



COMPLIANCE AUDIT in the public sector

INFORMATION PAPER

What does compliance mean for governments?

Governments uphold the rule of law and seek to ensure that all citizens and organisations are subject to the law. A key part of government is the maintenance of an extended framework of laws and regulations, together with the means to enforce compliance with those laws and regulations. The requirement to comply applies not only to individuals and corporations, but also to governments and public sector organisations, and this is an important element of public sector governance.

Assurance on compliance with laws and regulations is generally considered to be a vital dimension of the accountability of government¹. In many countries, the audit of compliance with the aspects of legality and regularity is a legal requirement for the public sector, and even in countries where these have no legal requirement there may be a longstanding tradition of compliance audit by Supreme Audit Institutions (SAIs).

What is compliance audit²?

According to the International Organisation of Supreme Audit Institutions (INTOSAI), compliance audit comprises the assessment 'whether the activities of public sector entities are in accordance with the relevant laws, regulations and authorities that govern such entities'³. It will often encompass a wide range of categories of authorisation (or 'authorities'), including budgetary resolutions, ministerial directives, government policy requirements, established codes, or agreed-upon terms (such as the terms of a contract or the terms of a funding agreement).

The key concepts in compliance audit are:

- **Regularity:** activities, transactions and information pertaining to an audited entity should be in accordance with government authorisation through law, regulation and wider authorities.
- **Propriety:** public sector financial management and the conduct of public sector officials should be in accordance with the intentions and reasonable expectations of elected governments and the citizens who they serve.

Compliance needs to be checked against specified criteria. The criteria may include:

- Formal requirements, such as laws or regulations, ministerial directives or agreed-upon terms; or
- Less formal authorities, such as a code of conduct, principles of propriety or expected behaviours.

Why is compliance audit important?

Compliance with authorities is an essential element of public sector governance. Auditor reporting on compliance helps make public sector organisations accountable to government, taxpayers and the public at large; it may also provide accountability for funds granted to entities which are outside of, or which operate in partnership with the public sector.

In many countries, the auditor role is key for the accountability and transparency of government and public sector organisations. Private sector accountancy firms are becoming increasingly involved in this area.

How is compliance audit performed?

The objectives of compliance audit must be tailored to specific circumstances, but its core activity is to obtain assurance on whether authorities comply with benchmarks represented by specified criteria. In general, this involves:

- Planning and designing the audit work;
- Performing the audit: gathering sufficient appropriate evidence using methods such as substantive testing, analytical procedures and system testing;
- Evaluating and concluding: exercising judgment to conclude whether the particular information is in compliance with the relevant criteria; and
- Reporting material findings and conclusions to legislative and/or other bodies.

While the above apply to all compliance audits, scope, implementation and practice can vary substantially across jurisdictions. The nature of compliance audit is significantly affected by whether the service is carried out as a standalone activity or in combination with other audit work. In some countries, compliance audit is performed together with the audit of financial statements while in others it is more usually performed as a standalone engagement.

Three different parties are relevant to conduct a compliance audit: the intended user, the responsible party and the auditor.

As summarised in the table below, the objective and focus of compliance audit are different from the ones of an audit of financial statements.

Compliance audit covers compliance of the public entity with relevant laws and regulations, but can also cover specific instances of non-compliance in areas related to:

- The operating effectiveness of controls over compliance with laws and regulations;
- The investigation of suspected misconduct, illegal acts, fraud or corruption; or
- The assessment of the truth and completeness of information submitted to supervisory bodies.

	FINANCIAL STATEMENT AUDIT	COMPLIANCE AUDIT
OBJECTIVE:	Express an opinion on the financial statements	Express an opinion or otherwise provide assurance on adherence to authorities and proper conduct of public business
AUDIT APPROACH:	Highly standardised	Tailored to the auditor's legal mandate and to expectations of government and civil society
FOCUS ON:	Historical financial information, applying a risk-based audit approach	Relevant laws and regulations, codes of conduct, internal policies, and public expectations

Compliance audits may be structured in a variety of ways. They may be direct engagements or attestation engagements⁴. They may be reasonable assurance engagements, limited assurance engagements, agreed-upon-procedure engagements⁵, or they may be less formally structured.

