

INTOSAI



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*Guidance to the financial auditing standards*

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***GUID 2900***

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# Section 1 - Preamble

## Introduction

- 1.1. The INTOSAI framework of professional pronouncements derives its financial audit standards (ISSAIs) from International Standards on Auditing (ISAs). During the application of these financial auditing standards in the public sector, auditors may face the interpretation of:
- Terminology not usually found in the public sector - for example, the terms engagement partner, listed entity
  - Audit mandates sourced from legislation
  - Distinguishing a compliance engagement from a financial audit with elements of compliance with authorities
  - Reporting matters required by law or regulation
- 1.2. The ISAs are relevant to engagements in the public sector. A Supreme Audit Institution (SAI)'s responsibilities, however, may be affected by the audit mandate or by obligations on public sector entities arising from law, regulation or other authority (such as ministerial directives, government policy requirements, or resolutions of the legislature), which may encompass a broader scope than an audit of financial statements in accordance with the ISAs. The ISAs therefore declare that this broader scope of a public-sector audit may be defined through INTOSAI's professional pronouncements or by standards or guidance issued by SAIs or other national standard-setters (cf. ISA 200.A59). The ISSAIs provide requirements relevant for public-sector auditing beyond those of the ISAs through the performance audit standards (ISSAI 3000-3899) and compliance audit standards (ISSAI 4000-4899).

## Objective

- 1.3. The GUID 2900 - Guidance to the financial auditing standards aims to support SAIs and auditors in implementing and using the financial auditing standards (ISSAI 2000-2899) by providing additional guidance in relation to the definitions, objectives, requirements and explanatory and further application material contained in the standards. Within the set of financial auditing standards, a reference to ISSAI 2xxx is equal to a reference to ISA xxx (where xxx is the number of the ISA), subject only to the modifications and further application material provided in the ISSAI 2000. The GUID 2900 covers selected issues in each of the ISSAIs 2200-2899.

## Definitions

- 1.4. Definitions that are necessary to understand guidance provided are found in individual guidance sections below.

## **Scope**

- 1.5. These guidelines provide supplementary audit guidance in relation to the financial auditing standards ISSAI 2200 to 2899 and do not contain any further requirements for the conducting of the audit.

## **Section 2 - ISSAI 2200 - Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With International Standards on Auditing**

### **Content of this Section**

- 2.1. This Section provides additional guidance for auditors related to:
- (a) Considerations Specific to Smaller Entities
  - (b) An Audit of Financial Statements
  - (c) Professional Skepticism

### **Considerations Specific to Smaller Entities**

- 2.2. Some ISSAIs contain considerations specific to audits of smaller entities. In audits of public sector entities and entities that receive government awards, these considerations are usually not applicable, even if the public sector entity has few employees, simple operations, or a relatively small budget. In those situations, the public sector entity may still have complicated transactions, such as transfers from other governments, as well as a need to comply with laws, regulations, policies and systems determined by a higher level of government and a need for accountability for use of taxpayer monies. Therefore, it is advised that auditors carefully consider the relevance of such considerations. Sections may include additional guidance in this area when considered important to add guidance relevant for audits of smaller public sector entities.

## **An Audit of Financial Statements**

- 2.3. ISSAI 2200.A8 provides examples of financial statements and the content of a complete set of financial statements. A complete set of financial statements for a public sector entity may be prepared on a cash basis of accounting, on a modified accrual basis of accounting, or on a full accrual basis of accounting, and may comprise but is not limited to:
- A statement of cash receipts and cash payments (cash basis of accounting)
  - A statement of financial position;
  - A statement of financial performance;
  - A statement of changes in net assets/equity;
  - A statement of revenues and expenditures;
  - A cash flow statement;
  - A comparison of budget and actual amounts either as a separate additional financial statement or as a reconciliation; and
  - Notes comprising a summary of significant accounting policies and other explanatory information.
- 2.4. In certain environments, and depending on the applicable financial reporting framework, a complete set of financial statements may also include other reports such as reports on performance and appropriation reports.
- 2.5. Some public sector entities do not produce financial statements since the primary objective of the accounting framework of the public sector entity is to control a budget process and to produce only the financial information that is needed to effectively achieve this objective. Financial reporting is therefore not the primary objective of the accounting framework for such public sector entities. The financial audit ISSAIs are designed to audit historical financial information presented in the form of financial statements but may be adapted as necessary to audit other forms of historical financial information. For this reason, the financial audit ISSAIs may be applied to audit the historical financial information produced by such public sector entities if the auditor concludes that the accounting framework provides appropriate criteria for the audit. Appropriate criteria are a precondition for an audit and preconditions are addressed in Section 3 of this GUID.

## **Professional Skepticism**

- 2.6. ISSAI 2200.15 requires the auditor to plan and perform an audit with professional skepticism recognizing that circumstances may exist that cause the financial statements to be materially misstated. The INTOSAI Fundamental Principles of Public-Sector Auditing in ISSAI 100.37<sup>1</sup> also address professional skepticism. The concept of professional skepticism enhances and broadens the concept of due care and is fundamental for the planning and performance of the audit.

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<sup>1</sup> ISSAI 100 - Fundamental Principles of Public-Sector Auditing

## Section 3 - ISSAI 2210 - Agreeing the Terms of Audit Engagements

### Content of this Section

- 3.1. This Section provides additional guidance for auditors related to:
- (a) Definitions
  - (b) Preconditions for an Audit
  - (c) Agreement on Audit Engagement Terms
  - (d) Recurring Audits
  - (e) Acceptance of a Change in the Terms of the Audit Engagement

### Definitions

- 3.2 **Abuse** - Involves behaviour that is deficient or improper when compared with behaviour that a prudent person would consider reasonable and necessary business practice given the facts and circumstances. Abuse also includes misuse of authority or position for personal financial interests or those of an immediate or close family member or business associate. Abuse does not necessarily involve fraud, violation of laws, regulations, or provisions of a contract or grant agreement. Abuse is a departure from the concept of propriety, which relates to the general principles of sound public sector financial management and conduct of public sector officials.

### Preconditions for an Audit

- 3.3. When establishing whether necessary preconditions for an audit are present as required in ISSAI 2210.6(a), auditors consider that in the public sector the financial reporting framework may often be prescribed by law and regulation. If auditors determine that the framework prescribed by law and regulation is not acceptable, they apply the requirements of ISSAI 2210.8, 19 and 20, and also consider:
- Informing the legislature; and
  - Influencing standard setting by professional or regulatory organizations.
- 3.4. When obtaining the agreement of management and, where appropriate, the legislature and those charged with governance that they acknowledge and understand their responsibility as stated in ISSAI 2210.6(b), auditors take into account the fact that the responsibilities of management and those charged with governance in the public sector may be broader than those responsibilities in the private sector. Legislative, governance and management structures may vary widely within the public sector, thereby enhancing the need to formalize the acknowledgement and understanding of such responsibilities.

### Agreement on Audit Engagement Terms

- 3.5. The terms of an audit engagement in the public sector are normally mandated and therefore not subject to requests from, and agreement with, management. Therefore the requirements in the



ISSAI, when applied in the public sector context, are useful in establishing a common, formal understanding of the respective roles and responsibilities of management and the auditor. Since the SAI is normally engaged by and reports to the legislature, agreements often need to be reached with both the legislature and management.

3.6. In the public sector, there may be additional matters besides the examples listed in ISSAI 2210.A24-A26 that auditors have to report on during the course of the audit and that may be relevant to the engagement letter, such as:

- **Non-effective performance of operations** – relates to management’s responsibility to undertake activities in an effective and efficient manner;
- **Instances of non-compliance with authorities** – relates to management’s responsibility to undertake activities, use resources, and fulfil accountability requirements, in accordance with authority granted by the legislature and all other relevant directions;
- **Ineffectiveness of internal control** – relates to management’s responsibility for, design, implementation and operation of internal control;
- **Legal implications** – relates to the responsibilities of those SAI’s with a Judicial Role;
- **Waste** – relates to management’s responsibility to obtain and apply resources in an economical manner, without any public money being wasted; and
- **Instances of abuse** – relates to management’s responsibility to meet the expectations of the legislature and the public as they relate to appropriate standards of behavior.

It may also be advisable to describe the arrangements to protect the SAI’s independence.

3.7. The financial auditing standards (ISSAIs 2000-2899) may not be sufficient to form the basis on which audit activities referred to in paragraph 3.6 are performed. Within the ISSAIs, performance audit standards (ISSAI 3000-3899) and compliance audit standards (ISSAI 4000-4899) are aimed at audits with objectives other than the audit of historical financial information. It may be relevant to specify in the terms of the audit engagement the standards adhered to with respect to additional reporting matters.

3.8. In addition to the points listed in ISSAI 2210.A26, auditors may also consider it relevant to include any arrangements whereby the audit work is contracted out to another auditor.

3.9. In the public sector, the acceptance and continuance process referred to in ISSAI 2210.7 is influenced by the fact that SAIs may not have the option to decline or withdraw from the audit. However, in cases where management or the legislature imposes a scope limitation prior to the start of the engagement, the effect of which may result in the auditor disclaiming the opinion on the financial statements, auditors are advised to consider the situation and how it may impact the risk assessment, the audit approach and the auditor’s report. In some cases it may also be appropriate to report separately to the legislature.

3.10. ISSAI 2210.8 discusses other factors affecting audit engagements acceptance. In a situation where the preconditions for an audit are not present and when SAIs do not have the option to decline an audit engagement, an appropriate response in addition to the requirements in ISSAI 2210.19 and 20 may include informing the legislature.

3.11. ISSAI 2210.A25 recommends that it may be helpful for the auditor to make reference, in the terms of the audit engagement, to the possibility of communicating key audit matters in the auditor’s

report. Auditors may be required to or may decide to communicate key audit matters to other parties, such as the legislature, in addition to management or those charged with governance or to the judiciary when relevant legal provisions do exist.

### **Recurring Audits**

- 3.12. When considering the requirements in ISSAI 2210.13, auditors may determine that some or all of the terms of an audit engagement in the public sector are mandated by law and therefore not subject to revision.

### **Acceptance of a Change in the Terms of the Audit Engagement**

- 3.13. When considering the requirements in ISSAI 2210.14 to 17, auditors may determine that some or all of the terms of an audit engagement in the public sector are mandated by law and therefore not subject to revision.
- 3.14. An illustrative example of a public sector engagement letter is presented in **Appendix A**.

## **Section 4 - ISSAI 2220 (Revised) - Quality Control for an Audit of Financial Statements**

### **Content of this Section**

4.1. This Section provides additional guidance for auditors related to:

- (a) System of Quality Control and Role of Engagement Teams
- (b) Relevant Ethical Requirements
- (c) Requirements for Listed Entities

### **System of Quality Control and Role of Engagement Teams**

4.2. It is fundamental to understand that the ISSAI is premised on the basis that the SAI is subject to ISSAI 140<sup>1</sup> or to national requirements that are at least as demanding. As covered by ISSAI 2000<sup>2</sup>, auditors apply ISSAI 140 to meet quality control requirements. ISSAI 140 intends to serve the same objective as ISQC 1<sup>3</sup> in relation to each SAI's mandate and circumstances. Although the general purpose and key principles of ISSAI 140 are consistent with ISQC 1, the requirements of ISSAI 140 are not identical to the requirements of ISQC 1. ISSAI 140 may therefore need to be supplemented by additional requirements in ISQC 1 when the auditor includes in their report an assertion of compliance with International Standards on Auditing (ISAs) and not with the ISSAIs. Options to refer to the ISSAI framework are explained in ISSAI 100.8 to 12.<sup>4</sup>

### **Relevant Ethical Requirements**

4.3. As covered by ISSAI 2000, auditors apply ISSAI 130, the INTOSAI Code of Ethics<sup>5</sup>. The INTOSAI Code of Ethics may need to be supplemented by additional requirements in the IESBA Code or national requirements that are more restrictive when the auditor includes in their report an assertion of compliance with International Standards on Auditing (ISAs) and not with the ISSAIs. Options to refer to the ISSAI framework are explained in ISSAI 100.8 to 12.<sup>6</sup>

### **Requirements for Listed Entities**

4.4. The ISSAIs have specific performance and reporting requirements for audits of listed entities. Listed entities are less common in the public sector. However, in applying the definition of listed entities which is provided in the ISSAIs, an auditor may conclude they are auditing a listed entity as the definition considers both shares and debt. As noted in Section 31 of this GUID, a SAI may have

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<sup>1</sup> ISSAI 140 - Quality Control for SAIs

<sup>2</sup> ISSAI 2000 - Application of the financial audit standards

<sup>3</sup> International Standards for Quality Control 1 - Quality Control for Firms that Perform Audits and Reviews of Financial Statements, and Other Assurance and Related Services Engagements

<sup>4</sup> ISSAI 100 - Fundamental Principles of Public-Sector Auditing

<sup>5</sup> ISSAI 130 - Code of Ethics

<sup>6</sup> ISSAI 100 - Fundamental Principles of Public-Sector Auditing

developed additional internal policies or guidance on the application of listed entity definitions, performance, and reporting requirements.

## **Section 5 - ISSAI 2230 - Audit Documentation**

### **Content of this Section**

- 5.1. This Section provides additional guidance for auditors related to:
- (a) Assembly of the Final Audit File
  - (b) Confidentiality and Transparency Issues
  - (c) Specific Considerations Regarding Documentation for SAIs with a Judicial Role

### **Assembly of the Final Audit File**

- 5.2. In the public sector, the finalization process leading up to the date of the auditor's report may be lengthy. However, this does not preclude assembly of the final audit file on a timely basis.
- 5.3. In the public sector, there may be requirements to retain audit documentation for periods shorter or longer than required for the private sector. These requirements may be due to the historical significance of certain types of documents which, for example, may require indefinite retention in the country's national archives. There may also be additional requirements related to national security classifications, including how documentation is stored. Auditors are advised to familiarize themselves with applicable legislation in regard to the retention and storage of documentation.

