodology and findings. SAI India shall also communicate the scope of audits undertaken as part of the reporting process. Its audit findings and recommendations shall be subject to procedures of comment, discussion and responses from the audited entity.

##### **1.4.2.4 SAI shall manage its operations economically, efficiently, effectively and in accordance with laws and regulations and report publicly on these matters.**

SAI India shall employ sound management practices including appropriate internal controls over its financial management and performance and reports on all areas of performance including various audits carried out covering compliance, performance and financial audits. SAI India's financial statements are open to Parliamentary review and its budget, financial resources and use of resources are in the public domain.



**1.4.2.5 SAI shall report publicly on the results of audits and on conclusions regarding overall public sector activities**

The audit reports of SAI India that include its conclusions and recommendations resulting from its audits shall be tabled in the concerned Legislature or presented to the audited entity's governing body as required and shall thereafter be in the public domain.

**1.4.2.6 SAI shall communicate timely and widely on its activities and audit results through the website, media and other means.**

Once the Audit Reports are tabled in the concerned legislature, SAI India shall communicate audit results through website and other means and may communicate with the media or other stakeholders on matters included in the reports thereby enhancing transparency and accountability of the audit work. Public and academic interest in important conclusions shall be encouraged. Its reports shall be made understandable to the wide public through various means e.g. summaries, graphics, video presentations and press releases.

**1.4.3 SAI shall apply high standards of integrity and ethics for staff of all levels.**

SAI India shall have a Code of Ethics that is aligned with the Code of Ethics (ISSAI 30) elaborated under the ISSAIs. The fundamental principles of ethics are integrity, independence, objectivity and impartiality, confidentiality and competence. SAI India shall ensure transparency and legality of its operations and actively promotes ethical behaviour throughout the organisation.

**1.4.4 Quality Assurance and Quality Control**

As an over-riding objective SAI India shall consider the risks to the quality of its work and establish a system of quality control that is designed to mitigate such identified risks. The risks to quality control depend upon the mandate and functions, conditions and environment under which it operates.

**1.4.4.1 SAI shall establish policies and procedures designed to promote an internal culture recognising that quality is essential in performing all of its work. The Head of SAI shall retain overall responsibility for the system of quality control.**

SAI India shall strive to achieve a culture that recognises and rewards high quality work throughout the SAI. It shall ensure that sufficient resources are available within the organisation to maintain the system of quality control.

**1.4.4.2 SAI shall establish policies and procedures designed to provide it with reasonable assurance that the SAI, including all personnel and any parties contracted to carry out work for the SAI comply with the relevant ethical requirements.**

SAI India shall recognize the importance of meeting relevant ethical requirements in carrying out its work. Policies and procedures shall be in place to reinforce the fundamental principles of ethics as defined in the code of ethics including rotation of key audit personnel to reduce the risk of familiarity with the entity being audited and to ensure that they remain and appear to remain objective obviating any possibility of conflict of interests. All personnel of SAI India

and any parties engaged to carry out any task for the SAI shall have to demonstrate appropriate ethical behaviour.

**1.4.4.3 SAI shall establish policies and procedures designed to provide reasonable assurance that its audits and other work are carried out in accordance with relevant standards, applicable legal and regulatory requirements, that SAI issues reports that are appropriate in the circumstances and that it has sufficient resources with the competence, capabilities and commitment to ethical principles as required to carry out its range of work.**

SAI India shall have an Audit Quality Management Framework that establishes appropriate quality control policies and procedures such as supervision and review responsibilities and ensures tools such as audit methodologies for all work carried out. It shall ensure that applicable standards are followed in all work carried out and if any requirement in a standard is not followed, the reasons are appropriately documented, approved and reported.

SAI India may draw on a number of different sources to ensure that it has the necessary skills and expertise to carry out its range of work. It may collaborate with academic/ research institutions in order to avail of the experienced members of the profession at large and may enter into formal relationships with professional bodies provided the relationships do not inhibit its independence and objectivity. As resources are limited, SAI India may prioritise its work in a manner that takes into account the need to maintain quality.

**1.4.4.4 SAI shall establish a monitoring process designed to provide it with reasonable assurance that the policies and procedures relating to the system of quality control are relevant and adequate and is operating effectively.**

SAI India shall ensure that its quality control system includes independent monitoring of the range of controls within the SAI.

SAI India may invite external independent assessment of its activities and implementation of standards through a peer review. Where appropriate, SAI India may consider other means of monitoring the quality of its work which may include but not be limited to independent academic review, stakeholder surveys and follow up reviews of recommendations or feedback from audited entities. There are procedures for dealing with complaints about the quality of work performed by SAI.

## **2. General Standards**

### **2.1 Public Sector Auditing and its Objectives**

- 2.1.1 Public sector<sup>2</sup> audit environment is that in which governments and other entities exercise responsibility for the use of national wealth, natural resources, resources derived from taxation and other sources in the delivery of services to citizens and other recipients. These entities are accountable for their management, performance and use of resources, both to those providing the resources and to those, including citizens, who depend on the services delivered using those resources. Public sector auditing helps to create suitable conditions and reinforce the expectation that public sector entities and public servants will perform their functions effectively, efficiently, ethically and in accordance with the applicable laws and regulations.
- 2.1.2 In general, public sector auditing can be described as a systematic process of objectively obtaining and evaluating evidence to determine whether information or actual conditions conform to established criteria. Public sector auditing is essential in that it provides legislature and oversight bodies, those charged with governance and the general public with information, independent and objective assessments concerning the stewardship and performance of public sector policies, programmes or operations.
- 2.1.3 All public sector audits start from objectives, which may differ depending on the type of audit being conducted. However, public sector auditing contributes to good governance by:
- a) providing the intended users with independent, objective and reliable information, conclusions or opinions based on sufficient and appropriate evidence relating to public sector entities;
  - b) enhancing accountability and transparency, encouraging continuous improvement and sustained confidence in the appropriate use of public funds and assets and the performance of public administration;
  - c) reinforcing the effectiveness of those bodies that exercise general monitoring and corrective functions over public sector and those responsible for the management of publicly funded activities; and
  - d) creating incentives for change by providing knowledge, comprehensive analysis and well-founded recommendations for improvement.

### **2.2 Types of Public Sector Audits**

Public sector audits can generally be categorised into one or more of the three main types – Financial audits, Compliance audits and Performance audits. The objectives of any given audit will determine which standards apply. The three main types of public sector audit are defined as follows:

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<sup>2</sup> Public sector refers to the sector that is controlled by Central, State and Local Governments. Public sector entities include all Central and State Public sector Ministries, Departments, Directorates /Commissionerates, and all other entities/bodies wholly or partially owned/controlled by the Central and/or State Governments or entities engaged in delivery of public goods and services.

- 2.2.1 **Financial Audit:** focuses on determining whether an entity's financial information is presented in accordance with the applicable financial reporting and regulatory framework. This is accomplished by obtaining sufficient and appropriate audit evidence to enable the auditor to express an opinion as to whether the financial information is free from material misstatement due to fraud or error.
- 2.2.2 **Compliance Audit:** focuses on whether a particular subject matter is in compliance with the criteria. Compliance auditing is performed by assessing whether activities, financial transactions and information are, in all material aspects, in compliance with the applicable authorities which include the Constitution, Acts, Laws, rules and regulations, budgetary resolutions, policy, contracts, agreements, established codes, sanctions, supply orders, agreed terms or the general principles governing sound public sector financial management and the conduct of public officials.
- 2.2.3 **Performance Audit:** focuses on whether interventions, programmes and institutions are performing in accordance with the principles of economy, efficiency and effectiveness and whether there is room for improvement. Performance is examined against suitable criteria and the causes of deviations from those criteria or other problems are analysed. The aim is to answer key audit questions and to provide recommendations for improvement.

SAI, India may carry out audits or engagements on any subject of relevance to the responsibilities of executive and those charged with governance and the appropriate use of public resources, within its given mandate. These engagements may include, but not be restricted to, reporting on the quantitative outputs and outcomes of the auditable entity's service delivery activities, sustainability reports, future resource requirements, and adherence to internal control standards, near real time audits or other matters. It may also conduct combined audits incorporating financial, performance and /or compliance aspects.

### 2.3 Elements of Public Sector Auditing

Public sector auditing is indispensable for the public administration, as the management of public resources is a matter of trust. Responsibility for the management of public resources in line with intended purposes is entrusted to an entity or person who acts on behalf of the public. Public sector auditing enhances the confidence of the intended users by providing information and independent and objective assessments concerning deviations from accepted standards or principles of good governance. All public sector audits have the same basic elements:

- a) The three parties
- b) Subject matter, criteria and subject matter information
- c) Types of engagement

#### 2.3.1 The Three Parties

Public sector audits involve at least three separate parties: the auditor, the responsible party and intended users. The relationship between the parties should be viewed within the context of the specific arrangements for each type of audit.

**The auditor:** In public sector auditing the role of auditor is fulfilled by SAI, India and by its personnel delegated with the task of conducting audits. .