Auditor reporting, either framed in an attestation or a direct audit engagement, may therefore take different forms such as:

- A separate compliance audit report;
- An audit opinion on compliance, which may be separate or embedded in the financial audit report;
- An audit opinion on compliance of certain transactions; or
- A report on instances of non-compliance.

In some jurisdictions, as part of the financial statements, the board or management of the audited entity has to issue an annual report on compliance, on which the auditor provides assurance or carries out other agreed procedures.

Which skills are needed for compliance audit?

Although compliance audit is different from an audit of financial statements, there are considerable similarities. Qualified auditors and many professional accountants already possess key skills and other characteristics that can be utilised in this area:

- They are experienced in assurance activities which evaluate a subject matter against a benchmark;
- They are trained in exercising professional judgment and professional behaviour in general; and
- Through membership of their professional accountancy organisations, they are committed to ethical behaviour, applying the fundamental principles of professional competence and due care, professional behaviour, integrity, objectivity and confidentiality as established by the IESBA Code of Ethics⁶.

Compliance auditors should also possess additional skills and knowledge, such as:

- Appropriate analytical skills;
- Substantial knowledge of the relevant laws and regulations; and
- Strong understanding of the public policy applicable and the governance issues relating to public sector organisations and the use of public funds.

In cases where compliance audit is linked to a judicial process, there may be a need to engage experts in public administration law or to work closely with public legal representatives.

In which countries is compliance audit carried out?

In all EU countries, auditor reporting on compliance is a key part of the accountability and transparency of government and public sector organisations. However, there are substantial differences in scope and outlook, depending on other elements of public sector governance, and differing cultural and political expectations of auditors. In some countries, the work is more often performed by supreme audit institutions and regional audit institutions. Other countries make substantially more use of private sector accountancy firms.

A key factor affecting the nature of the audit work is whether public sector audit is constituted as a judicial function, which is the case in Belgium, France, Greece, Italy, Portugal and Spain. In that case, the auditor compliance work may contribute to judicial outcome through court process. Another key factor is whether compliance audit is carried out separately or combined with an audit of financial statements, which is generally the case in Czech Republic, Germany, Ireland, Latvia, Lithuania, the Netherlands, Poland, Slovakia, Slovenia, Sweden and the United Kingdom, as well as at the European Court of Auditors (ECA).

¹ When referring to government, all levels of government are meant, including federal, state, regional and local government.

² 'Compliance audit' is a rather general term with several definitions used in different contexts. It can also be referred to for example as 'legality and regularity audit'. This information paper concentrates on compliance audit in public sector entities, but compliance audit may also be a legal requirement placed on non-public sector entities with regards to the application of a particular regulation. Refer to ISA 200 par A57, ISA 250 and ISAE 3000 par A8.

³ ISSAI 4000 Compliance Audit Guidelines - General Introduction (paragraph 1), available at: http://www.issai.org/media/13192/issai_4000_e_.pdf

⁴ A direct engagement will involve a measurement, an evaluation and a conclusion from the practitioner, while in an attestation engagement, the practitioner will base the audit work on a report or statement from another party.

More information in ISSAI 4000 (ED) paragraphs 27 to 29 and in ISAE 3000 paragraphs 2 and 12 (a) (ii) available at: <https://www.iaasb.org/system/files/publications/files/ISAE%203000%20Revised%20-%20for%20IAASB.pdf>

⁵ With an agreed-upon-procedure engagement, the practitioner is not required to form an opinion (it is hence not an 'assurance engagement'), but merely provides the agreed information to the recipient in a factual finding report. The recipient may use the auditor's report to form its own opinion.

More information in ISRS 4400 available at <http://www.ifac.org/system/files/downloads/b015-2010-iaasb-handbook-isrs-4400.pdf>

⁶ More information at: <http://www.ifac.org/ethics/>

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Federation of European Accountants

Avenue d'Auderghem 22-28
1040 Brussels

T: +32 (0)2 893 33 60

E: secretariat@fee.be

www.fee.be

 @FEE_brussels

 Federation of European Accountants