### **Confidentiality and Transparency Issues**

- 5.4. A fundamental difference between the private and public sector is that there may be specific legislative requirements in the public sector related to confidentiality on the one hand, and access by third parties on the other hand. There is an ongoing need in the public sector to balance confidentiality with the need for transparency and accountability.
- 5.5. The balance between confidentiality and transparency requires professional judgment to ensure that documentation of a confidential nature is clearly identified and treated as such, while at the same time granting access as appropriate. It is therefore important to be familiar with the SAI's policies and procedures addressing confidentiality. Such procedures might include types of audit documentation to be considered confidential, types of audit documentation to be made available to the public, clearly defined lines of responsibility for authorizing disclosure of audit documentation and routines for making such information available if required.
- 5.6. Furthermore, SAIs may have additional statutory responsibilities related to confidentiality. These responsibilities may be based on the mandate of the particular SAI, or legislation related to official secrets or privacy. Such legislation, for example, could relate to audits of defence, health, social service or tax agencies. Auditors are advised to familiarize themselves with the particular national requirements related to confidentiality to which they are bound.

- 5.7. It is good practice for auditors to also familiarize themselves with any legislation that grants public access to audit correspondence, for example where electronic or other post journals are open to public scrutiny. This type of correspondence may include letters to and from the audited entity, or other parties, related to the gathering of audit evidence, as well as considerations and judgments related to audit issues.
- 5.8. It is not unusual in the public sector to have to respond to requests from outside parties to obtain access to audit documentation. This can be especially sensitive when the outside party attempts to obtain information indirectly from the audit organization that it is unable to obtain directly from the audited entity.
- 5.9. As a matter of principle, when the audited entity has a statutory obligation to gather and retain certain information, requests from outside parties for such information are normally referred to the audited entity.
- 5.10. In situations where auditors consider granting access to audit documentation, they normally consult with relevant parties (such as the audited entity to whom the request relates) prior to the information being disclosed. In such cases the auditor ensures that those with access adhere to at least the same level of confidentiality as the auditor.
- 5.11. In some environments, public sector audit work is contracted out by the SAI to other auditors. The acceptance of such appointments normally requires the auditor performing the work to acknowledge that audit documentation may be subject to inspection by the auditor that appointed the other auditor. The audit documentation may also be subject to inspection by review agencies that have statutory rights of access to information relevant to the auditor's duties.

### **Specific Considerations Regarding Documentation for SAIs with a Judicial Role**

- 5.12. In some public sector environments, such as in a Court of Accounts environment, auditors may be required to comply with rules of evidence imposed by laws and regulations that could impact documentation requirements. Auditors operating in such environments familiarize themselves with the relevant laws and regulations and with the policies and procedures describing the additional documentation requirements. Auditors working in such environments are advised to consider the following matters which may affect documentation requirements:
- Legislation imposing additional audit documentation requirements;
  - The scope of such requirements (i.e. are they to be imposed on every document from the audit assignment or on specific documents relating to certain audit issues);
  - Additional processing, formalities or requirements to which audit documents are subject;
  - The purpose of each additional requirement with respect to the due process of law; and
  - Any further impairment that may be placed upon audit documentation due to the specific ways it has been collected and/or produced.
- 5.13. For SAIs with a judicial role, such as a Court of Accounts, documentation forms part of the basis of the official ruling. In such an environment, due process of law may establish specific and strict requirements to be adhered to in regard to confidentiality of documentation in connection with the

proceedings of a case. Additionally, as decisions may result in a legally binding public credit, there may be additional documentation retention requirements to which auditors adhere.

- 5.14. Auditors operating in such environments are advised to familiarize themselves with relevant laws and regulations in this respect and, if applicable, to follow stricter rules of evidence when potential irregularities or instances of misconduct are identified. This is done to meet the requirements for proceeding with a formal judgment, to provide evidence to the judicial department of the Court of Accounts and to cooperate with the judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.

## Section 6 - ISSAI 2240 - The Auditor's Responsibilities Relating to Fraud in an Audit of Financial Statements

### Content of this Section

- 6.1. This Section provides additional guidance for auditors related to:
- (a) Characteristics of Fraud
  - (b) Professional Skepticism
  - (c) Discussion Among the Engagement Team
  - (d) Risk Assessment Procedures and Related Activities
  - (e) Identification and Assessment of the Risks of Material Misstatement Due to Fraud
  - (f) Responses to the Assessed Risks of Material Misstatement Due to Fraud
  - (g) Auditor Unable to Continue the Engagement
  - (h) Communications to Management and with Those Charged with Governance
  - (i) Communications to Regulatory and Enforcement Authorities

### Characteristics of Fraud

- 6.2. ISSAI 2240.2 and 3 deal with the characteristics of fraud. Three conditions are normally present when fraud occurs. These conditions are often present in various ways in the public sector. These include:
- **Incentive or pressure** (placed on or perceived by management or employees giving them a reason to commit fraud) – public sector employees are often under pressure to deliver high quality services with few resources and to meet budget expectations. This may be especially relevant in difficult economic conditions where there is pressure to maintain user charges and tax rates, resulting in incentives to overstate revenues and understate expenditures. There may also exist incentives to spend the available budget by the end of the financial year;
  - **Opportunity** (characteristics or circumstances related to an entity allowing for the perpetration of fraud) – a difficult recruitment environment or a lack of sufficient qualified personnel may be more prevalent in the public sector. Such situations may often result in deficiencies in internal control creating the opportunity for fraud. Improper segregation of duties or collusion with outside parties can also create opportunities for fraud, in particular for individuals involved in public sector procurement. The widespread use of high volume, low value cash transactions in certain public sector entities such as cash transactions at police departments or health clinics may add to those risks. Although monetary values may be small, such situations may lead to violation of public trust, expectations and accountability; and
  - **Rationalization or attitude** (behaviour, character or ethical values that allow individuals to justify their reasons for committing fraud) - generally lower salary levels in the public sector compared to the private sector may lead employees to believe that they can justify misuse of funds. As above, this may violate principles of public trust, expectations and accountability.



## **Professional Skepticism**

- 6.3. The auditor's responsibility to maintain an attitude of professional skepticism throughout the audit, as provided for in the ISSAI, is addressed by ISSAI 100<sup>1</sup> and ISSAI 2200.
- 6.4. In the public sector, threats to maintaining an attitude of professional skepticism throughout the audit, as described in ISSAI 2240.13 to 15, may exist and include:
- The nature of personal or professional relationships as a result of the political process/environment;
  - The public sector audit organization's exclusive mandate, resulting in the lack of audit competitors; and
  - In some environments, the lack of requirements to rotate auditors regularly.
- 6.5. Therefore auditors take appropriate action to reduce such threats when they exist. Such actions may include introducing safeguards as addressed in Section 4 - ISSAI 2220.

## **Discussion Among the Engagement Team**

- 6.6. In the public sector, the discussion may also cover the additional objectives and related risks of material misstatement, as discussed in GUID 2900 Section 1 - Preamble. Auditors may include auditors engaged in other audit activities of the entity in such a discussion.

## **Risk Assessment Procedures and Related Activities**

- 6.7. When considering the requirement in ISSAI 2240.18(c), auditors may also inquire as to management's communication with other government bodies as appropriate.
- 6.8. When considering the requirements to make inquiries of those charged with governance as stated in ISSAI 2240.21, auditors may also include responsible officials of, for example, a ministry or members of relevant legislative committees.
- 6.9. According to ISSAI 2240.23, the auditor shall evaluate whether unusual or unexpected relationships that have been identified in performing analytical procedures, including those related to revenue accounts, may indicate risks of material misstatement due to fraud. In the public sector, in addition to revenue accounts, there may be other areas of significance for the purposes of performing analytical procedures depending on the nature of the operations of the entity. In many public sector entities, areas such as procurement and grants may be more relevant than revenue accounts for such purposes. When performing analytical procedures, auditors may consider the challenges unique to a particular basis of accounting, when applicable, and the related possibilities for manipulation of financial information, which may limit the value of the analytical procedures.

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<sup>1</sup> ISSAI 100 - Fundamental Principles of Public-Sector Auditing

## **Identification and Assessment of the Risks of Material Misstatement Due to Fraud**

- 6.10. In the public sector, revenue recognition may not always be the most relevant area for the presumption that there are risks of fraud, as required by ISSAI 2240.27. Revenue recognition may be highly relevant for tax authorities or other agencies that collect revenues such as state universities and colleges, hospitals or regulatory agencies, which charges fees for services rendered, or are recipients of donor funds. However, in many public sector entities, the focus is on expenditures and areas such as procurement and payment of grants. Therefore, in addition to revenue recognition, where relevant, auditors may consider such other areas when making the presumption of fraud risks.

## **Responses to the Assessed Risks of Material Misstatement Due to Fraud**

- 6.11. ISSAI 2240.33(c) deals with significant transactions that are outside the normal operations and activities of the audited entity. Examples of such transactions in the public sector may include:
- Expenses for health emergencies;
  - Expenses for natural disasters;
  - Economic development incentives;
  - Provisions in union contracts;
  - Real-estate purchases or sales;
  - Land swaps;
  - Granting of easements;
  - Major capital projects (e.g., infrastructure or information systems)
  - Public/private partnerships;
  - Privatization of governmental services;
  - Early extinguishment of debt; and
  - Government guarantees or assurances to rescue private sector entities if they have financial difficulties.

## **Auditor Unable to Continue the Engagement**

- 6.12. SAIs do not normally have the option to withdraw from an audit engagement as described in ISSAI 2240.39(b) and (c). Therefore, auditors are advised to consider the impact on the audit opinion and any requirements for other forms of reporting, including whether it may be appropriate to report separately to the legislature and/or to issue classified or restricted reports.

## **Communications to Management and with Those Charged with Governance**

- 6.13. Auditors may be required or may decide to communicate matters addressed in ISSAI 2240.41 with other parties such as the legislature, in addition to management and with those charged with governance.

## **Communications to Regulatory and Enforcement Authorities**

- 6.14. The requirements for reporting of fraud in the public sector may be subject to specific provisions of the audit mandate or related laws or regulations, in line with ISSAI 2240.44 regarding communication to a party outside the entity. Such parties may include regulatory and enforcement authorities. In some environments, there may be a duty to refer indications of fraud to investigative bodies and even cooperate with such bodies to determine if fraud or abuse has occurred. In other environments, auditors may be obliged to report circumstances that may indicate the possibility of fraud or abuse to the competent jurisdictional body or to the appropriate part of the government or legislature, such as prosecutors, the police and (if relevant to legislation) affected third parties. Auditors take care to avoid interfering with potential investigations or legal proceedings. Auditors need to be familiar with applicable laws and regulations in regard to reporting, communication and documentation of indications or suspicions of fraud. Furthermore, auditors consider the need to obtain legal advice in issues regarding indications of fraud.

## **Section 7 - ISSAI 2250 (Revised) - Consideration of Laws and Regulations in an Audit of Financial Statements**

### **Content of this Section**

- 7.1. This Section provides additional guidance for auditors related to:
- (a) Overall Considerations
  - (b) The Auditor's Consideration of Compliance with Laws and Regulations
  - (c) Reporting of Identified or Suspected Non-Compliance

### **Overall Considerations**

- 7.2. In the public sector, consideration of compliance with laws and regulations often has a broader scope than that set out in the financial auditing standards (ISSAI 2800-2899). This broader scope may, for example, include additional responsibilities for expressing a separate opinion as to the entity's compliance with laws and regulations. These additional responsibilities, and related audit and reporting objectives, are dealt with in ISSAI 4000<sup>1</sup>.
- 7.3. As noted in ISSAI 2250.2, the effect of laws and regulations on the financial statements varies considerably. In the public sector there may, for instance, be specific laws and regulations on how to distribute grants and subsidies from an agency that will have a direct impact on the financial statements. The financial reporting framework may also include information such as a budget report, appropriation report, or performance report. When the financial reporting framework includes such information, auditors may need to consider specific laws and regulations that may have a direct or indirect effect on the financial statements.

### **The Auditor's Consideration of Compliance with Laws and Regulations**

- 7.4. When considering the requirements in ISSAI 2250.15, auditors may also take into account findings related to non-compliance with laws and regulations from other types of audit activities undertaken by the SAI such as performance audits or jurisdictional review of the financial operations when the auditor's mandate includes such a capacity.

### **Reporting of Identified or Suspected Non-Compliance**

- 7.5. Some auditors may be required to communicate all identified instances of non-compliance with laws and regulations, even those that are clearly inconsequential. Some public sector audit organizations can, according to the audit mandate, order the entity to correct any instances of non-compliance with laws and regulations. In such cases, especially where there is an element of subjectivity in interpreting laws and regulations, auditors are advised to consider whether

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<sup>1</sup> ISSAI 4000 - Compliance Audit Standard

exercising this authority may impair their independence and, if so, take appropriate action to avoid such impairment.

- 7.6. When considering the requirement of ISSAI 2250.29 auditors may also determine whether such responsibilities include reporting separately to the legislature and/or other relevant authorities such as prosecutors, the police and (if relevant to legislation) affected third parties.