**The responsible party:** In public sector auditing, the relevant responsibilities are determined by constitutional or legislative arrangement. The responsible parties may be responsible for the subject matter information, for managing the subject matter or for addressing recommendations and may be individuals or organizations. Generally, auditable entities and those charged with governance of the auditable entities would be the responsible parties.

**Intended users:** The intended users are the individuals, organizations or classes thereof for whom the auditor prepares the audit report. The intended users may be legislative or oversight bodies, those charged with governance or the general public. The intended user is primarily the Parliament or the Legislature which represents the citizens by determining the priorities of public finance, purpose and content of public spending and income.

### 2.3.2 **Subject Matter, Criteria and Subject Matter Information**

Subject matter refers to the information, condition or activity that is measured or evaluated against certain criteria. It can take many forms and have different characteristics depending on the audit objective. An appropriate subject matter is identifiable and capable of consistent evaluation or measurement against the criteria, such that it can be subjected to procedures for gathering sufficient and appropriate audit evidence to support the audit opinion or conclusion.

The criteria are the benchmarks used to evaluate the subject matter. Each audit shall have criteria suitable to the circumstances of that audit. In determining the suitability of criteria the auditor considers their relevance and understandability for the intended users, as well as their completeness, reliability and objectivity (neutrality, general acceptance and comparability with criteria used in similar audits). The criteria used may depend on a range of factors, including the objectives and the type of audit. Criteria can be specific or more general and may be drawn from various sources, including the Constitution of India, laws, regulations, standards, sound principles and best practices. They shall be made available to the intended users to enable them to understand how the subject matter has been evaluated or measured.

Subject matter information refers to the outcome of evaluating or measuring the subject matter against the criteria. It can take many forms and have different characteristics depending on the audit objective and audit scope.

### 2.3.3 **Types of Engagement**

There are two types of engagement: Attestation Engagements and Direct Reporting Engagements.

In attestation engagements, the responsible party 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.

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, analyses or insights.

Financial audits are always attestation engagements, as they are based on financial information presented by the responsible party. Performance audits and compliance audits are generally direct reporting engagements.

## **2.4 Confidence and Assurance in Public Sector Auditing**

Audit has to provide reliable and relevant information to the intended users based on sufficient and appropriate evidence. Auditors shall perform procedures to reduce or manage the risk of reaching inappropriate conclusions.

### **2.4.1 Forms of providing assurance**

Depending on the audit and the users' needs, assurance can be communicated in two ways:

- a) **Through opinions and conclusions:** which explicitly convey the level of assurance. This applies to all attestation engagements and certain direct reporting engagements.
- b) **In other forms:** In some direct reporting engagements the auditor does not give an explicit statement of assurance on the subject matter. In such cases, the auditor provides the users with the necessary degree of confidence by explicitly explaining how 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.

### **2.4.2 Levels of assurance**

Assurance can be either reasonable or limited. Reasonable assurance is high, but not absolute, given the inherent limitations of an audit, the result of which is that most of the audit evidence obtained by the auditor will be persuasive rather than conclusive. In reasonable assurance the audit conclusion is expressed positively, either explicitly or in other forms conveying the necessary degree of confidence as stated at para 2.4.1 above.

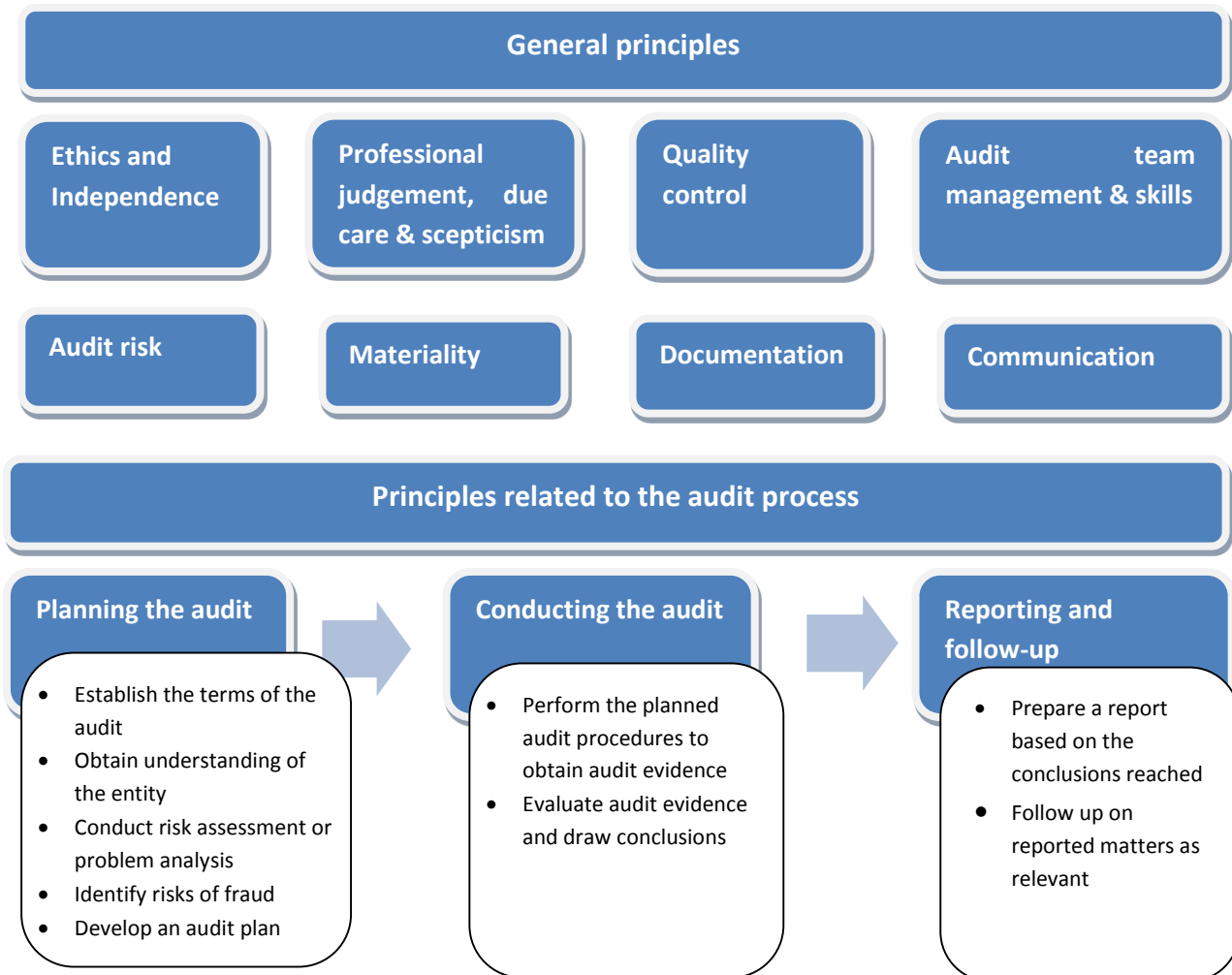
A limited assurance conveys the limited nature of the assurance provided and the audit conclusion is expressed in a negative manner stating that based on the procedures performed, nothing has come to the auditor's attention to cause the auditor to believe that the subject matter is not in compliance with the applicable criteria. The procedures performed in a limited assurance audit are limited compared with what is necessary to obtain reasonable assurance, but the level of assurance is expected, in the auditor's professional judgement, to be meaningful to the intended users.

## **2.5 Principles of Public Sector Auditing**

Auditing is a cumulative and iterative process. The principles of public sector auditing constitute the general standards that apply to SAI India's personnel as auditors and are

fundamental to the conduct of all types of public sector audits. The principles to be observed by all individual auditors are categorized into two distinct groups as shown in the diagram below.

- **General principles**
- **Principles related to the audit process**



### 2.5.1 General Principles

General principles relate to the basic audit concepts, which shall be considered by auditors prior to commencement and at more than one point during the audit process and comprise the following:

#### 2.5.1.1 Ethics and Independence

**Auditors shall comply with the relevant ethical requirements and be independent**

Ethical principles shall be embodied in an auditor’s professional behaviour and the auditors shall comply with SAI India’s code of ethics. Auditors shall remain independent so that their reports are impartial and be seen as such by the intended users.

#### 2.5.1.2 Professional Judgement, Due Care and Scepticism

**Auditors shall maintain appropriate professional behaviour by applying professional scepticism, professional judgment and due care throughout the audit**

The auditor's attitude shall be characterised by professional scepticism and professional judgement, which are to be applied when forming decisions about the appropriate course of action. Auditors shall exercise due care to ensure that their professional behaviour is appropriate.

Professional scepticism refers to maintaining professional distance, an alert and questioning attitude when assessing the sufficiency and appropriateness of evidence obtained throughout the audit. It also entails remaining open-minded and receptive to all views and arguments. Professional judgement implies the application of collective knowledge, skills and experience to the audit process. Due care denotes that auditors shall plan and conduct audits in a diligent manner. Auditors shall avoid any conduct that might discredit their work.

#### 2.5.1.3 **Quality Control**

**Auditors shall perform the audit in accordance with professional standards on quality control**

Auditors shall comply with professional standards on quality control, the aim being to ensure that audits are conducted at a consistently high level. Quality control procedures shall cover matters such as the direction, review and supervision of the audit process and the need for consultation in order to reach decisions on difficult or contentious matters.