## **Section 8 - ISSAI 2260 (Revised) - Communication with Those Charged with Governance**

### **Content of this Section**

- 8.1. This Section provides additional guidance for auditors related to:
- (a) Those Charged with Governance
  - (b) Matters to Be Communicated
  - (c) The Communication Process

### **Those Charged with Governance**

- 8.2. In the public sector, governance responsibilities may exist at several organizational levels as well as in several functions (i.e. vertically or horizontally). As a result, there may be instances where there are several distinct groups which are identified as those charged with governance. Furthermore, an audit in the public sector might involve both financial statement objectives as well as objectives addressed by other ISSAIs. In such cases, there may be separate governance bodies.
- 8.3. In situations where matters are communicated to subgroups of those charged with governance, as discussed in ISSAI 2260.12, auditors may need to convey the information, in full or in summary, to the governing body as a whole. This is particularly relevant in the public sector where it is not uncommon for those charged with governance to be involved in managing the entity. Auditors need to be particularly sensitive to meet the needs and expectations of the legislature or appropriate regulators about matters communicated to other governance levels, particularly where the matters may be of broad public interest or speculation.

### **Matters to Be Communicated**

- 8.4. ISSAI 2260.15 requires the auditor to communicate with those charged with governance an overview of the planned scope and timing of the audit. In the public sector, this requirement may be achieved by various means. For example, the scope and timing of the audit may be defined in relevant legislation or the audit mandate, or auditors may communicate an overview of the planned scope and timing of the audit in the engagement letter.
- 8.5. ISSAI 2260.A11(b) states that communication regarding the planned scope and timing of the audit may assist the auditor to better understand the entity and its environment. Auditors may find it helpful to communicate their understanding of which components' financial information should be included in the entity's financial statements and to use the entity's response to verify their understanding. For example, it may be difficult to determine if, and to what extent, joint ventures (including private and public sector entities) are to be included in the consolidated financial statements of an audited entity.

- 8.6. ISSAI 2260.16 lists the significant findings from the audit that the auditor is required to communicate to those charged with governance. SAls are often the mandated auditors of the whole, or parts, of the government and its administration. In this situation, auditors may have access to information from other entities and their audits, which might be of relevance to those charged with governance. Examples of this might include material errors in transactions with the audited entity, which also affect other entities, or designs of relevant controls, which have provided efficiency gains in other entities. Communicating this type of information to those charged with governance may add value to the audit when circumstances permit. However, laws, regulations or ethical requirements may prohibit communicating this type of information.
- 8.7. SAls' independence and objectivity are critical to their ability (a) to hold governments accountable to legislatures and the public, and (b) to help identify threats to the good stewardship of public funds, such as corruption and abuse. The requirement relating to listed entities contained in ISSAI 2260.17 to communicate compliance with relevant ethical requirements regarding independence may also apply to SAls where it is in the public interest to ~~so~~ report. Matters in the INTOSAI Code of Ethics, such as political neutrality, may be of particular importance in the public sector context.

### **The Communication Process**

- 8.8. ISSAI 2260.22 requires the auditor to evaluate whether the two-way communication between the auditor and those charged with governance has been adequate for the purpose of the audit. If the two-way communication is not adequate, the ISSAI requires the auditor to take appropriate action. In the public sector, appropriate action may include communicating with the legislature or the appropriate regulators, or funding agencies.

## **Section 9 - ISSAI 2265 - Communicating Deficiencies in Internal Control to Those Charged with Governance and Management**

### **Content of this Section**

- 9.1. This Section provides additional guidance to auditors related to:
- (a) Identifying Those Charged with Governance in the Public Sector
  - (b) Determination of Whether Deficiencies in Internal Control Have Been Identified

### **Identifying Those Charged with Governance in the Public Sector**

- 9.2. When considering the requirements in ISSAI 2265.9, auditors may consider that identifying those charged with governance in the public sector might not be as straight forward as it is in the private sector. Section 8 - ISSAI 2260 provides guidance to auditors to help identify those charged with governance in public sector entities.

### **Determination of Whether Deficiencies in Internal Control Have Been Identified**

- 9.3. When determining whether deficiencies in internal control have been identified, auditors may need to identify any relevant laws or regulations related to internal control and the requirements of the laws or regulations that are relevant for the public sector entity.



## **Section 10 - ISSAI 2300 - Planning an Audit of Financial Statements**

### **Content of this Section**

10.1. This Section provides additional guidance for auditors related to:

- (a) The Role and Timing of Planning
- (b) Preliminary Engagement Activities
- (c) Planning Activities
- (d) Considerations Specific to Smaller Entities
- (e) Additional Considerations in Initial Audit Engagements
- (f) Specific Considerations for SAIs with a Judicial Role

### **The Role and Timing of Planning**

10.2. ISSAI 2300.2 deals with the benefits of adequate planning. The application and other explanatory material in ISSAI 2300.A1 to A3 provides guidance on the role and timing of planning. In the public sector environment, additional planning considerations may include:

- Obtaining an understanding of the legal and regulatory framework applicable to the entity due to the broader objectives of the audit;
- The implications for the audit of the financial statements of knowledge obtained from other audit activities relevant to the entity, including the implications of previous recommendations;
- The implications for the audit of the financial statements of knowledge obtained from other audit planning activities related to the relevant department and ministry; and
- The expectations of the legislature and other users of the auditors' report.

10.3. ISSAI 2300.A3 states that the auditor may decide to discuss elements of planning with the entity's management to facilitate the conduct and management of the audit engagement. Laws, regulations or the audit mandate may limit what the auditor may discuss about the audit strategy and audit plan. Auditors are advised to familiarize themselves with such laws, regulations or audit mandate.

### **Preliminary Engagement Activities**

10.4. ISSAI 2300.6 sets out the activities to be undertaken at the beginning of a current audit engagement. They include procedures regarding the continuance of the client relationship and the specific audit engagement. The continuance process for SAIs is influenced by the fact that they may not have the option to resign from an engagement. If information becomes available to auditors that would normally result in declining or discontinuing an engagement, auditors are advised to consider such information when performing further planning and risk assessment activities. Auditors may also have a statutory responsibility to report such issues and may consult with legal counsel in these circumstances.

## **Planning Activities**

- 10.5. ISSAI 2300.8 prescribes procedures to be performed in establishing the overall audit strategy. In establishing the audit strategy, auditors may consider additional characteristics such as:
- Additional reporting responsibilities for the entity. Examples of such additional responsibilities may include a requirement for the entity to report on government funding, including grants; and
  - Additional reporting responsibilities for the public sector auditor as discussed in Section 3, paragraph 3.6

## **Considerations Specific to Smaller Entities**

- 10.6. ISSAI 2300.A11 contains guidance specific to smaller entities. Audits of smaller public sector entities are normally not conducted by a sole practitioner. Furthermore, due to the reporting structure of government entities, the concept of the owner-manager normally does not exist. In the public sector, control structures of smaller entities are often part of the control structure of a larger government body. Therefore, the assumption of few relevant control activities is often not appropriate in the public sector. Additional control aspects of the larger government body may be included in the auditors' audit plans.

## **Additional Considerations in Initial Audit Engagements**

- 10.7. ISSAI 2300.13, supplemented by application and other explanatory material in ISSAI 2300.A22, requires the auditor to undertake certain activities prior to starting an initial audit. In the public sector, audit engagements are normally not initiated in the same way as in the private sector. Auditors may be selected through a competitive process or may be appointed by statute. Nonetheless, the guidance and requirements contained in ISSAI 2300.13 and A22 is relevant for auditors where the circumstances described exist.

## **Specific Considerations for SAs with a Judicial Role**

- 10.8. In some public sector environments, such as in a Court of Accounts environment, the auditors' report is often adjudicated upon and used to determine personal legal implications of those who are responsible for financial acts, including significant matters, control deficiencies, and instances of non-compliance with authorities. Such information is normally provided in the form of a separate report on the audit work performed and the related findings. Auditors are advised to familiarize themselves with any such policies and procedures describing additional requirements relating to determining personal legal implications of those who are responsible for financial acts, including significant matters, control deficiencies, and instances of non-compliance with authorities. In addition, auditors in such environments may plan and perform procedures to meet legal requirements and follow stricter rules of evidence when potential irregularities or instances of misconduct are identified, such that relevant requirements for proceeding with a formal judgement are met. This is done to provide evidence of such potential irregularities and instances of misconduct to the judicial department of the Court of Accounts, and cooperate with the judicial department as necessary.

## **Section 11 - ISSAI 2315 (Revised 2019) - Identifying and Assessing the Risks of Material Misstatement ~~through Understanding the Entity and Its Environment~~**

### **Content of this Section**

- 11.1. This Section provides additional guidance for auditors related to:
- (a) Risk Assessment Procedures and Related Activities
  - (b) ~~The Required~~Obtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control
  - (c) Identifying and Assessing the Risks of Material Misstatement
  - (d) Additional Examples of Conditions and Events That May Indicate Risks of Material Misstatement

### **Risk Assessment Procedures and Related Activities**

- 11.2. When carrying out the risk assessment procedures and related activities in ISSAI 2315 (Revised 2019).13 to 18, auditors may take into account the broader objectives of the audit mandate as described in Section 1 - Preamble.
- 11.3. When making inquiries of management and others, auditors may also obtain information from additional sources such as:
- Auditors involved in performance and other audits related to the entity;
  - Government officials; and
  - Legislative reports or minutes.
- 11.4. When performing analytical procedures, auditors may also consider relationships such as:
- Expenditures versus appropriations;
  - Benefit payments, such as child support and pensions versus demographic information; and
  - Interest as a percentage of national debt compared to the government borrowing rate.
- 11.5. When performing observation and inspection, auditors may also observe and inspect items such as:
- Additional documents prepared by management for the legislature, such as performance reports or funding requests;
  - Testimonies of agency officials;
  - Ministerial and other directives; and
  - Official records of proceedings of the legislature.

- 11.6. When using information obtained from previous experience with the entity and previous audits, auditors may also use reports from previous performance audits and other audit activities relevant to the entity.
- 11.7. ISSAI 2315 (Revised 2019).<sup>17</sup> requires the engagement partner and other key engagement team members to discuss the susceptibility of the entity's financial statements to material misstatement, and application of the applicable financial reporting framework to the entity's facts and circumstances. In the public sector, this discussion may cover the additional objectives and related risks of material misstatement, as discussed in paragraph 11.2 above. Auditors may include auditors engaged in performance audits and other audit activities of the entity in such a discussion.

### **The RequiredObtaining an Understanding of the Entity and Its Environment, the Applicable Financial Reporting Framework and the Entity's System of Internal Control**

- 11.8. In obtaining the understanding of the entity and its environment in accordance with ISSAI 2315 (Revised 2019).<sup>19</sup>, auditors may take into account:
- (a) Governance structures may be affected by the legal structure of the entity, for example whether the entity is a ministry, department, agency or other type of entity;
  - (b) Ownership of public sector entities may not have the same relevance as in the private sector;
  - (c) Program objectives and strategies may include public policy elements;
  - (d) Specific laws and regulations to which the entity is subject and the potential impact of non-compliance with these;
  - (e) Decisions initiated outside the entity as a result of political processes. Such decisions may influence management's activities. Examples include:
    - New geographic locations or closures of existing locations;
    - Reorganizations, including transfer of activities to other entities;
    - New program areas; and
    - Budgetary constraints or cut backs.
  - (f) Knowledge of the government activities carried out, including relevant programs;
  - (g) The budget process and execution of the budget;
  - (h) Issues related to management's assumptions ongoing concern may not be relevant;
  - (i) Knowledge of the stakeholders (companies, organisations, citizens) and their interests ~~and~~ motives;
  - (j) The public opinion towards relevant issues;
  - (k) Current issues and developments in the society; and
  - (l) Interests of members of parliament and discussions in parliament.
- 11.9. ISSAI 2315 (Revised 2019).<sup>19</sup>(a)(iii) refers to the measurement and review of financial performance. Auditors may include non-financial information such as achievement of outcomes (for example, number of people helped by the program) in their measurement or review. Also, in the public sector there are additional external parties who may measure and review performance. These external parties may include the legislature, other public sector entities, and the media.

- 11.10. In obtaining the understanding of the entity's system of internal controls relevant to the audit required by ISSAI 2315 (Revised 2019).21-46, auditors may take the following into account:
- (a) Any additional reporting responsibilities regarding the entity's system of internal controls;
  - (b) Relevant controls that relate to compliance with authorities;
  - (c) Relevant controls related to monitoring performance against the budget;
  - (d) Relevant controls related to transferring budgetary funds to other entities;
  - (e) Relevant controls for classified data related to national security and sensitive personal data, such as tax and health information;
  - (f) Supervision and other controls performed by parties outside the entity and related to areas such as:
    - Compliance with procurement regulations;
    - Execution of the budget;
    - Other areas as defined by legislation or audit mandate;
    - Management's accountability.
- 11.11. In obtaining the understanding of the entity's risk assessment process required by ISSAI 2315 (Revised 2019).22, auditors are advised to take into account that such process may be set out in legislation, included in directives, or conducted by other public sector entities.
- 11.12. In some audit environments, such as a Court of Accounts environment, auditors may work closely with prosecutors and police when dealing with financial fraud or non-compliance. Therefore, they may have obtained information from prosecutors and police that is relevant to the understanding of the entity and its environment, and to the risk assessment.

### **Identifying and Assessing the Risks of Material Misstatement**

- 11.13. When auditors identify and assess the risks of material misstatement in accordance with ISSAI 2315 (Revised 2019).28 and 29, auditors may take into account additional matters such as:
- The fact that the identification and assessment of risks at the financial statement level and the assertion level may include issues related to the political climate, public interest and program sensitivity; and
  - The fact that the assertions for classes of transactions, account balances and disclosures may be expanded to include assertions that transactions and events have been carried out in accordance with legislation or proper authority consistent with ISSAI 2315 (Revised 2019).A192.
- 11.14. In exercising judgment as to which risks are significant risks as required by ISSAI 2315 (Revised 2019).32, auditors may also take the following into account:
- (a) Complexity and inconsistency in regulations and directives;
  - (b) Non-compliance with authorities; and
  - (c) The budget process and the execution of the budget.

## **Additional Examples of Conditions and Events That May Indicate Risks of Material Misstatement**

11.15. The following are examples of additional conditions and events that may indicate risks of material misstatement for entities in the public sector:

- Budget overspending due to weak budgetary controls;
- Privatizations;
- New programs;
- Major changes to existing programs;
- New financing sources;
- New laws and regulations or directives;
- Political decisions such as relocation of operations;
- Programs without sufficient allocated resources and funding;
- Increased public expectations;
- Procurement of goods and services in certain industries such as defence;
- Outsourcing of government activities;
- Operations subject to special investigations;
- Changes in political leadership;
- Indications of waste or abuse;
- Higher than normal expectations to meet budget;
- Public and private partnerships; and
- Planning and implementation of large infrastructure projects.

## **Section 12 - ISSAI 2320 - Materiality in Planning and Performing an Audit**

### **Content of this Section**

- 12.1. This Section provides additional guidance for auditors related to:
- (a) Materiality in the Context of an Audit
  - (b) Determining Materiality and Performance Materiality when Planning the Audit
  - (c) Revision as the Audit Progresses

### **Materiality in the Context of an Audit**

- 12.2. When determining materiality for planning purposes in the public sector both quantitative and qualitative matters as well as the nature of items are of importance. The context in which the matter appears may be of importance. Furthermore, the inherent nature or characteristics of items, or groups of items, may render them material.
- 12.3. ISSAI 2320.A3 states that the legislators and regulators are often the primary users of the public sector entities' financial statements, and that the financial statements may be used to make decisions other than economic ones. Legislators represent the citizens and provide funding for various government programs, activities, and functions. Legislators and/or regulators frequently evaluate or make decisions about an entity's activities. Other users may include entity management, bondholders or the media. Financial statements that meet the needs of legislators and regulators will also meet most of the needs of other users.
- 12.4. The financial statements may also represent a key element of a public sector entity's accountability to the public. The accountability framework may introduce other factors that influence the determination of materiality at different levels. As a consequence, materiality is likely to be a result of both quantitative and qualitative factors, and materiality levels for particular classes of transactions, account balances and disclosures may be set at a lower level.

### **Determining Materiality and Performance Materiality When Planning the Audit**

- 12.5. As noted above, materiality in the public sector includes both quantitative and qualitative aspects (referred to in the ISSAIs as aspects related to the "size" and "nature" of misstatements). The determination of a materiality level or levels is described in ISSAI 2320.10 and 11. Materiality levels for classes of transactions, account balances or disclosures may be set at a lower level. This may be for a variety of reasons, including the context of the matter, or the nature and characteristics of the systems and entities involved as explained in paragraphs 12.2 to 12.4 above. Furthermore, certain procedures may be required to be performed by audit mandate or legislation. Examples of such procedures might be tests of ministerial salaries regulated by statute and sensitive payments such as travel and hospitality of senior staff. In the rare cases where the auditors want to detect all such misstatements, they test all relevant transactions.

- 12.6. Where auditors also provide opinions on the effectiveness of controls or compliance with laws and regulations, they consider the need to establish materiality for these objectives in addition to materiality for the financial statements. For example, when reporting on the effectiveness of controls, the auditor may use a benchmark based on the percentage of transactions or monetary amounts sampled to determine materiality for evaluating control deviations. In determining materiality for these other types of engagements, the auditor may use guidance provided by other ISSAIs as stated in paragraph 3.7 above.
- 12.7. ISSAI 2320.A3 describes considerations specific to determining materiality levels in the public sector. When determining whether a particular class of transactions, account balance, disclosure, or other assertion which is part of the financial reporting framework, is material by virtue of its nature, auditors take into account qualitative aspects such as:
- The context in which the matter appears, for example if the matter is also subject to compliance with authorities, legislation or regulations, or if law or regulation prohibits overspending of public funds, regardless of the amounts involved;
  - The needs of the various stakeholders and how they use the financial statements;
  - The nature of the transactions that are considered sensitive to users of the financial statements;
  - Public expectations and public interest, including emphasis placed on the particular matter by relevant committees in the legislature, such as a public accounts committee, including the necessity of certain disclosures;
  - The need for legislative oversight and regulation in a particular area; and
  - The need for openness and transparency, for example if there are particular disclosure requirements for frauds or other losses.
- 12.8. ISSAI 2320.A4 to A8 discusses identifying appropriate benchmarks for financial statement materiality. In the public sector, the budget, usually the total annual expenditure of an institution may be the most appropriate basis for determining materiality where that institution's primary function or mandate is service delivery. For public sector entities that are expected to recover costs or break-even, net costs may not be an appropriate benchmark. In those cases gross expenditure or gross revenues may be a more relevant benchmark. For public sector entities that are custodians of large amounts of assets, total assets, total liabilities, net assets or net liabilities or certain classes of assets might be an appropriate benchmark if they are accounted for in the financial statements. In some cases, especially when considering qualitative materiality, other types of benchmarks may also be useful. For example:
- Those amounts previously considered material by a relevant committee in the legislature, such as public accounts committee; and
  - Benefit payments as compared to cost of living indicators, for example the importance to the eligible recipient of monthly benefit payments, such as retirement or disability, paid out in accordance with public sector programs.



## **Revision as the Audit Progresses**

- 12.9. ISSAI 2320.12, 13 and A14 discuss the need to revise materiality levels in the event of becoming aware of new information during the course of the audit. Due to governance structures and interrelationships of entities within the public sector, it is not unusual for auditors to receive new information during the course of the audit.

## **Section 13 - ISSAI 2330 - The Auditor's Responses to Assessed Risks**

### **Content of this Section**

- 13.1. This Section provides additional guidance for auditors related to:
- (a) Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level
  - (b) Evaluating the Sufficiency and Appropriateness of Audit Evidence
  - (c) [Specific Considerations for SAls with a Judicial Role](#)

### **Audit Procedures Responsive to the Assessed Risks of Material Misstatement at the Assertion Level**

- 13.2. ISSAI 2330.A17 states that the audit mandate and any other special auditing requirements may affect the auditor's consideration of the nature, timing and extent of further audit procedures. Examples of such other requirements are found in Section 3, paragraph 3.6.
- 13.3. ISSAI 2330.8 describes the circumstances in which the auditor is required to perform tests of controls to obtain sufficient appropriate audit evidence as to the operating effectiveness of relevant controls. As a result of the additional objectives described in paragraph 13.2 above, tests of controls for a public sector entity may be broader and more detailed than those for a private sector entity. Auditors may perform tests of controls on other types of engagements other than in the audit of financial statements and may seek guidance on performing these from ISSAIs other than the ISSAIs 2000-2899.
- 13.4. In designing and performing tests of controls as required by ISSAI 2330.10, auditors determine whether the entity is part of a larger government control environment. As a result, controls may exist outside the entity. The auditor determines whether and how to obtain sufficient appropriate audit evidence about those controls.
- 13.5. When using audit evidence about the operating effectiveness of controls obtained in previous audits, as stated in ISSAI 2330.13, auditors may consider using evidence obtained in performance audits or other audit activities relevant to the entity. When considering evidence obtained in previous performance audits, auditors evaluate whether the assertions used and tests performed are adequate for the purpose of the financial statement audit.

### **Evaluating the Sufficiency and Appropriateness of Audit Evidence**

- 13.6. ISSAI 2330.27 requires the auditor to express a qualified opinion or disclaim an opinion on the financial statements if the auditor is unable to obtain sufficient appropriate audit evidence. ISSAI 2330.A62 provides factors that may influence the auditor's judgment as to what constitutes sufficient appropriate audit evidence. In evaluating what is sufficient appropriate audit evidence,

auditors also take into account the need to obtain sufficient appropriate evidence to meet any additional objectives as described in paragraph 13.2 above.

### **Specific Considerations for SAs with a Judicial Role**

- 13.7. In some public sector environments, such as a Court of Accounts environment, the auditors' report is often judged and used to determine personal legal implications of those responsible for financial acts, including significant matters, control deficiencies and instances of non-compliance with authorities. Therefore, auditors in such environments, when evaluating the sufficiency and appropriateness of audit evidence, perform procedures to identify those responsible for financial acts and for compliance with legal requirements.

## **Section 14 - ISSAI 2402 - Audit Considerations Relating to an Entity Using a Service Organization**

### **Content of this Section**

- 14.1. This Section provides additional guidance for auditors related to:
- (a) Scope of the ISSAI
  - (b) Definitions
  - (c) Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control
  - (d) Specific Considerations for SAs with a Judicial Role

### **Scope of the ISSAI**

- 14.2. ISSAI 2402.2 refers to organizations that provide services that are integral to the entity's operations. In the public sector, service organizations may also be an integral part of a user entity's capacity to comply with the authorities that govern it, carry out its program objectives and to ensure effective internal control. The nature and extent of the work to be performed by the auditors in this context depends on the nature and significance of those services to the public sector entity and the relevance of those services to the public sector audit mandate.

### **Definitions**

- 14.3. The terms 'service organization' and 'subservice organization' are defined in ISSAI 2402.8(e) and 8(g). In addition to being part of a user entity's information system relevant to financial reporting, in the public sector these terms may also extend to organizations that provide services integral to the user entity's ability to achieve its program objectives, such as the determination of eligibility, and distribution of pension payments to individuals, or grants to individuals or organizations.

### **Obtaining an Understanding of the Services Provided by a Service Organization, Including Internal Control**

- 14.4. ISSAI 2402.9 relates to the user auditor obtaining an understanding of how a user entity uses a service organization in its operations. When considering the significance of the services provided to the user entity, the nature and materiality of transactions processed, as well as the nature of the relationship between the user entity and the service organization, auditors may also consider the service organization's role related to the user entity's compliance with authorities, achievement of program objectives and effectiveness of internal control. Sources of information which auditors may use to obtain this understanding are documented in contract or the service agreement governing the relationship between the parties involved.

- 14.5. Furthermore, when considering the nature of transactions processed by a service organization for a user entity, auditors may consider the degree of accountability of the flow of funds between the two entities. The accountability between the two entities may vary from:
- (a) A situation where the user entity uses a service organization to provide unconditional funding to eligible recipients, with no requirements for the recipients or the service organization to report back to the user entity on the use of those funds, to;
  - (b) A situation where there is full accountability for the funds, whereby the transactions carried out by the service organization are fully accounted for, and assurance has been provided to the user entity that the transactions carried out by the service organization are in compliance with the authorities which govern them, and that relevant program objectives have been achieved.
- 14.6. In addition, when considering the nature of the relationship between the user entity and the service organization, auditors may also consider relevant governance structures, as well as accountability structure and the extent of influence one entity may have on the other.
- 14.7. The definitions of 'service auditor' and 'user auditor' in ISSAI 2402.8(d) and 8(h) may be deemed to imply that there are two separate audit organizations involved. However, in the public sector, one level of government may provide services to other levels of government. These levels may ultimately be considered as belonging to the same governmental structure and may, as a result, be audited by the same public sector audit organization. Being a part of the same public sector audit organization may affect how the two individual auditors responsible for the service organization and the user entity respectively, communicate with, and report to one another in accordance with the requirements set out in ISSAI 2402.12 to 18. For example, in such situations, communication between the service auditor and user auditor may, depending on their mandate, not be subject to the same confidentiality requirements as in the private sector.
- 14.8. For example, ISSAI 2402.12 describes options the user auditor may employ to obtain a sufficient understanding of the user entity's internal control relevant to the audit in order to provide a basis for the identification and assessment of risks of material misstatement. When the user auditor and the service auditor are from the same public sector audit organization, some or all of the options described in ISSAI 2402.12 may not be practical. Nonetheless, in such cases, the information exchanged between the user auditor and the service auditor is shared in a transparent manner. This information may include matters similar to those included in a type 1 or type 2 report.
- 14.9. Furthermore, in such situations, it may be helpful to give sufficient consideration to identifying and addressing relevant reporting needs, channels and forms at the planning stage of the engagement.

### **Specific Considerations for SAs with a Judicial Role**

- 14.10. In some public sector audit environments, such as in a Court of Accounts environment, there may be additional considerations that auditors take into account. These considerations may include:
- Assessing the risks of potential non-compliance or misconduct, at either the user entity or the service organization, that may have a material impact on financial statements of the user entity;
  - Following stricter rules of evidence when potential irregularities or instances of misconduct are identified, such that relevant requirements for proceeding with a formal judgment are met; and

- Providing evidence of such potential irregularities and instances of misconduct to the judicial department of the Court of Accounts, and cooperating with the judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.

## **Section 15 - ISSAI 2450 - Evaluation of Misstatements Identified during the Audit**

### **Content of this Section**

15.1. This Section provides additional guidance for auditors related to:

- (a) Evaluating the Effect of Uncorrected Misstatements
- (b) Written Representations
- (c) Specific Considerations for SAs with a Judicial Role

### **Evaluating the Effect of Uncorrected Misstatements**

- 15.2. In applying ISSAI 2450.11, auditors with additional reporting responsibilities related to non-compliance with authorities and control deficiencies separately evaluates each of these objectives. However, misstatements, instances of non-compliance with authorities and control deficiencies can be interrelated, potentially increasing the risk to each objective.
- 15.3. ISSAI 2450.12 to 13 deal with communication of uncorrected misstatements with those charged with governance. Where appropriate to a SA's mandate, this communication may include instances of non-compliance with authorities and control deficiencies. Auditors may also need to communicate misstatements, instances of non-compliance with authorities and control deficiencies to additional parties such as government officials.
- 15.4. When communicating with those charged with governance or with additional parties as described in paragraph 15.3 above, auditors may be expected to communicate all misstatements, even those that have been corrected by the entity. When communicating with those charged with governance, auditors use ways of reporting relevant to their environment. Auditors may also be called upon to present before the legislature on the results of the financial statement audit.