#### 2.5.1.4 **Audit Team Management and Skills**

**Auditors shall possess or have access to the necessary skills**

The audit team shall collectively possess the knowledge, skills expertise and competence necessary to successfully complete the audit. This includes an understanding and practical experience of the type of audit being conducted, familiarity with the applicable standards and legislation, an understanding of the entity's operations and the ability and experience to exercise professional judgement. Auditors shall maintain their professional competence through ongoing professional development.

Where relevant or necessary, and in line with SAI India's mandate and applicable legislation, the auditor may use the work of internal auditors, other auditors or experts. The auditor's procedures shall provide a sufficient basis for using the work of others, and in all cases the auditor shall obtain evidence of other auditors' or experts' competence, independence and the quality of work performed. However, SAI, India has the sole responsibility for any audit opinion or report it might produce on the subject matter and that responsibility is not reduced by its use of work done by other parties.

SAI, India may use the work of other auditors at state, provincial, regional, district or local level, or of public accounting firms that have completed audit work related to the audit objective. Audits may require specialised techniques, methods or skills from disciplines not available within SAI, India. In such cases, experts may be used to provide knowledge or carry out specific tasks or for other purposes.



#### 2.5.1.5 **Audit Risk**

##### **Auditors shall manage the risks of providing a report that is inappropriate in the circumstances of the audit**

The audit risk is the risk that the audit report may be inappropriate. The auditor performs procedures to reduce or manage the risk of reaching inappropriate conclusions, recognising that the limitations inherent to all audits mean that an audit can never provide absolute certainty of the condition of the subject matter. When the objective is to provide reasonable assurance, the auditor shall reduce audit risk to an acceptably low level given the circumstances of the audit. The audit may also aim to provide limited assurance, in which case the acceptable risk that criteria are not complied with is greater than in a reasonable assurance audit. A limited assurance audit provides a level of assurance that, in the auditor's professional judgment, will be meaningful to the intended users.

#### 2.5.1.6 **Materiality**

##### **Auditors shall consider materiality throughout the audit process**

Materiality is relevant in all audits. A matter can be judged material if knowledge of it would be likely to influence the decisions of the intended users. Determining materiality is a matter of professional judgement and depends on the auditor's interpretation of the users' needs. This judgement may relate to an individual item or to a group of items taken together. Materiality is often considered in terms of value, but it also has other quantitative as well as qualitative aspects. The inherent characteristics of an item or group of items may render a matter material by its very nature. A matter may also be material because of the context in which it occurs. Materiality shall be considered for the purposes of planning, evaluating the evidence obtained and reporting, though the materiality levels could differ for each of the processes. Materiality considerations affect decisions concerning the nature, timing and extent of audit procedures and the evaluation of audit results. Considerations may include stakeholder concerns, public interest, regulatory requirements and consequences for society.

#### 2.5.1.7 **Documentation**

##### **Auditors shall prepare audit documentation that is sufficiently detailed to provide a clear understanding of the work performed, evidence obtained and conclusions reached.**

Audit documentation shall include an audit strategy and audit plan. It shall record the procedures performed and evidence obtained and support the communicated results of the audit. Documentation shall be sufficiently detailed to enable an experienced auditor, with no prior knowledge of the audit, to understand the nature, timing, scope and results of the procedures performed, the evidence obtained in support of the audit conclusions and recommendations, the reasoning behind all significant matters that required the exercise of professional judgement and the related conclusions. Adequate audit documentation is important for several reasons. It will:

- a) confirm and support the auditor's opinions and reports;
- b) serve as a source of information for preparing reports or answering any enquiries from the audited entity or any other party;

- c) serve as evidence of the auditor's compliance with the auditing standards;
- d) facilitate planning, supervision and review; help with the auditor's professional development;
- e) help to ensure that delegated work has been satisfactorily executed; and
- f) provide evidence of work done for future reference.

Further requirements relating to documentation in the following areas also need to be met:

- (i) the timely preparation of documentation;
- (ii) the form, content and extent of documentation;
- (iii) documentation requirements where the auditor judges it necessary to depart from a relevant requirement in the applied auditing standards;
- (iv) documentation requirements where the auditor performs new or additional audit procedures or draws new conclusions after the date of the auditor's report; and
- (v) the assembly of the final audit file.

#### 2.5.1.8 **Communication**

##### **Auditors shall establish effective communication throughout the audit process**

It is essential that the entity being audited be kept informed of all matters relating to the audit. This is key to developing a constructive working relationship. Communication shall include obtaining information relevant to the audit and providing management/ those charged with governance with timely observations and findings throughout the engagement. It is important to promote effective two-way communication throughout the engagement. Written communication is vital for significant audit findings, which auditors are required to communicate to those charged with governance. The auditor may also have a responsibility to communicate audit-related matters to other stakeholders, such as legislative and oversight bodies.

#### 2.5.2 **Principles related to the audit process**

Principles related to the audit process relate to the specific steps in the audit process and comprise the following:

##### 2.5.2.1 **Planning an audit**

Auditors shall ensure that the terms of the audit have been clearly established. Most of the audits undertaken by SAI, India are as per the constitutional mandate, which may not require formal agreement with the auditable entities on terms of audit. In some cases, such as in case of an entrusted audit, there is a need for arriving at an agreement on the terms of audit with the auditable entity. Important information like the subject, scope and objectives of audit, access to data, the audit process, roles and responsibilities of different parties to the engagement shall be firmed up before audit is carried out.

##### **a) Auditors shall obtain an understanding of the nature of the entity/programme to be audited**

This includes understanding the relevant objectives, operations, regulatory environment, internal controls, financial and other systems and business processes, and researching the

potential sources of audit evidence. Knowledge can be obtained from interaction with management, other relevant stakeholders and experts. Documents (including earlier studies and other sources) shall be examined in order to gain a broad understanding of the subject matter to be audited and its context.

**b) Auditors shall conduct a risk assessment or problem analysis and revise this as necessary in response to the audit findings**

The nature of the risks identified will vary according to the audit objectives. The auditor shall consider and assess the risk of different types of deficiencies, deviations or misstatements that may occur in relation to the subject matter. Both general and specific risks shall be considered. This can be achieved through procedures that serve to obtain an understanding of the entity or programme and its environment, including the relevant internal controls. The auditor shall assess the management's response to identified risks, including its implementation and design of internal controls to address them. In a problem analysis the auditor shall consider actual indications of problems or deviations from what should be or is expected. This process involves examining various problem indicators in order to define the audit objectives. To facilitate the process of risk assessment or problem analysis data from multiple sources may be collated and/or combined to gain insights and discern patterns. Technology and data analytical techniques may be appropriately utilised in the process. The identification of risks and their impact on the audit shall be considered throughout the audit process.

**c) Auditors shall identify and assess the risks of fraud relevant to the audit objectives**

The primary responsibility for the prevention and detection of fraud rests with the entity's management and those charged with governance. It is important that management, under the oversight of those charged with governance, strongly emphasise fraud prevention (limiting opportunities for fraud to take place) and fraud deterrence (dissuading individuals from committing fraud because of the likelihood of detection). Fraud is a broad legal concept and the auditor does not make legal determination of fraud. Auditors shall make enquiries and perform procedures to identify and respond to the risks of fraud relevant to the audit objectives. They shall maintain an attitude of professional scepticism and be alert to the possibility of fraud throughout the audit process.

**d) Auditors shall plan their work to ensure that the audit is conducted in an effective and efficient manner**

Planning for a specific audit includes strategic and operational aspects. Strategically, planning shall define the audit scope, objectives and approach. The objectives refer to what the audit is intended to accomplish. The scope relates to the subject matter and the criteria which the auditors will use to assess and report on the subject matter and is directly related to the objectives. The approach will describe the nature and extent of the procedures to be used for gathering audit evidence. The audit shall be planned to reduce audit risk to an acceptably low level. Professional judgement shall be exercised to decide on a suitable sampling

methodology depending upon the subject matters, audit objectives being pursued and the envisaged scope of audit.

Operationally, planning entails setting a timetable for audit and defining the nature, timing and extent of the audit procedures. During planning, auditors shall assign the members of their team as appropriate and identify other resources that may be required, such as subject experts. Audit planning shall be responsive to significant changes in circumstances and conditions. It is an iterative process that takes place throughout the audit.

#### 2.5.2.2 **Conducting an Audit**

##### **a) Auditors shall perform audit procedures that provide sufficient and appropriate audit evidence to support the audit report**

The auditor's decisions on the nature, timing and extent of audit procedures will impact on the evidence to be obtained. The choice of procedures will depend on the risk assessment or problem analysis. Audit evidence is any information used by the auditor to determine whether the subject matter complies with the applicable criteria. Evidence may take many forms, such as electronic and paper records of transactions, written and electronic communication with outsiders, and observations by the auditor and oral or written testimony by the audited entity. Methods of obtaining audit evidence can include inspection, observation, inquiry, confirmation, recalculation, re-performance, analytical procedures and/or other research techniques.