### **Written Representations**

- 15.5. ISSAI 2450.14 requires the auditor to obtain written representation that management considers the effects of uncorrected misstatements on the financial statements to be immaterial. Where auditors have additional responsibilities for compliance with authorities and effectiveness of internal control these representations may be made in a single document.

### **Specific Considerations for Auditors with a Judicial Role**

- 15.6. In some public sector audit environments, such as in a Court of Accounts environment, the auditors' report is often used to determine personal legal implications of those responsible for financial acts, including significant matters, instances of non-compliance with authorities, and control deficiencies. Therefore, auditors in such environments, when evaluating the misstatements, instances of non-compliance with authorities and control deficiencies identified during the audit, also identify those

responsible for the financial acts and for compliance with legal requirements, and follow stricter rules of evidence when potential irregularities or instances of misconduct are identified, such that relevant requirements for proceeding with a formal judgment are met. This is done to provide evidence of such potential irregularities and instances of misconduct to the judicial department of the Court of Accounts, and cooperate with the judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.

- 15.7. ISSAI 2450.8 requires the auditor to communicate on a timely basis all misstatements accumulated during the audit with the appropriate level of management. Where SAIs have mandates which include the legal authority to order the entity to correct any misstatements as well as instances of non-compliance with authorities, they are advised to consider whether exercising this authority may impair their independence and, if so, take appropriate action to avoid such impairment.



## **Section 16 - ISSAI 2500 - Audit Evidence**

### **Sufficient Appropriate Audit Evidence**

- 16.1. Some audit evidence is obtained by performing audit procedures to test accounting records. Audit evidence comprises both information that supports and corroborates management's assertions, and any information that contradicts such assertions. In the case of financial statements in the public sector, management may often assert that transactions and events have been carried out in accordance with legislation or proper authority. Such assertions may fall within the scope of a financial audit.
- 16.2. When considering information from sources independent of the entity as referred to in ISSAI 2500.A12 auditors may consider sources as independent of the entity even though they ultimately report to the same authority e.g. operationally independent government agencies reporting to the same authority. The nature of benchmarking data in the public sector may include other sources e.g. comparisons between similar programs, or performance indicators.
- 16.3. When considering the sources of evidence in accordance with ISSAI 2500.A5 auditors may also consider evidence obtained in performance audits or other audit activities relevant to the entity. When relying on evidence obtained in performance audits, auditors evaluate whether the assertions used and tests performed are adequate for the purpose of the financial statement audit.
- 16.4. When the audit mandate includes objectives related to compliance with authorities, auditors may need to consider the nature and timing of audit procedures as explained in ISSAI 2500.A16 e.g. the ability to apply certain audit procedures to establish the compliance with authorities or the effectiveness of the controls may be adversely affected by the passage of time.
- 16.5. Public sector entities will usually have established internal controls designed to secure the compliance with authorities. However, where the audited entity is responsible for giving grants or other financial assistance to other parties, it is often the case that the compliance with authorities will depend, in part, on the other parties satisfying the criteria and meeting the terms for receiving assistance. Additional evidence may be required concerning the entity's exercise of its responsibilities to satisfy itself about the transactions of these other parties.
- 16.6. When considering the guidance in ISSAI 2500.A17, auditors may take into account that data retention requirements for public sector entities may be different as stipulated by relevant legislation. Auditors are advised to familiarize themselves with applicable legislation in regard to retention of data.
- 16.7. Auditors in some environments, such as a Court of Accounts environment, may be subject to laws and regulations requiring the auditors to understand and follow precise procedures related to rules of evidence. Auditors are advised to familiarize themselves with any such policies and procedures describing additional requirements relating to audit evidence and that are designed to ensure compliance with authorities. For example, auditors operating in such an environment may need to consider the following matters related to evidence collection:

- Legislation imposing additional requirements on audit evidence;
- The scope of additional requirements (i.e., are they to be imposed on every document from the audit assignment or on specific documents relating to certain audit issues);
- Additional processing, formalities or requirements to which audit evidence is subject;
- The purpose of each additional requirement as regards due process of law in following the steps of the audit; and
- Any restrictions that may be placed upon audit evidence due to specific ways it has been collected and/or produced.

16.8. **Appendix B** provides information on sources of audit evidence concerning management of risks related to laws and regulations.

## **Section 17 - ISSAI 2501 - Audit Evidence - Specific Considerations for Selected Items**

### **Content of this Section**

17.1. This Section provides additional guidance for auditors related to:

- (a) Inventory
- (b) Litigation and Claims
- (c) Segment Information

### **Inventory**

- 17.2. Inventory in the public sector is often different from inventory in the private sector. For example, inventory in the public sector is often held for use rather than for resale; therefore, the nature of internal controls and the assessed risk of material misstatement may be different. Auditors may have other objectives and assertions to consider in addition to existence and condition such as public expectations for effective management of inventory.
- 17.3. When applying the requirements of ISSAI 2501.4, to decide whether to attend physical counts, auditors consider the matters described above.
- 17.4. Where auditors are restricted by either management, legislation or regulations and cannot attend a physical count as required by ISSAI 2501.4 or request confirmation from a third party as required by ISSAI 2501.8 and other audit procedures are not possible, auditors are advised to consider the effect on the auditor's report.<sup>1</sup> The auditor's response may be different when the limitation is imposed by management rather than imposed by legislation or regulations.
- 17.5. In some public sector audit environments, such as a Court of Accounts, auditors may have extended responsibilities for identifying who is responsible for the existence and condition of the inventory, including development and implementation of controls. This may include, where applicable, determining sanctions. Therefore the auditor provides evidence of such potential irregularities and instances of misconduct to the judicial department of the Court of Accounts, and cooperates with the judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.

### **Litigation and Claims**

- 17.6. When designing and performing audit procedures in accordance with ISSAI 2501.9 and A18, auditors may have additional responsibilities in relation to litigation and claims. In addition, there may be ambiguities between public sector entities regarding liabilities and commitments that arise from litigation and claims. Thus, the responsibilities may include identifying probable future claims

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<sup>1</sup> ISSAI 2705 - Modifications to the Opinion in the Independent Auditor's Report

and the potential wider consequences of those claims on the public sector. Due to the complexity and structure of public sector organizations, auditors may need to inquire of other public sector organizations in addition to management of the audited public sector entity. For example, a central legal department may administer all claims against the government; the auditors would inquire of that department in addition to management of the audited entity.

- 17.7. Where legal counsels within the government do not charge the public sector entity for their services, public sector entities may not have legal expense accounts as discussed in ISSAI 2501.9(c).
- 17.8. Auditors may need to consider other sources of information when performing audit procedures to identify litigation and claims involving the entity such as:
- Media reports;
  - General public and stakeholder feedback;
  - Other information obtained by regulators, officials, public prosecutors, or other investigative agencies;
  - Information from complaints officials and whistle-blowers; and
  - Outcomes of performance or other audits.
- 17.9. When applying the requirements in ISSAI 2501.10, SAIs, in accordance with their mandate, may have the right to communicate directly with the entity's external legal counsel without management's permission. Auditors consider the independence and objectivity of a legal counsel who may be part of the entity or part of another government organization. When the independence or objectivity of legal counsel is in doubt, the auditors may wish to consider obtaining information from another source.
- 17.10. When seeking direct communication through a letter of general or specific inquiry as referred to in ISSAI 2501.A22 and A23, auditors may include other specific inquiries if permitted by the applicable financial reporting framework. For example, this may include whether the entity is operating within its legislative mandate.

### **Segment Information**

- 17.11. Presentation and disclosure of segment information may not be required by certain financial reporting frameworks or relevant in the context of certain public sector entities. However, there may be other information similar to segment information required by laws or regulations or by the applicable financial reporting framework. For example, public sector entities may be required to report incomes and expenditures by fund, appropriation, program or category; auditors might be required to audit that information. In certain circumstances auditors may be required to express an opinion on the segmental or similar information either as part of the overall audit opinion or on a stand-alone basis.

## **Section 18 - ISSAI 2505 - External Confirmations**

### **Content of this Section**

- 18.1. This Section provides additional guidance for auditors related to:
- (a) External Confirmation Procedures to Obtain Audit Evidence
  - (b) Management's Refusal to Allow the Auditor to Send a Confirmation Request

### **External Confirmation Procedures to Obtain Audit Evidence**

- 18.2. ISSAI 2505.A1 and ISSAI 2330.A50 state that confirmations can be used to obtain evidence about the presence or absence of certain conditions (e.g. "side agreements" not included in formal arrangements). In addition to assertions related to the audit of financial statements, auditors may find confirmations useful in obtaining evidence related to additional audit objectives stipulated by their audit mandate or arising from legislation, regulation, ministerial directives, government policy requirements, or resolutions of the legislature. For example, external confirmations can be used to obtain evidence about:
- The presence or absence of agreements or arrangements with third parties of legislated or other terms and conditions such as guarantees of performance or funding;
  - The commitment of expenditures that have not yet been authorized by the legislature;
  - The continued eligibility of individuals in receipt of pensions, income assistance, annuities or other ongoing payments; or
  - The presence of "side deals" with suppliers for the return of goods for credit in order to use funding that would have otherwise lapsed in a subsequent fiscal period.
- 18.3. When requesting an external confirmation as defined in ISSAI 2505.6(a), auditors are advised to ensure that the requests are directed to third-parties who are independent of the audited entity and the responses are reliable in light of the relationship between the entity and the confirming party. However, auditors may consider some sources as independent of the entity even though the audited entity and the entity that is the source ultimately report to the same authority. In such circumstances, a higher standard in the audit evidence documentation on how independence was assessed and considered by the auditors is encouraged.

### **Management's Refusal to Allow the Auditor to Send a Confirmation Request**

- 18.4. Auditors may, in addition to the requirement to communicate to those charged with governance as stated in ISSAI 2505.9, be required or expected to communicate to the legislature or appropriate oversight body. Management's refusal to allow the auditor to send a confirmation request has a direct impact on the risk assessment and audit risk conclusions made thereof.

## **Section 19 - ISSAI 2510 - Initial Audit Engagements - Opening Balance**

### **Initial Audit Engagements**

- 19.1. An initial audit might occur when an entity is nationalized without resulting in the formation of a new entity or when a SAI's mandate is changed to include a new or additional audit of an already existing entity. An initial audit may also occur when a public sector entity is created, and legislation, regulation or framework require the appropriation of all or parts of prior balances of a predecessor public sector entity, which have been audited by a predecessor auditor.

## Section 20 - ISSAI 2520 - Analytical Procedures

### Content of this Section

20.1. This Section provides additional guidance for auditors related to:

- (a) Analytical Procedures
- (b) Substantive Analytical Procedures
- (c) Investigating Results of Analytical Procedures

### Analytical Procedures

20.2. In performing analytical procedures, either in the assessment of risk, substantive testing or forming an overall conclusion auditors may also consider, without limitation to the list below, relevant relationships such as:

- Expenditures versus budget or appropriations;
- Benefit payments, such as child support and pensions versus demographic information;
- Tax revenues versus demographic information or economic conditions or indicators;
- Interest as a percentage of national debt compared to the government borrowing rate;
- Results accomplished in relation to expenditure, where performance information is included as part of the financial statements; and
- Government grants for economic and social development, e.g. grants for low income farmers and grants for school buildings, versus economic and demographic indicators.

20.3. In order to be an effective procedure, such tests are advised to be at an appropriate level of detail.

### Substantive Analytical Procedures

20.4. When designing analytical procedures, auditors may consider the information obtained and conclusions reached in related audit activities, including performance and other audits. When relying on other audit activities, auditors are advised to evaluate whether the related objectives, assertions covered and tests performed are appropriate for the purpose of the financial statement audit.

20.5. The auditor's determination of the acceptable amount referred to in ISSAI 2520.A16 is influenced by materiality which in the public sector is may be influenced by the audit mandate and public expectations amongst other considerations.

20.6. When assessing the reliability of data referred to in ISSAI 2520.A12(a) auditors may use information obtained from other entities within the government even though they ultimately report to the same authority. For example, comparative data in the public sector may include comparisons between similar entities and/or programs.

20.7. When considering the guidance in ISSAI 2520.A13 for performing analytical procedures, auditors are advised to understand the design of the controls and may need to test the operating

effectiveness of the controls over the entity's non-financial information used in analytical procedures.

### **Investigating Results of Analytical Procedures**

- 20.8. Auditors consider that they may have additional responsibilities when management is unable to provide explanations for differences identified in performing analytical procedures referred to in ISSAI 2520.A21. For example, auditors in some audit environments, such as a Court of Accounts environment, may need to investigate further the underlying reasons for the lack of information and determine who is responsible. The auditor may also provide evidence of such potential irregularities and instances of misconduct to the judicial department of the Court of Accounts, and cooperate with the judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.



## **Section 21 - ISSAI 2530 - Audit Sampling**

### **Content of this Section**

21.1. This Section provides additional guidance for auditors related to:

- (a) Sample Design, Size and Selection of Items for Testing
- (b) Nature and Cause of Deviations and Misstatements
- (c) Projecting Misstatements
- (d) Evaluating Results of Audit Sampling

### **Sample Design, Size and Selection of Items for Testing**

- 21.2. When designing an audit sample in accordance with ISSAI 2530.6 SAs may have greater responsibilities under a mandate. In such situations auditors may set different levels of parameters, including materiality and a higher level of confidence, and this may affect the sample size. Auditors might design separate samples to test controls and compliance or may design one sample to test both. For example, a sample of disbursements might be used to test controls over disbursements as well as whether the disbursements were in accordance with authorities.
- 21.3. Public sector auditors are more likely than private sector auditors to consider the need to sample non-financial information. As a result of additional public sector objectives, such as testing compliance with authorities and reviewing non-financial information contained in financial statements, auditors may consider whether sampling will be useful in testing such non-financial information contained in financial statements. An example of such non-financial information may be information contained in sustainable development measures.
- 21.4. Auditors may be mandated to report additional information about audit sampling. Such requirements may include reporting the sampling methods used, whether the results of the sample may be projected to the population, and if so, the results of that projection. Auditors may consider such needs in deciding whether to use statistical or non-statistical approaches.

### **Nature and Cause of Deviations and Misstatements**

- 21.5. When analyzing deviations and misstatements identified as stated in ISSAI 2530.A17 auditors consider that they may have extended audit and reporting responsibilities related to fraud. Section 6 of this GUID provides additional information for auditors related to the auditor's responsibilities relating to fraud in an audit of financial statements.

### **Projecting Misstatements**

- 21.6. When performing audit sampling for testing controls, auditors may be required to project the deviation rate in the population, including a confidence interval, and report the sample results as noted paragraph 21.4 above. In some audit environments, such as Courts of Accounts, reporting

on the deviation rates may be required to explain, for example, the deficiencies in internal control or non-compliance with authorities.

### **Evaluating Results of Audit Sampling**

- 21.7. In addition to the guidance in ISSAI 2530.A23 auditors are advised to consider their responsibilities under their mandate when management is unable to provide an adequate explanation for deviations and misstatements. For example, auditors in a Court of Accounts environment may need to investigate further the underlying reasons for the lack of information and determine who is responsible.
- 21.8. In addition to the guidance in ISSAI 2530.A23 (second bullet point), auditors may need to consider any additional responsibilities as described in Section 3, paragraph 3.6.

## **Section 22 - ISSAI 2540 (Revised) - Auditing Accounting Estimates and Related Disclosures**

### **Content of this Section**

- 22.1 This Section provides additional guidance for auditors related to:
- (a) Nature of Accounting Estimates
  - (b) Objective
  - (c) Risk Assessment Procedures and Related Activities
  - (d) Responses to the Assessed Risks of Material Misstatement
  - (e) Further Substantive Procedures to Respond to Significant Risks
  - (f) Evaluating the Reasonableness of the Accounting Estimates, and Determining Misstatements
  - (g) Indicators of Possible Management Bias
  - (h) Written Representations
  - (i) Documentation

### **Nature of Accounting Estimates**

- 22.2 When and how public sector entities use accounting, estimates depend on the types of financial items reported and the applicable financial reporting framework. Some important estimates in the public sector may relate to assets, liabilities and disclosure items, such as:
- Social insurance programs;
  - Government employee pension programs;
  - Health care programs;
  - Veterans' benefits programs;
  - Government guarantee programs;
  - Environmental liabilities;
  - Tax revenue and receivables; and
  - Certain property and equipment such as specialized military equipment and heritage assets.
- 22.3 Due to the nature of government operations, some accounting estimates of public sector entities will have a high level of estimation uncertainty, such as guarantees related to loans or distressed entities.
- 22.4 In addition to the guidance provided in ISSAI 2540.A72-A75, in the public sector fair value measurement is not always required by the applicable financial reporting framework. In those cases, auditors may assess the alternative valuation method used and determine whether it is in accordance with the applicable financial reporting framework and is not misleading.

## **Objective**

- 22.5 When considering the objective of ISSAI 2540.11 to obtain sufficient appropriate audit evidence about whether accounting estimates and related disclosures are reasonable in the context of the financial reporting framework, auditors may consider the following:
- Financial reporting frameworks may require disclosure of non-financial information such as program results and other operational information. This information may be based on estimates; or
  - Some liabilities such as Government policy related guarantees have such a high level of estimation uncertainty that the applicable financial reporting framework may not allow their recognition but may still require disclosure of the estimation uncertainty. Where these potential liabilities threaten the sustainability of government programs, auditors may use Emphasis of Matters or Other Matters paragraphs to highlight the issues.
  - Due to the complexity, nature and the element of management judgement, the reporting of a Key Audit Matter in such situations in line with ISSAI 2701 may be appropriate.

## **Risk Assessment Procedures and Related Activities**

- 22.6 In the public sector, the actual amounts of certain long-term estimated liabilities may not be known for an extended period of time. For example, social insurance liabilities extend for many years into the future and, therefore, auditors will not be able to use subsequent events to evaluate them. By its nature, the public sector has access to prior year records that extend through a significant amount of time from which the auditor may generate trends on the accuracy of estimates. These trends may be relevant in the application of ISSAI 2540.A55 to A60.

## **Responses to the Assessed Risks of Material Misstatement**

- 22.7 When considering whether specialized skills or knowledge in relation to one or more aspects of the accounting estimates are required in order to obtain sufficient appropriate audit evidence as required by ISSAI 2540.15, auditors' consideration of the need for specialized skills may be particularly relevant in relation to estimates such as those for but not limited to:
- Social insurance programs;
  - Government employee pension plans; and
  - Veterans' compensation programs.

Further guidance in using experts is included in Section 29 of this GUID.

## **Further Substantive Procedures to Respond to Significant Risks**

- 22.8 When evaluating accounting estimates in accordance with the requirements in ISSAI 2540.24(d), auditors may consider that management may not be in a position to carry out the specific course of action on which the estimate is based. As discussed in ISSAI 2315 (Revised), such decisions related to carrying out the specific course of action on which the estimate is based may be made outside the audited entity's control as a result of political processes. In such circumstances, the

auditor may need to consider the sufficiency and appropriateness of audit evidence and any impact on the auditor's conclusion on the financial statements.

## **Evaluating the Reasonableness of the Accounting Estimates, and Determining Misstatements**

- 22.9 When public sector financial statements include a number of very large estimates, which may have a large estimation uncertainty, auditors may need to evaluate the adequacy of disclosure of the estimation uncertainty and its effect on the auditor's report.

## **Indicators of Possible Management Bias**

- 22.10 Auditors review the judgments and decisions made by management in making accounting estimates to identify whether there are indicators of possible management bias in accordance with ISSAI 2540.32. In this process, managers can base their assumptions on different types of information extracted from internal and external sources, the relevance and reliability of which will be variable. The specific assumptions will also vary according to the characteristics of the asset or liability to be valued, the valuation method used (e.g. a market or performance approach) and the requirements of the applicable financial reporting framework. In doing this, auditors may consider reasons for possible bias that may be specific to the public sector such as:

- Strong political motives;
- Changing or unstable political and economic environment;
- Increased public expectations;
- Higher than normal expectations to meet budget;
- Pressure to adhere to regional and international treaties such as Sustainable Development Goals (SDGs);
- Reduction in budgets without corresponding reduction in service delivery expectations;
- Public and private partnerships; and
- Tolerance of errors in financial information.

- 22.11 Auditors operating in some environments, such as a Court of Accounts environment, may have additional responsibilities related to when they determine an intention by management to mislead. Such responsibilities often include identifying the individual(s) responsible for such actions and to recommend the filing of the appropriate civil and criminal charges against them. For that purpose, the auditors provide evidence of such potential irregularities and instances of misconduct either to the judicial department of the Court of Accounts or the relevant prosecutor's office, and cooperate with the judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.

## **Written Representations**

- 22.12 Due to the complexity, nature and the element of management judgement in relation to accounting estimates in the public sector, the auditor may consider the need to obtain representations about specific accounting estimates, including in relation to the methods, assumptions, or data used.

## **Documentation**

- 22.13 In cases where the auditors used the extensive long backdating prior year data and knowledge available in the public sector when developing an “Auditor’s range” in accordance with ISSAI 2540.29, the auditors may consider documenting over and above the requirements of ISSAI 2540.39 the basis for the auditor's evaluation of the reasonableness of the accounting estimates and related disclosures using such data.

## **Section 23 - ISSAI 2550 - Related Parties**

### **Content of this Section**

- 23.1. This Section provides guidance for auditors related to:
- (a) Restricted Transactions
  - (b) Definitions
  - (c) Risk Assessment Procedures and Related Activities
  - (d) Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions
  - (e) Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions

### **Restricted Transactions**

- 23.2. Public sector entities may also be subject to specific restrictions on the nature and scope of the transactions that they can have with related parties. The restrictions may prohibit transactions or practices that might be permissible in related party relationships outside the public sector.

### **Definitions**

- 23.3. ISSAI 2550.10(b) provides a definition of 'related party' where the applicable financial reporting framework establishes minimal or no related party requirements. Auditors will note that, under this definition, entities that are under common control by a state (i.e. a national, regional or local government) are not considered related unless they engage in significant transactions or share resources to a significant extent with one another.
- 23.4. Auditors may consider whether the exemption from the definition of related parties of entities under common control by the state leads to areas of greater risk in their audit of public sector entities. For example, there may be a situation where a ministry is composed of a number of entities. While these entities may not share resources or transact to a significant extent, there may be many, smaller apparently 'insignificant' transactions taking place which may be deemed irregular. There may also be situations where there is no transaction at all. For example the minister may exert influence on one entity to withhold paying a dividend to another entity in order to influence cash flow and possible budgetary appropriations decisions.
- 23.5. Auditors are advised to keep the wider definition of related parties in mind when applying the ISSAI.

### **Risk Assessment Procedures and Related Activities**

- 23.6. In obtaining an understanding of the public sector entity's related party relationships and transactions, in addition to the procedures described in ISSAI 2550.11 to 14 auditors have regard to:

- The legal structure and regulatory requirements governing the entity and its related parties, for example whether the entity is a ministry, department, agency or another form of public entity;
- Understanding the business operations of public sector entities will often include obtaining knowledge of types of government activities carried out including relevant programs and the principal entities it engages with in the execution of those programs;
- The organizational structure for controlling the entity and establishing accountability, recognizing that in the public sector those charged with governance serve as representatives of the citizens. Ownership of public sector entities may not have the same relevance as in private sector;
- Obtaining an understanding of the entity's reporting requirements, including those for the disclosure of related party relationships and transactions; and
- Other regulations that may be relevant to the public sector entity's ability to conduct business with related parties. This may include compliance with procurement regulations, which may include a requirement for public sector entities to demonstrate that transactions with related parties are conducted at arm's length.

23.7. The discussion on the susceptibility of the entity's financial statements to material misstatement may also cover the additional objectives and related risks of material misstatement, as discussed in ISSAI 2550.A8. Auditors may include auditors engaged in performance audits and other audit activities of the entity in such a discussion.

23.8. The discussion among the engagement team related to fraud may include consideration of the susceptibility of the entity's procurement process to fraud carried out by or through related parties.

### **Identification and Assessment of the Risks of Material Misstatement Associated with Related Party Relationships and Transactions**

23.9. In addition to the assertions set out in ISSAI 2315, the management of public sector entities may assert that transactions and events have been carried out in accordance with legislation or proper authority as noted in ISSAI 2315.A192. Such assertions may extend to the relationships and transactions with related parties and fall within the scope of the financial statement audit.

23.10. Auditors may be required by their mandate to consider the legal framework and regulations governing the entity and any requirements or specific limitations these may place on the entity, those charged with governance, management and employees, for entering into and the conduct of transactions with a related party. There may also be limitations on the entity's capacity to establish wholly or partly owned entities which would be deemed related parties.

23.11. There may also be a requirement for those charged with governance of public sector entities, management and employees to declare their interests in entities with which they transact on a professional or commercial basis. Where such legislative requirements exist, auditors need to apply risk assessment procedures to identify and assess the risks of material misstatements arising from non-compliance with those requirements.



## **Responses to the Risks of Material Misstatement Associated with Related Party Relationships and Transactions**

- 23.12. ISSAI 2550.23(b) requires auditors to obtain evidence that significant transactions with related parties outside the entity's normal course of business are appropriately authorized and approved. In the public sector, the audit mandate may involve a responsibility to report on compliance with laws and regulations. This may include a responsibility to obtain evidence that the relationships and transactions with related parties comply with laws and regulations and have been authorized and approved. Auditors may also have to seek evidence that management has obtained authorization and approval from the legislature, the finance ministry, or a 'parent' or sponsoring department, or the appropriate oversight body. These procedures may apply irrespective of whether the transactions are significant or outside the normal course of business.
- 23.13. ISSAI 2550.24 requires auditors to obtain sufficient appropriate evidence about a management's assertion that related party transactions are conducted at terms equivalent to those prevailing in an arm's length transaction if such an assertion was made by management in the financial statements. In the public sector laws or regulations related to procurement may require that contracts with third parties, including related parties, are subject to competitive tendering or some other form of 'market testing' to demonstrate 'value for money'.

## **Section 24 - ISSAI 2560 - Subsequent Events**

### **Content of the Section**

- 24.1. This Section provides additional guidance for auditors related to:
- (a) Events Occurring Between the Date of the Financial Statements and the Date of the Auditor's Report
  - (b) Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued

### **Events Occurring between the Date of the Financial Statements and the Date of the Auditor's Report**

- 24.2. In addition to the specific inquiries identified in ISSAI 2560.A9 auditors may also consider events that have occurred which:
- (a) Have relevance for the government entity's ability to fulfill its program objectives; and
  - (b) May impact the presentation of any performance information in the financial statements.
- 24.3. In addition to the procedures described in ISSAI 2560.A10 the auditor may also consider matters arising from relevant proceedings of the legislature and other relevant bodies which the auditors may have become aware of during the course of the audit as being scheduled to take place at or after the period end, the outcome of which may require adjustment of, or disclosure in, the financial statements.