Evidence shall be both sufficient (quantity) to persuade a knowledgeable person that the findings are reasonable, and appropriate (quality) – i.e. relevant, valid and reliable. The quantity of evidence required depends on the risk of material misstatement or non-compliance of the subject matter information (the greater the risk, the more evidence is likely to be required) and on the quality of such evidence (the higher the quality, the less may be required). Accordingly, the sufficiency and appropriateness of evidence are interrelated. However, merely obtaining more evidence does not compensate for its poor quality. The reliability of evidence is influenced by its source and nature, and is dependent on the specific circumstances in which the evidence was obtained. While recognizing that exceptions may exist, the following generalizations about the reliability of evidence may be useful:

- a) Evidence is more reliable when it is obtained from sources external to the responsible party.
- b) Evidence that is generated internally is more reliable when the related controls are effective
- c) Evidence obtained directly by the auditor (for example, through observation of the application of a control) is more reliable than evidence obtained indirectly or by inference (for example, through inquiry into the application of a control).
- d) Evidence is more reliable when it exists in documentary form, whether paper, electronic, or other media (for example, a simultaneous written record of a meeting is more reliable than a subsequent oral report of what was discussed).

- e) Evidence provided by original documents is more reliable than evidence provided by photocopies or facsimiles.

The auditor's assessment of the evidence shall be objective, fair and balanced. Preliminary findings shall be communicated to and discussed with the entity being audited to confirm their validity. The auditor must respect all requirements regarding confidentiality.

**b) Auditors shall evaluate the audit evidence and draw conclusions**

After completing the audit procedures, the auditor will review the audit documentation in order to determine whether the subject matter has been sufficiently and appropriately audited. Before drawing conclusions, the auditor reconsiders the initial assessment of risk and materiality in the light of the evidence collected and determines whether additional audit procedures need to be performed. The auditor shall evaluate the audit evidence with a view to obtaining audit findings. When evaluating the audit evidence and assessing materiality of findings the auditor shall take both quantitative and qualitative factors into consideration. Based on the findings, the auditor shall exercise professional judgement to reach a conclusion on the subject matter or subject matter information.

**2.5.2.3 Reporting and Follow-up**

**a) Auditors shall prepare a report based on the conclusions reached.**

The audit process involves preparing a report to communicate the results of the audit to stakeholders, others responsible for governance and the general public. The purpose is also to facilitate follow-up and corrective action. Reports shall be easy to understand, free from vagueness or ambiguity and complete. They shall be objective and fair, only including information which is supported by sufficient and appropriate audit evidence and ensuring that findings are put into perspective and context. The form and content of a report will depend on the nature of the audit, the intended users, the applicable standards and legal requirements. The reports can appear in short form or long form. Long-form reports generally describe in detail the audit scope, audit findings and conclusions, including potential consequences and constructive recommendations to enable remedial action. Short-form reports are more condensed and generally in a more standardized format.

**i. Attestation engagements**

In attestation engagements the audit report may express an opinion as to whether the subject matter information is, in all material respects, free from misstatement and/or whether the subject matter complies, in all material respects, with the established criteria. In an attestation engagement the report is generally referred to as the Auditor's Report.

**ii. Direct reporting engagements**

In direct reporting engagements the audit report needs to state the audit objectives and describe how they were addressed in the audit. It includes findings and conclusions on the subject matter and may also include recommendations. Additional information about criteria, methodology and sources of data may also be given, and any limitations to the audit scope

shall be described. The audit report shall explain how the evidence obtained was used and why the resulting conclusions were drawn.

#### **b) Opinion or conclusion**

When an audit opinion or conclusion is used to convey the level of assurance, the opinion or conclusion shall be in a standardised format. It may be unmodified or modified. An unmodified opinion/conclusion is used when either limited or reasonable assurance has been obtained. A modified opinion or conclusion may be:

- **Qualified** (except for) – where the auditor disagrees with, or is unable to obtain sufficient and appropriate audit evidence about certain items in the subject matter which are, or could be, material but not pervasive;
- **Adverse** – where the auditor, having obtained sufficient and appropriate audit evidence, concludes that deviations or misstatements, whether individually or in the aggregate, are both material and pervasive;
- **Disclaimed** – where the auditor is unable to obtain sufficient and appropriate audit evidence due to an uncertainty or scope limitation which is both material and pervasive.

Where the opinion or conclusion is modified the reasons shall be put in perspective by clearly explaining, with reference to the applicable criteria, the nature and extent of the modification. Conveying an opinion is generally related to financial audits and expression of conclusion is relevant to compliance audits. Depending on the type of audit, recommendations for corrective action and any contributing internal control deficiencies may also be included in the report.

#### **c) Follow-up**

SAI India shall monitor action taken by the responsible party in response to the matters raised in an audit report. Follow-up focuses on whether the audited entity has adequately addressed the matters raised. Insufficient or unsatisfactory action by the audited entity may call for a further report by SAI India.

### **3. Specific Standards**

#### **3.1 Introduction**

The general principles relating to the basic audit concepts and those relating to the audit process applicable to all types of public sector audits constituting the general standards have been described in Chapter 2. In addition, this section contains the specific considerations regarding their applicability to financial, compliance and performance audits, which the auditors shall observe as specific standards during the conduct of these audits.

#### **3.2 Financial Audit**

The purpose of an audit of financial statements is to enhance the degree of confidence of intended users in the financial statements. This is achieved through the expression of an opinion by the auditor as to whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework, or – in the case of financial statements prepared in accordance with a fair presentation financial reporting framework – whether the financial statements are presented fairly, in all material respects, or give a true and fair view, in accordance with that framework.

##### **3.2.1 In conducting an audit of financial statements, the overall objectives of the auditor are:**

- a) To obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, thereby enabling the auditor to express an opinion on whether the financial statements are prepared, in all material respects, in accordance with an applicable financial reporting framework; and
- b) To report on the financial statements, and communicate the result of the audit in accordance with the auditor's findings.

The objectives of financial audit in public sector are often broader than expressing an opinion on the financial statements. The audit mandate arising from legislations, regulation and government policy requirements may result in additional objectives.

##### **3.2.2 Financial Reporting Frameworks**

Financial reporting frameworks may be for general or specific use. A framework designed to meet the information needs of a wide range of users is referred to as a general-purpose framework, while special-purpose frameworks are designed to meet the specific needs of a specific user or group of users.

**a) General Purpose frameworks:** The International Public Sector Accounting Standards (IPSASs), International Financial Reporting Standards (IFRSs), the Indian Accounting Standards, or other national financial reporting frameworks for use in public sector constitute general purpose frameworks. A complete set of financial statements for a public sector entity prepared in accordance with such a financial reporting framework, normally consists of:

- (i) a statement of financial position;

- (ii) a statement of financial performance;
- (iii) a statement of changes in net assets/equity;
- (iv) a cash flow statement;
- (v) a comparison of budget and actual amounts – either as a separate additional financial statement or as a reconciliation;
- (vi) notes, comprising a summary of significant accounting policies and other explanatory information.
- (vii) In certain environments a complete set of financial statements may also include other reports, such as reports on performance and appropriation reports.

If the financial statements are prepared in accordance with a framework for other accounting bases, such as modified accrual or cash basis (e.g. Indian Government Accounting Standards – IGAS), a complete set of financial statements may not include all of the above.

**b) Special-Purpose Frameworks:** In addition to preparing general-purpose financial statements, a public sector entity may prepare financial statements for other parties (such as governing bodies, the legislature or other parties with an oversight function), which may require financial statements tailored to meet their specific information needs. In some environments financial statements of this kind are the only financial statements prepared by the public sector entity. Special-purpose frameworks relevant to the public sector may include:

- (i) the cash receipts and disbursements, basis of accounting for cash flow information that an entity may be required to prepare for a governing body;
- (ii) the financial reporting provisions established by an international funding organization or mechanism;
- (iii) the financial reporting provisions established by a governing body, the legislature or other parties that perform an oversight function to meet the requirements of that body; or
- (iv) the financial reporting provisions of a contract, such as a project grant.

**c) Frameworks prescribed by law or regulation:** Frameworks prescribed by law or regulation will often be deemed acceptable by the auditor. Such frameworks invariably require presentation of original and final budget amounts and actual amounts on a comparable basis to complete the accountability cycle by enabling users of financial statements to identify whether the resources were obtained and used in accordance with the approved budget.

The accounting base, basis of classification, the level of aggregation of budget heads for presentation in financial statements are determined by law, rules and regulations. Such financial reporting frameworks are thus invariably governed by standards, which are rule based and could be different from the principles envisaged in general purpose frameworks. The Government Accounting Rules, 1990, General Financial Rules, 2005, Delegation of Financial Powers Rules, 1978 and List of Major and Minor Heads, Annual Appropriation Acts,



Finance and Accounts Codes and rules that govern preparation and compilation of finance and appropriation accounts of the Union and the States constitute the rule based standards. These auditing standards would apply to audits of such frameworks with appropriate modifications.

### 3.2.3 Materiality

**The auditor shall apply the concept of materiality in an appropriate manner when planning and performing the audit.**

A misstatement is material, individually or when aggregated with other misstatements, if it could reasonably be expected to influence the decisions taken by users on the basis of the financial statements. When planning the audit strategy, the auditor shall assess materiality for the financial statements as a whole. However, where one or more classes of transactions, account balances or disclosures could reasonably be expected to influence the decisions of users on the basis of the financial statements, the auditor shall also determine the materiality level or levels for the classes of transactions, account balances or disclosures concerned.

Even while the auditor's opinion deals with the financial statements as a whole, the auditor shall still identify and document quantitative –non- material misstatements, as they may be material due to their nature or when aggregated. Misstatements trivial in nature need not be considered. The auditor therefore considers not only the size but also the nature of uncorrected misstatements (e.g. if it is a result of fraud or corruption) and the particular circumstances of their occurrence when evaluating their effect on the financial statements. The auditor also considers the nature and extent of misstatements identified in previous audits, sensitive nature of certain transactions or programmes, public interest, the need for effective legislative oversight and regulation and other qualitative factors while assessing materiality, which is a matter of auditor's judgement.

### 3.2.4 Audit risk

**The audit risk in an audit of financial statements is the risk that the auditor will express an inappropriate conclusion if the subject matter information is materially misstated.** The auditor will reduce the risk to an acceptably low level in the circumstances of the audit to obtain reasonable assurance as the basis for expressing a conclusion in a positive form. In general, the audit risk depends on the inherent risk and control risk, which constitute the risks of material misstatement and the detection risk:

- a) **Inherent risk** – the susceptibility of the subject matter information to material misstatement, assuming that there are no related controls;
- b) **Control risk** – the risk that a material misstatement could occur and will not be prevented or detected and corrected at the appropriate time by related controls. Some control risk will always exist due to the limitations inherent in the design and operation of internal controls.
- c) **Detection risk** – the risk that the auditor will not detect a material misstatement.

The risk assessment is a matter of professional judgement and is not capable of precise measurement. The degree to which the auditor considers each element of risk will depend on the circumstances of each audit.

### 3.2.5 Risk Assessment

**The auditor shall assess the risks of material misstatement at the financial statement level and the assertion level for classes of transactions, account balances and disclosures so as to provide a basis for designing and performing further audit procedures.**

For this purpose, the auditor needs to:

- a) identify risks throughout the process of obtaining an understanding of the entity being audited and its environment, by examining relevant controls that relate to the risks and considering the classes of transactions, account balances and disclosures in the financial statements;
- b) assess the risks identified and evaluate whether they relate more pervasively to the financial statements as a whole and could potentially affect many assertions;
- c) relate the risks identified to what could go wrong at the assertion level, taking account of relevant controls that the auditor intends to test; and
- d) consider the likelihood of misstatement, including the possibility of multiple misstatements, whether the potential for misstatement is such as to render it material.

As part of the risk assessment, the auditor determines whether any of the risks identified is, in the auditor's judgment, significant. When judging which risks are significant, the auditor needs to consider at least the following:

- (i) risk of fraud;
- (ii) recent significant economic, accounting or other developments, which requires specific attention;
- (iii) the complexity of transactions;
- (iv) significant transactions with related parties;
- (v) the degree of subjectivity in the measurement of financial information related to the risk, especially measurements which involve a wide range of measurement uncertainty;
- (vi) significant transactions that are outside the entity's normal course of business, or that otherwise appear to be unusual; and
- (vii) compliance with laws and regulations.

The auditor shall act appropriately to address the assessed risks of material misstatement in the financial statements. Responses to assessed risks include designing audit procedures that address the risks, such as substantive procedures and test of controls. Substantive procedures include both tests of details and substantive analysis of classes of transactions, account balances and disclosures.

### 3.2.6 Going Concern Considerations

**The auditor shall consider whether there are events or conditions that may cast significant doubt on the entity's ability to continue as a going concern.**

Financial statements are normally prepared on the assumption that the entity is a going concern and will continue to meet its statutory obligations for the foreseeable future. In assessing whether the going-concern assumption is appropriate, those responsible for preparation of the financial statements take into account all available information for the foreseeable future. General-purpose financial statements are typically prepared on a going-concern basis.

The going-concern concept may have little or no relevance for public-sector entities such as those funded through appropriations on the public sector budget. When such organizations are abolished or merged with others, their liabilities and assets are usually taken over by other public-sector entities. For some other types of entities, such as public sector business enterprises and joint ventures with other principals (including private sector entities operating in legal forms that provide for limited owner liability), this may not be the case. The responsibility for implementing public sector programmes may also be contracted out to private sector organizations, such as NGOs and private companies, but the programmes may still be audited by SAI, India, making the going-concern concept and the auditor's judgement in this regard relevant to public-sector financial audit.

### 3.2.7 Considerations Relating to Fraud in an Audit of Financial Statements

**The auditor shall identify and assess the risks of material misstatement in the financial statements due to fraud, shall obtain sufficient and appropriate audit evidence regarding the assessed risks of material misstatement due to fraud and shall respond appropriately to fraud or suspected fraud identified during the audit.**

The auditor is responsible for obtaining reasonable assurance that the financial statements taken as a whole are free from material misstatement, whether caused by fraud or error. Misstatements in the financial statements can arise from either fraud or error. The distinguishing factor is whether the action resulting in a misstatement was intentional or unintentional. Fraud is a broad legal concept and the auditor does not make legal determination of fraud. The auditor is concerned only with fraud that causes a material misstatement in the financial statements. Two types of intentional misstatements are relevant to the auditor - misstatements resulting from fraudulent financial reporting and those resulting from the misappropriation of assets.

Areas in which auditors shall be alert to fraud risks leading to material misstatement may include procurement, grants, privatisations, intentional misrepresentation of results or information and misuse of authority or power. Auditors shall also consider that the use of public monies tends to raise the profile of fraud. As a result auditors may need to be responsive to public expectations regarding fraud detection.

### 3.2.8 Considerations Relating to Laws and Regulations in an Audit of Financial Statements

**The auditor shall identify the risks of material misstatement due to direct and material non-compliance with laws and regulations.**

The auditor shall obtain sufficient and appropriate audit evidence regarding compliance with the laws and regulations such as the Appropriation Acts (which prescribe budgetary allocations against which expenditures are incurred and are subject to audit) that are generally recognised to have a direct and material effect on the determination of material amounts and disclosures in financial statements. However, the auditor is not responsible for preventing non-compliance and cannot be expected to detect all breaches of laws and regulations.

The effect of laws and regulations on the financial statements varies considerably. The provisions of some laws or regulations have a direct effect on the financial statements in that they determine the nature of reported amounts and disclosures while other laws or regulations, which are to be complied with by management, may not have a direct effect on the entity's financial statements. Non-compliance with laws and regulations may result in fines, litigation or other consequences for the audited entity that may have a material effect on the financial statements. Matters involving non-compliance with laws and regulations that come to the auditor's attention during the course of the audit shall be communicated to management/those charged with governance, save where the matters are clearly inconsequential.

### 3.2.9 Consideration of Subsequent Events

**The auditor shall obtain sufficient and appropriate audit evidence that all events occurring between the date of the financial statements and the date of the auditor's report that require an adjustment to, or disclosure in, the financial statements have been identified.**

Financial statements may be affected by certain types of subsequent events (those occurring after the date of the financial statements). Many financial reporting frameworks specifically refer to such events. Ordinarily, two types of events are identified:

- a) Events that provide evidence of conditions that existed at the date of the financial statements; and
- b) Events that provide evidence of conditions that arose after the date of the financial statements.

Procedures shall be designed, as nearly as possible, to cover the period from the date of the financial statements to the date of the auditor's report. The auditor is not, however, expected to perform additional audit procedures on matters to which previous audit procedures have provided satisfactory conclusions. Procedures for obtaining sufficient and appropriate audit evidence may include:

- (i) steps to obtain an understanding of any procedures established by management to ensure that subsequent events are identified;

- (ii) inquiries of management;
- (iii) scrutiny of minutes of the Board / those charged with governance;
- (iv) scrutiny of the entity's most recent interim financial statements, if any
- (v) written confirmation from the management /those charged with governance.

The auditor is under no obligation to perform any audit procedures on the financial statements after the date of the auditor's report. However, if, after the date of the auditor's report but before the financial statements have been issued, a fact becomes known to the auditor that, had it been known at the date of the auditor's report, might have caused an amendment to the report, appropriate action shall be taken. Such action may include:

- 1) discussing the matter with the management and, where appropriate, those charged with governance,
- 2) determining whether the financial statements need amendment and, if so,
- 3) inquiring how the management intends to address the matter in the financial statements.
- 4) obtaining written confirmation from the management.

If the management does not take the necessary steps and does not amend the financial statements, the auditor shall notify the management and those charged with governance that the auditor will seek to prevent future reliance on the auditor's report. This may entail seeking legal advice and reporting to the appropriate statutory body.

### 3.2.10 Evaluating Misstatements

**Uncorrected misstatements shall be evaluated for materiality, individually or in aggregate, to determine their effect on the opinion to be given in the auditor's report.**

The auditor needs to determine whether uncorrected misstatements are material, individually or in the aggregate. To this end, the auditor shall consider

- a) the size and nature of the misstatements, in relation both to particular classes of transactions, account balances or disclosures and to the financial statements as a whole, and the particular circumstances of their occurrence; and
- b) the effect of uncorrected misstatements from prior periods on the relevant classes of transactions, account balances or disclosures, and on the financial statements as a whole.