### **Facts Which Become Known to the Auditor after the Financial Statements Have Been Issued**

- 24.4. With respect to auditor action to seek to prevent reliance on the auditor's report in ISSAI 2560.A20 auditors may seek legal advice and also consider reporting to the appropriate statutory body.

## **Section 25 - ISSAI 2570 (Revised) - Going Concern**

### **Content of the Section**

- 25.1. This Section provides additional guidance for auditors related to:
- (a) Going Concern Assumption
  - (b) Evaluating Management's Assessment
  - (c) Additional Audit Procedures When Events or Conditions Are Identified

### **Going Concern Assumption**

- 25.2. Auditors may be required to review and report upon the entity's arrangements to maintain its general financial standing.
- 25.3. Public sector entities may spend more in one year than they have resources to cover, such that their income may be less than their expenditure or there is an excess of liabilities over assets. However, it is uncommon for the operational existence of a public sector entity to cease or its scale of operations to be subject to a forced reduction because of an inability to finance its operations or of net liabilities.
- 25.4. Cessation of a public sector entity is most likely to result from a government policy decision. A policy decision may be taken to wind up and dissolve an entity in its entirety, to scale back its operations and transfer some of its functions to another public entity, merge with another public entity or privatize the entity. In each of these cases the operational existence of all or part of the entity ceases. Auditors may consider the manner in which entity activities are being wound up and/or transferred in order to conclude on matters related to going concern.
- 25.5. In forming a view of the entity's ability to continue its operations, auditors' consideration of going concern embraces two separate, but sometimes overlapping, factors:
- The greater risk associated with changes in policy direction (for example, where there is a change in government); and
  - The less common operational, or business, risk (for example, where an entity has insufficient working capital to continue its operations at its existing level and is unable to raise additional capital).
- 25.6. To minimize the risk of changes in government policies not coming to the auditor's attention which could impact on the going concern assumption, the auditor may ascertain whether:
- The government has declared its intention to review an area of policy affecting the audited entity;
  - A review has been announced and is in progress;
  - A review has indicated that the audited entity could be rationalized or that an entity's future may be re-examined; or
  - There is a government policy to privatize the activities of the audited entity.

## **Evaluating Management's Assessment**

- 25.7. Auditors are aware that changes of government policies can have a significant impact on the status and functions of public sector entities. However, political decisions may be unknown to the auditor.

## **Additional Audit Procedures When Events or Conditions Are Identified**

- 25.8. When considering the requirements of ISSAI 2570.16 auditors may consider whether to request that the entity secures direct confirmation from the department or executive body responsible for providing financial backing or future funding to the entity. When considering requesting such confirmation, auditors are advised to take into account any constraints imposed by the political process. In such circumstances, a representation provided by the responsible financial officer of the entity that financial backing or future funding will be received may not be sufficient as meaningful assurance on the future of an entity. This is because the intentions of the financial backer might not be known by the entity.
- 25.9. In addition to the audit procedures set out in the ISSAI, auditors may also read official records of changes in policy and relevant proceedings of the legislature and inquire about matters addressed in proceedings for which official records are not yet available.

## **Section 26 - ISSAI 2580 - Written Representations**

### **Content of the Section**

- 26.1. This Section provides additional guidance for auditors related to:
- (a) Overall Considerations
  - (b) Management from Whom Written Representations Requested
  - (c) Communicating a Threshold Amount
  - (d) Date of and Period(s) Covered by Written Representations
  - (e) Doubt as to the Reliability of Written Representations and Requested Written Representations Not Provided

### **Overall Considerations**

- 26.2. In the public sector management's responsibilities may be broader than those responsibilities in the private sector. When requesting written representations about management's responsibilities, auditors may take this broader premise into account.

### **Management from Whom Written Representations Requested**

- 26.3. When considering the guidance in ISSAI 2580.A2 auditors are advised to take into account that requirements with regard to responsibility for preparation of financial statements may vary as stipulated by legislation. Auditors are advised to familiarize themselves with applicable legislation to identify those from whom written representations should be requested. Auditors may also inform and agree, at the planning stage, with those charged with governance on those individuals identified as responsible for providing written representations.

### **Communicating a Threshold Amount**

- 26.4. According to ISSAI 2580.A14 the auditor may consider communicating to management a threshold for purposes of the requested written representations. Auditors are advised to take into account the broader public sector perspective by which they may be required to communicate all misstatements, even those that have been corrected by the entity, and all control deficiencies, and instances of non-compliance with authorities. For purposes of requesting written representations auditors may consider communicating such requirements. ~~Public sector a~~Auditors are advised to take into account the broader public sector perspective and procedures describing additional objectives, responsibilities and requirements.

### **Date of and Period(s) Covered by Written Representations**

- 26.5. As stated in ISSAI 2580.A15 the date of the written representations should be as near as practical to the date of the auditor's report on the financial statements. In the public sector management representations may sometimes be obtained from high governance levels and it is therefore

important for auditors to plan in advance so that written representations may be obtained in time to avoid any delay in issuing the audit report.

### **Doubt as to the Reliability of Written Representations and Requested Written Representations Not Provided**

- 26.6. Auditors may be appointed in accordance with statutory procedures and therefore may not in a position to decline or withdraw from an engagement. In such cases, auditors may report to the legislature as appropriate.
- 26.7. **Appendix C** lists other items that an auditor may choose to include in the management representation letter.

## **Section 27 - ISSAI 2600 - Special considerations - Audits of Group Financial Statements (Including the Work of Component Auditors)**

### **Content of this Section**

- 27.1. This Section provides additional guidance for auditors related to:
- (a) Definitions
  - (b) Acceptance and Continuance
  - (c) Understanding the Group, its Components and their Environments
  - (d) Understanding the Component Auditor
  - (e) Materiality
  - (f) Responding to Assessed Risks
  - (g) Consolidation Process
  - (h) Communication with the Component Auditor
  - (i) Communication with Group Management and Those Charged with Governance of the Group

### **Definitions**

- 27.2. When considering the definitions in ISSAI 2600.9 in addition to referring to the guidance in ISSAI 2600.A2 to A6 additional characteristics may apply in the public sector as follows;
- (a) Component - In a public sector environment, components may also include agencies, departments, bureaus, corporations, funds, component units, districts, joint ventures and non-governmental organizations; and
  - (b) Significant Component - In a public sector environment the determination of significant components may also involve matters that have heightened public sensitivity, such as national security issues, donor funded projects or the reporting on tax revenue.

### **Acceptance and Continuance**

- 27.3. The inability to be involved in the work of a component auditor as discussed in ISSAI 2600.13 and the inability to obtain sufficient appropriate audit evidence may be less likely to occur in a public sector environment, because laws or regulations may prohibit restrictions of access to information.
- 27.4. When complying with the requirements of ISSAI 2600.13 in addition to referring to the guidance in ISSAI 2600.A18 public sector group auditors may communicate with the legislature or other regulatory bodies as appropriate, about removing restrictions on access to audit evidence imposed by group management or laws or regulations.
- 27.5. In the public sector, the significant changes that affect the group engagement team's ability to obtain sufficient appropriate audit evidence as mentioned in ISSAI 2600.A12 may be affected by additional changes, such as;

- Changes in laws and regulations affecting the financial management information system and/or the financial reporting framework; and
- Changes in the nature, sources or amounts of funding, including changes in the structure of public debt.

## **Understanding the Group, its Components and their Environments**

- 27.6. The group auditor is required to understand the group and its components and guidance is provided in ISSAI 2600.A23 to A31. The group engagement team may also obtain an understanding about additional public sector matters which may include:
- Controls over compliance with laws and regulations;
  - Adherence to budgetary requirements and spending authorities;
  - Consistent classification of codes for reporting budgetary and actual amounts; or
  - Participation of group and/or components in public and private partnerships.
- 27.7. In certain cases, the Government may have relationships with independent entities through transfers or through its role as a regulator for certain industries. In these cases it can be difficult to determine whether the Government's relationship with an entity justifies their inclusion in the group. For example;
- The application of the financial reporting framework may result in the exclusion of a specific type of agency, department, bureau, corporation, fund, district, joint venture or non-governmental organization from the group financial statements. In such cases, if the public sector group auditor believes that this outcome would result in a misleading group financial statement presentation, the public sector group auditor may, in addition to considering the impact on the auditor's report, also consider the need to communicate the matter to the legislature or other appropriate regulatory bodies; or
  - The financial reporting framework may not provide specific guidance for inclusion or exclusion of the entities, mentioned above, in the group financial statements. In such cases, the public sector group auditor may participate in discussions between group management and component management to determine whether the treatment of the component in the group financial statements will result in fair presentation. In addition, it is possible that group management may not agree with the inclusion of the component in group financial statements, which, in turn, may limit the ability of the group auditor to communicate with and use the work of the component auditor.

## **Understanding the Component Auditor**

- 27.8. Where the public sector group auditor plans to request a component auditor to perform additional audit work on financial information related to a component or the group, the guidance in ISSAI 2600.A33 is particularly relevant. In certain public sector environments the group auditor's methodology may differ from the methodology or practices of component auditors. In such cases the group auditor may prescribe procedures consistent with the group auditor's methodology.



- 27.9. When considering ISSAI 2600.A37 auditors may note that in the public sector, the component auditor may also be subject to the requirements of INTOSAI Code of Ethics as adopted by the public sector audit organization.
- 27.10. The second bullet of ISSAI 2600.A38 discusses the group engagement team's understanding of the component auditor's professional competence and whether the component auditor possesses the special skills (e.g. industry specific knowledge) necessary to perform the work. In the context of the public sector environment this would include knowledge of that environment and applicable laws and regulations relevant to the group audit.
- 27.11. ISSAI 2600.A41 discusses circumstances where law or regulation prohibits access to relevant parts of the audit documentation of the component auditor. In such circumstances, the public sector also may consider whether to communicate the matter to the legislature or other appropriate regulatory bodies.

## **Materiality**

- 27.12. When determining materiality for the group financial statements as required by ISSAI 2600.21 to 23, auditors may use the guidance in ISSAI 2320.A3 and A10 which addresses determining materiality in the public sector. In the context of group financial statements, materiality for classes of transactions, account balances, disclosures as well as component materiality may be assessed at a low level in the public sector. This may occur for a variety of reasons, including the context of the matter, or the nature and characteristics of the systems and entities involved. In addition, there might be requirements for separate opinions on components, thus indicating a need for lower materiality for the components. Furthermore, certain procedures may be required to be performed by audit mandate or legislation, or the auditors may design audit procedures for transactions that are significant solely because of their nature.
- 27.13. As required by ISSAI 2600.21(d) the determination of a threshold, above which statements cannot be regarded as clearly trivial to the group financial statements, may be influenced by the nature of the subject matter and public sensitivity. Public sector group auditors also take into account the broader public sector perspective by which they may be required to communicate all misstatements, including those that have been corrected by the entity, and all control deficiencies, and instances of non-compliance with authorities. In such cases no thresholds would be established.

## **Responding to Assessed Risks**

- 27.14. When applying the requirements of ISSAI 2600.24 at the group level, public sector group auditors may consider that in the public sector the nature of activities performed by different components is a major determinant of risk of material misstatement. For instance, the risk of material misstatements in a disaster-relief operation will usually be higher than the risk of material misstatements in a more stable operation such as payment of salaries to school teachers. To assess the risk of material misstatements in group wide operations, the group auditor may categorize components according to the nature of their operations, assessing risk for each category

separately. Such an exercise may enable the group auditor to determine the nature, timing and extent of the work to be performed on the Consolidation process.

## **Consolidation Process**

- 27.15. When considering the guidance in ISSAI 2600.A56 in the context of the public sector there may be a variety of transactions recorded only at the group level especially in the consolidated financial statements of the government. Such transactions may include recording of natural resources or historical treasures. In such cases, group auditors are responsible for obtaining sufficient appropriate audit evidence for these transactions.
- 27.16. These are examples of public sector related conditions in addition to the examples included in Appendix 3 of ISSAI 2600, which might indicate risks of material misstatements of the group financial statements.
- Management's lack of knowledge of applicable laws and regulations;
  - Budget overspending due to weak budgetary controls;
  - Privatizations of components;
  - New programs or components or major changes to existing programs or components;
  - New financing sources for the group or components and between components;
  - Changes in laws and regulations or directives;
  - Political decisions such as reorganization of components;
  - Major programs within a component without sufficient allocated resources and/or funding;
  - Increased public expectations;
  - Procurement of goods and services in certain components, such as defence or national security;
  - Outsourcing of component activities;
  - Components subject to special investigations or parliamentary or legislative oversight;
  - Changes in political leadership;
  - Indications of waste or abuse;
  - Higher than normal expectations to meet budget;
  - Public and private partnerships;
  - Political interference in allocation of public resources; or
  - Direct influence of government in management and/or lack of professional experience in management versus political appointment.

## **Communication with the Component Auditor**

- 27.17. When communicating with the component auditor in accordance with ISSAI 2600.40 public sector group auditors may find it relevant to provide the component auditors with information on the risk of non-compliance with laws or regulations that could give rise to a material misstatement in the group financial statements or affect the nature, timing and extent of audit procedures and reporting requirements.

- 27.18. Additional matters that may be relevant in the public sector in addition to requested or suggested matters in Appendix 5 of ISSAI 2600 may include:
- A list of laws and regulations relevant to the audit of the component audit as well as a list of laws and regulations relevant to the group audit; or
  - A list of additional procedures that the group auditor determines is necessary to be performed by the component auditor.