The auditor shall invite the management to correct misstatements, and if the management refuses to correct some or all communicated misstatements the auditor shall ascertain the reasons. When evaluating whether the financial statements as a whole are misstated, the auditor shall consider the reasons given for not making corrections. Those charged with governance shall be notified of uncorrected misstatements and the effect that they may have, individually or in aggregate, on the opinion in the auditor's report. The auditor's notification shall individually identify uncorrected material misstatements in classes of transactions, account balances or disclosures. Misstatements that are clearly trivial need not normally be communicated, save where the auditor is required by mandate to report all misstatements.

### 3.2.11 Forming an Opinion and Reporting on the Financial Statements

**The auditor shall form an opinion based on an evaluation of the conclusions drawn from the audit evidence obtained, as to whether the financial statements as a whole are prepared in accordance with the applicable financial reporting framework. The opinion shall be expressed clearly in a written report that also describes the basis for the opinion.**

In order to form an opinion, the auditor must first conclude whether reasonable assurance has been obtained as to whether the financial statements as a whole are free from material misstatement, whether due to fraud or error. The conclusion shall take into account:

- a) Whether sufficient and appropriate evidence has been obtained;
- b) Whether uncorrected misstatements are material, individually or in aggregate; and
- c) The auditor's evaluations of the financial statements. .

#### **i) Form of Opinion**

The auditor shall express an unmodified opinion if it is concluded that the financial statements are prepared, in all material respects, in accordance with the applicable financial framework. If the auditor concludes that, based on the audit evidence obtained, the financial statements as a whole are not free from material misstatement, or is unable to obtain sufficient and appropriate audit evidence to conclude that the financial statements as a whole are free from material misstatement, the auditor shall modify the opinion in the auditor's report. Auditors may provide three types of modified opinions: a qualified opinion, an adverse opinion and a disclaimer of opinion as envisaged in para 2.5.2.3 of Chapter 2.

**ii) Determining the type of modification to the auditor's opinion** - The decision regarding which type of modified opinion is appropriate depends upon:

- a) The nature of the matter giving rise to the modification – that is, whether the financial statements are materially misstated or, in the event that it was impossible to obtain sufficient and appropriate audit evidence, may be materially misstated; and
- b) The auditor's judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements.

If financial statements prepared in accordance with the requirements of a fair presentation framework do not achieve fair presentation, the auditor shall discuss the matter with the management and, depending on the requirements of the applicable financial reporting framework and how the matter is resolved, determine whether it is necessary to modify the audit opinion.

**iii) Expression of opinion in the Auditor's Report** - The expression of opinion in the Auditor's Report shall use one of the following equivalent phrases when expressing an unmodified opinion on the financial statements prepared in accordance with a fair presentation framework:

- a) The financial statements present fairly, in all material respects... in accordance with [the applicable reporting framework]; or
- b) The financial statements give a true and fair view of ... in accordance with [the applicable financial reporting framework]

When expressing an unmodified opinion on financial statements prepared in accordance with a compliance framework, the auditor's opinion shall be that the financial statements are prepared, in all material respects, in accordance with [the applicable financial reporting framework]. When expressing a modified opinion, the auditor shall also modify the heading to correspond with the type of opinion expressed.

Apart from the section that contains the Opinion, Auditor's Report may include separate sections on a) responsibility of Management for the financial statements, stating that the management is responsible for the financial statements in accordance with the applicable financial reporting framework, b) responsibility of Auditors, stating that the responsibility of the auditor is to express an opinion based on the audit of the financial statements and describing the scope of audit and audit procedures carried out, c) Emphasis of Matter and Other Matters paragraphs and d) other regulatory and reporting responsibilities of auditors.

#### **iv) Emphasis of Matter and Other Matters Paragraphs in the Auditor's Report**

If the auditor considers it necessary to draw users' attention to a matter presented or disclosed in the financial statements that is of such importance that it is fundamental to their understanding of the financial statements, but there is sufficient and appropriate evidence that the matter is not materially misstated in the financial statements, the auditor shall include an Emphasis of Matter paragraph in the auditor's report. Emphasis of Matter paragraphs shall only refer to information presented or disclosed in the financial statements.

If the auditor considers it necessary to communicate a matter, other than those that are presented or disclosed in the financial statements, which, in the auditor's judgement, is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report, and provided this is not prohibited by law or regulation, this shall be done in a paragraph with the heading "Other Matter," or another appropriate heading. This paragraph shall appear immediately after the opinion and any Emphasis of Matter paragraph.

#### **3.2.12 Comparative information – 'Corresponding figures and comparative financial statements Comparative information' refers to amounts and disclosures included in the financial statements in respect of one or more prior periods. The auditor shall evaluate whether:**

- a) the comparative information agrees with the amounts and other disclosures that were presented in the prior period or, where appropriate, have been restated; and
- b) the accounting policies reflected in the comparative information are consistent with those applied in the current period or, if there have been changes in accounting policies, whether those changes have been properly accounted for and adequately presented and disclosed.

If the auditor becomes aware, during the current period, of a possible material misstatement in the comparative information, the auditor shall perform such additional audit procedures as are necessary in the circumstances to obtain sufficient and appropriate audit evidence as to whether a material misstatement exists.

### **3.2.13 Special Considerations – Audits of financial statements prepared in accordance with Special-Purpose Frameworks**

**The auditor is required to determine the acceptability of the financial reporting framework that was applied when preparing the financial statements. In an audit of special-purpose financial statements, the auditor shall obtain an understanding of:**

- a) the purpose for which the financial statements are prepared;**
- b) the intended users; and**
- c) the steps taken by management to determine that the applicable financial reporting framework is acceptable in the circumstances.**

In planning and performing an audit of special-purpose financial statements, the auditor shall determine whether the circumstances of the engagement require special consideration to be given to application of these standards. When forming an opinion and reporting on special-purpose financial statements, the auditor shall comply with the same requirements as for general-purpose financial statements. The auditor's report on special-purpose financial statements shall:

- (i) describe the purpose for which the financial statements have been prepared; and
- (ii) make reference to the management's responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances where the management has a choice of frameworks to use in preparing the financial statements.

The auditor shall include an Emphasis of Matter paragraph alerting users to the fact that the financial statements have been prepared in accordance with a special-purpose framework and that, as a result, they may not be suitable for another purpose.

### **3.2.14 Special Considerations – Audits of single financial statements and specific elements, accounts or items of a financial statement**

**In the case of an audit of a single financial statement, or of a specific element of a financial statement, the auditor shall first determine whether the audit is practicable. These standards also apply to audits of a single financial statement, or of a specific element of a financial statement, irrespective of whether the auditor is also engaged to audit the entity's complete set of financial statements.**

The auditor shall consider whether the expected form of opinion is appropriate in the circumstances of the engagement, and shall adapt the reporting requirements as necessary. If the auditor is engaged to report on a single financial statement, or on a specific element of a financial statement, in conjunction with an engagement to audit the entity's complete set of financial statements, the auditor shall express a separate opinion for each engagement.



If the opinion in the auditor's report on an entity's complete financial statements is modified, or the report includes an Emphasis of Matter paragraph or Other Matter paragraph, the auditor shall determine the effect this may have on the auditor's report on a single financial statement or a specific element of a financial statement. Where appropriate, the auditor shall modify the auditor's report on the single financial statement or specific element of a financial statement.

### 3.2.15 **Considerations relevant to audits of Consolidated Financial Statements (including Whole of Public Sector Financial Statements)**

**While auditing the group financial statements, auditors shall obtain sufficient and appropriate audit evidence regarding the financial information of all components and the consolidation process to express an opinion as to whether the Consolidated Financial Statements (including whole-of-public sector financial statements) are prepared, in all material respects, in accordance with the applicable financial reporting framework.**

In situations where the audit is of consolidated financial statements, such as whole-of-public sector accounts, specific requirements and considerations may apply. The auditor carrying out an audit of consolidated financial statements is referred to as the principal auditor. The principal auditor shall establish a consolidated audit strategy and develop a consolidated audit plan. The principles for understanding the entity shall include an understanding of the group, its components and their environments, including group-wide controls, as well as the consolidation process. The understanding thus obtained shall be sufficient to confirm or revise the initial identification of components that are likely to be significant for the consolidated financial statements, and to assess the risks of material misstatement, whether due to fraud or error, of the consolidated financial statements.

## **3.3 Performance Audit**

3.3.1 Performance audit is an independent, objective and reliable examination of whether public sector undertakings, systems, operations, programmes, activities or organizations are operating in accordance with the principles of economy, efficiency and effectiveness. **The main objective of performance audit is to constructively promote economical, effective and efficient governance. It also contributes to accountability and transparency.** Performance audit promotes accountability by assisting those charged with governance and oversight responsibilities to improve performance through an examination of whether:

- a) decisions by the legislature or the executive are efficiently and effectively prepared and implemented and
- b) tax payers or citizens have received value for money.

It does not question the intentions and decisions of the legislature, but examines whether any shortcomings in the implementation of the law and framing of regulations have prevented the specified objectives from being achieved. Performance audit focuses on areas in which it can add value for citizens and which have the greatest potential for improvement. It provides constructive incentives for the responsible parties to take appropriate action.

Performance audit promotes transparency by affording all stakeholders an insight into the management and outcomes of different public sector activities. It thereby directly contributes to providing useful information to the citizen, while also serving as a basis for learning and improvements.

### 3.3.2 Perspective of Performance Audit

Performance audits undertaken by SAI, India may have overlaps with other audit types (or combined audits) and in such circumstances the following points shall be considered:

- a) Elements of performance audit can be part of a more extensive audit that also covers compliance and financial auditing aspects.
- b) In the event of an overlap, the primary objective of the audit shall guide the auditors as to which standards to apply.

In determining whether performance considerations form the primary objective of the audit engagement, it should be borne in mind that performance auditing focuses on activity and results rather than reports or accounts, and that its main objective is to promote economy, efficiency and effectiveness rather than report on compliance.

### 3.3.3 Type of Engagement and Assurance

Performance audits are essentially direct reporting engagements where the auditor measures or evaluates the subject matter against the criteria. Performance audits are not normally expected to provide an overall opinion, comparable to the opinion on financial statements, on the audited entity's achievement of economy, efficiency and effectiveness. The degree of economy, efficiency and effectiveness achieved may be conveyed in the performance audit report in different ways:

- a) either through an overall view on aspects of economy, efficiency and effectiveness, where the audit objective, the subject matter, the evidence obtained and the findings reached allow for such a conclusion;
- b) or by providing specific information on a range of points including the audit objective, the questions asked, the evidence obtained, the criteria used, the findings reached and the specific conclusions.

Performance audits are designed to provide a reasonable assurance with a set of conclusions and, if applicable, a single overall conclusion and to present a balanced report by taking into account all relevant viewpoints.

### 3.3.4 Audit Risk

**Auditors shall actively manage audit risk, which is the risk of obtaining incorrect or incomplete conclusions, providing unbalanced information or failing to add value for users.**

Many topics in performance auditing are complex and sensitive. The risk that an audit will fail to add value ranges from the likelihood of not being able to provide new information or perspectives to the risk of neglecting important factors and consequently not being able to provide users of the audit report with knowledge or recommendations that would make a real contribution to better performance. Important aspects of risk may include not possessing

the competence to conduct sufficiently broad or deep analysis, lacking access to quality information, obtaining inaccurate information (e.g. because of fraud or irregular practices), being unable to put all findings in perspective, and failing to collect or address the most relevant arguments. Auditors shall therefore actively manage risk. Dealing with audit risk is embedded in the whole process and methodology of performance audit.

### 3.3.5 Selection of topics

**Auditors shall select audit topics through the strategic planning process by analysing potential topics and conducting research to identify risks and problems.**

Determining which audits will be pursued is usually part of SAI India's strategic planning process. If appropriate, auditors shall contribute to this process in their respective fields of expertise. They may share knowledge from previous audits, and information from the strategic planning process may be relevant for the auditor's subsequent work. In this process, auditors shall consider that audit topics are sufficiently significant as well as auditable and in keeping with SAI India's mandate. The topic selection process shall aim to maximise the expected impact of the audit while taking account of audit capacities (e.g. human resources and professional skills). Formal techniques to prepare the strategic planning process, such as risk analysis or problem assessments, can help structure the process but need to be complemented by professional judgement to avoid one-sided assessments. Performance auditing generally requires that audit-specific, substantive and methodological knowledge be acquired before the audit is launched ("pre-study/ pilot study").

### 3.3.6 Audit design

**Auditors shall plan the audit in a manner that contributes to a high-quality audit that will be carried out in an economical, efficient, effective and timely manner and in accordance with the principles of good project management.**

In planning an audit, it is important to consider:

- a) the background knowledge and information required for an understanding of the audited entities so as to allow an assessment of the problem and risk, possible sources of evidence, auditability and the significance of the area considered for audit, consultation with stakeholders, if necessary, including domain specialists or experts in the field to build up proper knowledge
- b) the audit objectives, questions, criteria, subject matter and methodology (including techniques to be used for gathering evidence and conducting the audit analysis);
- c) the necessary activities, staffing and skills requirements (including the independence of the audit team, human resources and possible external expertise), the key project timeframes and milestones and the main points for control.

The planning phase shall also involve research work aimed at building knowledge, testing various audit designs and checking whether the necessary data are available. This may involve combining and comparing data from different sources, drawing preliminary conclusions and

compiling findings in order to build hypotheses that can be tested, if necessary, against additional data. This makes it easier to choose the most appropriate audit method. Technology and data analytics may be optimally utilised to facilitate this process.

### 3.3.7 Audit approach

**Auditors shall choose a result, problem or system-oriented approach, or a combination thereof, to facilitate the soundness of audit design.**

It determines the nature of the examination to be made and defines the necessary knowledge, information, data and the audit procedures needed to obtain and analyse them. Performance auditing generally follows one of three approaches:

- a) a system-oriented approach, which examines the proper functioning of management systems, e.g. financial management systems;
- b) a result-oriented approach, which assesses whether outcome or output objectives have been achieved as intended or programmes and services are operating as intended;
- c) a problem-oriented approach, which examines, verifies and analyses the causes of particular problems or deviations from criteria.

All three approaches can be pursued from a top-down or bottom-up perspective. Top-down audits concentrate mainly on the requirements, intentions, objectives and expectations of the legislature and central public sector. A bottom-up perspective focuses on problems of significance to people and the community.

### 3.3.8 Audit procedures

**When planning the audit, the auditor shall design the audit procedures to be used for gathering sufficient and appropriate audit evidence.**

The methods chosen shall be those which best allow evidence to be gathered in an efficient and effective manner. This can be approached in several stages:

- a) deciding on the overall audit design (which questions to ask, e.g. explanatory /descriptive/evaluative);
- b) determining the level of observation (e.g. looking at a process or individual files) and methodology (e.g. full analysis or sample);
- c) specific data-collection techniques (e.g. analysis of records, questionnaire, interview or focus group). Data-collection methods and sampling techniques shall be carefully chosen.

While the auditors shall aim to adopt best practices, practical considerations such as the availability of data may restrict the choice of methods. It is therefore advisable that planning be flexible and pragmatic. For this reason, performance audit procedures shall not be overly standardised. Excessive prescriptiveness may hamper the flexibility, professional judgement and high levels of analytical skills that are required in a performance audit. In certain cases – where, for example, the audit requires data to be gathered in many different regions or areas

or the audit is to be conducted by a large number of auditors – there may be a need for a more detailed audit plan in which audit questions and procedures are explicitly defined.

When planning an audit, auditors shall also assess the risk of fraud. If this is significant within the context of the audit objectives, the auditors shall obtain an understanding of the relevant internal control systems and examine whether there are signs of irregularities that hamper performance. The overall aim at the planning stage is to decide, by building up knowledge and considering a variety of strategies, how best to conduct the audit.

Auditors shall establish suitable criteria which correspond to the audit questions and are related to the principles of economy, efficiency and effectiveness. Diverse sources can be used to identify criteria, including performance measurement frameworks. The criteria shall be discussed with the auditable entities, but it is ultimately the auditor's responsibility to select suitable criteria. While defining and communicating suitable criteria during the planning phase may enhance their reliability and general acceptance, in audits covering complex issues it is not always possible to set criteria in advance and instead they will be defined during the audit process.

### 3.3.9 Quality Control

**Auditors shall apply procedures to safeguard quality, ensuring that the applicable requirements are met and placing emphasis on appropriate, balanced and fair reports that add value and answer the audit questions.**

In the conduct of performance audits the following specific issues need to be addressed:

- a) Performance audit is a process in which the audit team gathers a large amount of audit-specific information and exercises a high degree of professional judgement and discretion concerning the relevant issues. This must be taken into account in quality control. The need to establish a working atmosphere of mutual trust and responsibility and provide support for audit teams shall be seen as part of quality management.
- b) In performance auditing, even if the report is evidence-based, well-documented and accurate, it might still be inappropriate or insufficient if it fails to give a balanced and unbiased view, includes too few relevant viewpoints or unsatisfactorily addresses the audit questions. These considerations shall therefore be an essential part of measures to safeguard quality.
- c) As audit objectives vary widely between different audit engagements, it is important to define clearly what constitutes a high-quality report in the specific context of an audit engagement. General quality control measures shall therefore be complemented by audit-specific measures.

No quality control procedures at the level of the individual audit can guarantee high-quality performance audit reports. It is equally important for auditors to be – and remain – competent, motivated and willing to innovate. Control mechanisms shall therefore be complemented by support, such as on-the-job training and guidance for the audit team.

### 3.3.10 Reporting

**Auditors shall strive to provide audit reports which are comprehensive, convincing, timely, reader-friendly and balanced.**

To be comprehensive, the report shall include information about the audit objective, audit questions and answers to those questions, the subject matter, criteria, methodology, sources of data, any limitations to the data used, and audit findings. The audit findings shall be put into perspective. It shall clearly answer the audit questions or explain why this was not possible. To be convincing, it shall be logically structured and present a clear relationship between the audit objective, criteria, findings, conclusions and recommendations. All relevant arguments shall be addressed. The report shall explain why and how problems observed in the findings hamper performance in order to encourage the audited entity or the user to initiate corrective action. It shall, where appropriate, include recommendations for improvements to performance. The report shall be as clear and concise as the subject matter permits and phrased in unambiguous language. As a whole it shall be constructive, contribute to better knowledge and highlight any necessary improvements.

Being balanced means that preparation of the report needs to be impartial in content and tone. In preparing a balanced and constructive report the auditors shall strive to present (i) findings objectively and fairly. The facts shall be presented and interpreted in neutral terms, avoiding biased information or language that can generate defensiveness and opposition (ii) different perspectives and viewpoints. Where different interpretations of the evidence can legitimately be made, they need to be presented to ensure fairness and balance and (iii) both positive and negative aspects and give credit where it is due.

### 3.3.11 Recommendations

**Auditors shall seek to provide constructive recommendations that are likely to contribute significantly to addressing the weaknesses or problems identified by the audit.** Recommendations shall be well-founded and add value. They shall address the causes of problems and/or weaknesses. However, they shall be phrased in such a way that avoids truisms or simply inverting the audit conclusions and they shall not encroach on the management's responsibilities.

It shall be clear who and what is addressed by each recommendation, who is responsible for taking any initiative and what the recommendations mean – i.e. how they will contribute to better performance. Recommendations shall be practical and be addressed to the entities which have responsibility and competence for implementing them. Recommendations shall be presented in a logical and reasoned fashion. They shall be linked to the audit objectives, findings and conclusions. Together with the full text of the report, they shall convince the reader that they are likely to significantly improve the conduct of public sector operations and programmes, e.g. by lowering costs, simplifying administration, enhancing the quality and volume of services, or improving effectiveness, impact or the benefits to society.

### 3.3.12 Follow-up

**Auditors shall follow up previous audit findings and recommendations wherever appropriate. Follow-up shall be reported appropriately in order to provide feedback to the legislature together, if possible, with the conclusions and impacts of all relevant corrective action.**

Follow-up refers to the auditors' examination of corrective action taken by the audited entity, or another responsible party, on the basis of the results of a performance audit. It is an independent activity that increases the value of the audit process by strengthening the impact of the audit and laying the basis for improvements to future audit work. Follow-up is not restricted to the implementation of recommendations but focuses on whether the audited entity has adequately addressed the problems and remedied the underlying situation after a reasonable period of time.

When conducting follow-up of an audit report, the auditor shall concentrate on findings and recommendations that are still relevant at the time of the follow-up and adopt an unbiased and independent approach. Follow-up results may be reported individually or as a consolidated report, which may in turn include an analysis of different audits, possibly highlighting common trends and themes across a number of reporting areas.

## 3.4 Compliance Audit

3.4.1 Compliance audit is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. Compliance audits are carried out by assessing whether activities, financial transactions and information comply in all material respects, with the authorities which govern the audited entity. Compliance auditing may be concerned with

- a) Regularity - adherence of the subject matter to the formal criteria emanating from relevant laws, regulations and agreements applicable to the entity
- b) Propriety - observance of the general principles governing sound financial management and the ethical conduct of public officials

While regularity is the main focus of compliance auditing, propriety is equally pertinent in the public-sector context, in which there are certain expectations concerning financial management and the conduct of officials.

### 3.4.2 Objectives of Compliance Audit

Compliance audit promotes transparency by providing reliable reports as to whether funds have been administered, management exercised and citizens' rights to due process honoured as required by the applicable authorities. It promotes accountability by reporting deviations from and violations of authorities, so that corrective action may be taken and those accountable may be held responsible for their actions. It promotes good governance both by identifying weaknesses and deviations from laws and regulations and by assessing propriety where there are insufficient or inadequate laws and regulations. Fraud and corruption are, by

their very nature, elements which counteract transparency, accountability and good stewardship. Compliance audit therefore also considers the risk of fraud in relation to compliance.

The objective of compliance auditing, therefore, is to enable assessment of whether the activities of auditable entities are in accordance with the authorities governing those entities in order to express a conclusion designed to enhance the degree of confidence of the intended users.

### **3.4.3 Perspectives of Compliance Audit**

Compliance audit can be part of a combined audit that may also include other aspects. Though other possibilities exist, compliance auditing is generally conducted either:

- in relation with the audit of financial statements, or
- separately as individual compliance audits, or
- in combination with performance auditing

#### **3.4.3.1 Compliance Audit in relation with the audit of Financial Statements**

The legislature, as an element of public democratic process, establishes the priorities for public-sector income and expenditure and for the calculation and attribution of expenditure and income. The underlying premises of legislative bodies, and the decisions they take are the source of the authorities governing cash flow in the public sector. Compliance with those authorities constitutes a broader perspective alongside the audit of financial statements in budgetary execution.

Laws and regulations are important both in compliance auditing and in the audit of financial statements. Which laws and regulations apply in each field will depend on the audit objectives. Compliance audit focusses on obtaining sufficient and appropriate evidence regarding compliance of a given subject matter with applicable authorities identified as criteria. Whereas, in the audit of financial statements, only those laws and regulations with a direct and material effect on the financial statement are relevant, in compliance auditing any law and regulation relevant to the subject matter may be relevant for audit.

#### **3.4.3.2 Compliance Audit conducted separately**

Compliance audits may be planned, performed and reported on separately from the audit of financial statements and from performance audits. Such audits may be conducted separately on a regular basis, as distinct and clearly-defined audits each related to a specific subject matter.

#### **3.4.3.3 Compliance Audit in combination with Performance Auditing**

When compliance audit is part of a performance audit, compliance is seen as one of the aspects of economy, efficiency and effectiveness. Non-compliance may be the cause of, an explanation for, or a consequence of the state of the activities that are the subject of performance audit. In combined audits of this kind, auditors shall use their professional judgement to decide whether performance or compliance is the primary focus of the audit and whether to apply the performance audit standards, compliance audit standards or both.



#### 3.4.4 **Type of Engagement in Compliance Audit**

Compliance audits can be conducted as direct reporting engagements or attestation engagements. An auditor performs procedures to reduce or manage the risk of providing incorrect conclusions, recognising that, owing to the inherent limitations in all audits, no audit can ever provide absolute assurance of the condition of the subject matter. 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. Compliance auditing enhances the confidence of the intended users in the information provided by the auditor or another party.

#### 3.4.5 **Audit Risk**

**Consideration of audit risk is relevant in both attestation and direct engagements.**

The auditor shall consider three different dimensions of audit risk – inherent risk, control risk and detection risk – in relation to the subject matter and the reporting format, i.e. whether the subject matter is quantitative or qualitative and whether the audit report is to include an opinion or a conclusion. The relative significance of these dimensions of audit risk depends on the nature of the subject matter and whether it is a direct reporting or an attestation engagement.

#### 3.4.6 **Materiality**

**Materiality in compliance auditing has both quantitative and qualitative aspects, although the qualitative aspects generally play a greater role in the public sector.**

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

#### 3.4.7 **Risk assessment**

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

#### 3.4.8 Risk of fraud, abuse and non-compliance

**Auditors shall consider the risk of fraud, abuse and non-compliance. If the auditor comes across instances of non-compliance which may be indicative of fraud, the auditor shall exercise due professional care and caution so as not to interfere with any future legal proceedings or investigations.**

Fraud in compliance auditing relates mainly to the abuse of public authority, but also to fraudulent reporting on compliance issues. Abuse occurs when the conduct of the entity, program, activity or function falls far short of societal expectations for prudent behaviour. Non-compliance comprises violation of laws, rules and regulations, provisions of contracts and other agreements. Instances of non-compliance with authorities may constitute deliberate misuse of public authority for improper benefit. The execution of public authority includes decisions, non-decisions, preparatory work, advice, information handling and other acts in the public service. Improper benefits are advantages of a non-economic or economic nature gained by an intentional act by one or more individuals among management, those charged with governance, employees or third parties. While detecting fraud is not the main objective of compliance audit, auditors shall include fraud risk factors in their risk assessments and remain alert to indications of fraud.

#### 3.4.9 Reporting

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

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

Reporting may vary between various forms of conclusions, presented in short or long form. However, the report shall be complete, accurate, objective, convincing and as clear and concise as the subject matter permits. The conclusion may take the form of a clear written statement on compliance or may be expressed as a more elaborate answer to specific audit questions. While a conclusion is common in attestation engagements, the answering of specific audit questions is more often used in direct reporting engagements.

#### 3.4.10 Follow-up

**Auditors shall follow up instances of non-compliance when appropriate.**

A follow-up process facilitates the effective implementation of corrective action and provides useful feedback to the audited entity, the users of the audit report and the auditor (for future audit planning). The need to follow up previously reported instances of non-compliance will vary with the nature of the subject matter, the non-compliance identified and the particular circumstances of the audit.