### **Communication with Group Management and Those Charged with Governance of the Group**

- 27.19. Public sector group auditors may have reporting responsibilities regarding communicating fraud identified at the component level in addition to the requirements in ISSAI 2600.47. These responsibilities may include reporting to parties outside the entity, such as regulatory and enforcement authorities. Further guidance on the auditor's responsibilities on reporting fraud is included in ISSAI 2240.

## Section 28 - ISSAI 2610 (Revised 2013) - Using the Work of Internal Auditors

### Content of this Section

28.1. This Section provides additional guidance for auditors related to:

- (a) Determining Whether, in Which Areas, and to What Extent ~~to Use~~ the Work of the Internal Auditors Function Can Be Used
- (b) Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance

### **Determining Whether, in Which Areas, and to What Extent ~~to Use~~ the Work of the Internal Auditors Function Can Be Used**

28.2. When evaluating the objectivity of the internal audit function as required by ISSAI 2610.15(a) auditors are advised to consider INTOSAI GUIDs addressing the topics of internal auditor independence and objectivity. Where the internal audit function is established by legislation or regulation, and the following criteria are met, there is a strong indication that the internal audit function is objective:

- (a) Is accountable to top management, for example the head or deputy head of the government entity, and to those charged with governance;
- (b) Reports the audit results both to top management, for example the head or deputy head of the government entity, and to those charged with governance;
- (c) Is located organizationally outside the staff and management function of the unit under audit;
- (d) Is sufficiently removed from political pressure to conduct audits and report findings, opinions, and conclusions objectively without fear of political reprisal;
- (e) Does not permit internal audit staff to audit operations for which they have previously been responsible for to avoid any perceived conflict of interest; and
- (f) Has access to those charged with governance

### **Determining Whether, in Which Areas, and to What Extent Internal Auditors Can Be Used to Provide Direct Assistance**

28.3. In consideration of the public expectation about independence of those conducting the audit, it may be relevant for auditors to evaluate the threats and safeguards in using internal auditors to provide direct assistance, in addition to those criteria already identified in the ISSAI.

## **Section 29 - ISSAI 2620 - Using the Work of an Auditor's Expert**

### **Content of Section**

- 29.1. This Section provides additional guidance for auditors related to:
- (a) Determining the Need for an Auditor's Expert
  - (b) The Competence, Capabilities and Objectivity of the Auditor's Expert
  - (c) Agreement with the Auditor's Expert

### **Determining the Need for an Auditor's Expert**

- 29.2. When determining the need to use the work of an auditor's expert, auditors are advised to consider that, based on the laws, regulations or mandate, financial audits may include additional responsibilities related to fraud. Auditors may in such cases need to use the work of experts from the police or anti-corruption bureaus. For some public sector environments, such as a Court of Accounts environment including judgment mandates, the judgment decision may be based on expert's evidences which become legally binding and force the responsible person of the fraud or corruption to pay penalties and debts. Prosecutors can sue the agent responsible for fraud or corruption and also seize assets necessary to pay the debt. Therefore, the auditors provide evidence of such potential irregularities and instances of misconduct to the judicial department of the Court of Accounts or the relevant prosecution office, and cooperate with these judicial department as necessary. Such information is normally provided in the form of a separate report on the audit work performed and the related findings.

### **The Competence, Capabilities and Objectivity of the Auditor's Expert**

- 29.3. The issue of independence is of utmost importance in the public sector and may include legislative requirements or government policies with which auditors and experts must comply. The procedures recommended in ISSAI 2620.A20 related to the evaluation of objectivity may also be adopted by auditors to evaluate the independence of the expert. Moreover, when considering independence, auditors may also consider evaluating the expert's actual and perceived political neutrality. Activities which could call into question an expert's political neutrality may include running for or holding political office or taking part in events sponsored by political associations, lobby groups or organizations with political affiliations. These factors should be considered in the context of the expert's level of involvement and the perceived potential for personal benefit and/or bias.

### **Agreement with the Auditor's Expert**

- 29.4. Paragraphs 70 and 71 of INTOSAI Code of Ethics require auditors to observe confidentiality especially with regard to sensitive data, unless specific authority has been given to disclose some information or there is a legal or professional right or duty to do so. One fundamental difference between the private and public sector is that there may be specific legislative requirements in the

public sector related to confidentiality on the one hand, and access by third parties on the other. There is an ongoing need in the public sector to balance confidentiality with the need for transparency and accountability. When considering confidentiality matters as stated in ISSAI 2620.11(d) auditors are advised to be aware of any legislation giving public access to the work of an expert used in the audit in a public sector.

- 29.5. Receiving the requests from outside regulatory entities, police, prosecutors or judges to obtain access to the work of an expert is not unusual in the public sector. Auditors are advised to inform the expert that his or her evidence or report may be requested from outside the public sector audit organization and be used in other processes or investigations.
- 29.6. The expert that works for the public sector may have additional responsibilities related to confidentiality which may be based on the mandate of the particular Supreme Audit Institution, or laws related to official secrets or private acts. Such legislation may, for example, relate to audits of defence, health, social service or tax agencies. Auditors may need to familiarize themselves with any particular requirements related to confidentiality to which he or she is bound.
- 29.7. The balance between confidentiality and transparency requires the auditors to use professional judgment to ensure that the work of an expert of a confidential nature is clearly identified and treated as such, while at the same time granting access as appropriate. Auditors are advised to be aware of those clearly defined policies and procedures set up by the audit organization to deal with such situations.

## **Section 30 - ISSAI 2700 (Revised) - Forming an Opinion and Reporting on Financial Statements**

### **Content of this Section**

30.1. This Section provides additional guidance for auditors related to:

(a) Auditor's Report

### **Auditor's Report**

- 30.2. In the public sector, law or regulation may set out the responsibilities for the financial statements and the auditor determines the responsibilities of management and those charged with governance<sup>1</sup> that will be included in the auditor's report as guided by ISSAI 2700.A44 to A49.
- 30.3. According to ISSAI 2700.43, if the auditor addresses other reporting responsibilities in the auditor's report on the financial statements that are in addition to the auditor's responsibilities under the financial audit ISSAIs, these other reporting responsibilities shall be addressed in a separate section in the auditor's report with a heading titled "Report on Other Legal and Regulatory Requirements" or otherwise as appropriate to the content of the section, unless these other reporting responsibilities address the same topics as those presented under the reporting responsibilities required by the financial audit ISSAIs in which case the other reporting responsibilities may be presented in the same section as the related report elements required by the financial audit ISSAIs. This financial audit ISSAI reporting requirement exists to help ensure the clarity of the audit opinion on the financial statements by requiring information that is reported in the ISSAI financial audit report that is not relevant to the opinion on the financial statements to be clearly differentiated within the ISSAI financial audit report. The financial audit ISSAIs do not address the nature and extent of the procedures that must be performed to support the reporting of such information or how such information may be presented in a separate report. The application of other auditing standards may therefore be necessary when reporting such information.
- 30.4. ISSAI 2220 may be referred to when reporting on ethical responsibilities in the Basis for Opinion section in accordance with ISSAI 2700.28.
- 30.5. In cases where auditors are required by law or regulation to use a specific layout or wording of the auditor's report, auditors evaluate whether such layout or wording contains the minimum elements, as required by ISSAI 2700.50. If such elements are not included, auditors cannot state that the audit complies with the financial auditing standards (ISSAI 2000-2899).

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<sup>1</sup> ISSAI 2260 (Revised), "Communication with Those Charged with Governance"

- 30.6. When applying ISSAI 2700.A21 and when law, regulation or the terms of the engagement do not specify the addressee for the auditor's report, auditors are advised to address the auditor's report to those charged with governance or relevant part of the legislature, as appropriate.
- 30.7. Law or regulation may establish deadlines for the date of the auditor's report. In circumstances where auditors are unable to meet the deadline, auditors may consider taking appropriate actions such as informing those charged with governance or the legislature.



## **Section 31 - ISSAI 2701 - Communicating Key Audit Matters in the Independent Auditor's Report**

### **Content of this Section**

31.1. This Section provides additional guidance for auditors related to:

- a) Determining Key Audit Matters
- b) Communicating Key Audit Matters

### **Determining Key Audit Matters**

- 31.2. While the requirement to report Key Audit Matters is mandatory for listed entities as per ISSAI 2701, auditors may also consider reporting key audit matters when auditing entities other than listed entities since the public sector is a significant participant of any economy and is responsible for maintaining and providing important functions that affect citizens.
- 31.3. When deciding to communicate key audit matters when auditing entities other than listed entities, auditors may consider the following criteria:
- If laws and regulations or the audit mandate require the auditors to report specific issues related to the work of the auditor which would be similar to key audit matters, the auditors may consider whether communication of key audit matters in the auditor's report would be relevant.
  - Communication of matters similar to key audit matters that are required by law and regulation may be communicated in different ways. If communicated in the auditor's report, ISSAI 2701 may not be applicable but when the communication is presented in separate reports only addressing specific users, the auditor may find it relevant to apply ISSAI 2701 since the auditor's report will reach all potential stakeholders and users.
  - ISSAI 2700.A75 provides further guidance on the interaction between key audit matters and other reporting requirements in the public sector.
- 31.4. If the auditor decides to apply ISSAI 2701 for an audit of an entity other than a listed entity, it may be advisable to establish a policy to communicate key audit matters for all audited entities (other than listed entities) or just specific entities. Criteria may be established to identify audited entities for which key audit matters will be communicated. Examples of such criteria:
- Audited entities with the highest impact on the state budget;
  - Audited entities with the largest impact on the consolidated financial statements; and
  - Audited entities which will affect the market (e.g. national debt).

### **Communicating Key Audit Matters**

- 31.5. When communicating key audit matters, auditors are advised to consider laws and regulations that restrict the reporting of such information by imposing confidentiality requirements. The need for confidentiality may be based on the mandate of the auditor or legislation related to official secrecy

or privacy. For example, audits of entities responsible for defence, health, social service and taxation may be subject to such restrictions. Auditors may identify such laws and regulations and consider these confidentiality requirements when determining the key audit matters to communicate. ISSAI 2701.14 and A52 to A56 provide guidance on how this circumstance may be addressed.

31.6. **Appendix D** presents an illustrative example of a Key Audit Matters paragraph.

## **Section 32 - ISSAI 2705 (Revised) - Modifications to the Opinion in the Independent Auditor's Report**

### **Content of this Section**

- 32.1. This Section provides additional guidance for auditors related to:
- (a) Circumstances When a Modification to the Auditor's Opinion is Required
  - (b) Determining the Type of Modification to the Auditor's Opinion
  - (c) Nature of Material Misstatements
  - (d) Nature of an Inability to Obtain Sufficient Appropriate Audit Evidence
  - (e) Form and Content of the Auditor's Report When the Opinion is Modified
  - (f) Communication With Those Charged With Governance

### **Circumstances When a Modification to the Auditor's Opinion is Required**

- 32.2. In applying the requirements in ISSAI 2705.6 auditors having responsibilities relating to reporting on non-compliance with authorities while conducting an audit of financial statements may consider the impact of a matter of non-compliance, normally reported in a separate section of the auditor's report as per ISSAI 2705.43.

### **Determining the Type of Modification to the Auditor's Opinion**

- 32.3. In addition to the responses required by ISSAI 2705.13(b) auditors may be required, or decide, to report separately to the legislature or other regulatory bodies as appropriate about any instances of management refusing to remove restrictions on access to audit evidence.

### **Nature of Material Misstatements**

- 32.4. When applying ISSAI 2705.A3 auditors will also find further guidance in ISSAI 2450.A24 and A25.

### **Nature of and Inability to Obtain Sufficient Appropriate Audit Evidence**

- 32.5. In the public sector, additional examples of circumstances relating to the nature or timing of the auditor's work as described in ISSAI 2705.A11 may include legislative changes, national disasters and political decisions such as military operations and major relocation of government operations.

### **Form and Content of the Auditor's Report When the Opinion Is Modified**

- 32.6. In the public sector, it may not always be relevant to quantify the effect on income tax, income before taxes, net income and equity, the example provided in ISSAI 2705.A22. Auditors may instead quantify the effects on the financial statements in other terms such as gross expenditure, gross revenue or national debt or surplus.

## **Communication with Those Charged with Governance**

- 32.7. Auditors may be required to, or may decide to, communicate with other intended users, such as the legislature, in addition to those charged with governance, as set out in ISSAI 2705.30.

## **Section 33 - ISSAI 2706 (Revised) - Emphasis of Matter Paragraphs and Other Matter Paragraphs in the Independent Auditor's Report**

### **Content of the Section**

33.1. This Section provides additional guidance for auditors related to:

- (a) Emphasis of Matter Paragraphs in the Auditor's Report
- (b) Other Matter Paragraphs in the Auditor's Report
- (c) Communication With Those Charged With Governance

### **Emphasis of Matter Paragraphs in the Auditor's Report**

33.2. In the public sector, audit mandates or expectations may expand circumstances relevant for reporting an Emphasis of Matter paragraph concerning a matter appropriately presented or disclosed in the financial statements. In addition to examples discussed in the application guidance of the ISSAI, auditors may consider the following factors when considering reporting an Emphasis of Matter paragraph:

- Legislative actions on programs or the budget;
- Laws, regulations or directives with a significant effect on the entity;
- Fraud, abuse or losses;
- Significant transactions;
- Significant internal control deficiencies;
- Questionable business practices;
- Transactions entered into without due regard for economy;
- Prior period errors;
- Environmental issues; or
- Corporate social responsibility issues.

### **Other Matter Paragraphs in the Auditor's Report**

33.3. The same examples provided in paragraph 33.2 above may be relevant for Other Matter Paragraphs, as outlined in ISSAI 2706.10 when the information is not disclosed in the financial statements.

33.4. Audits conducted by the public sector auditor may be mandated by law or regulation, and therefore public sector auditors may not be able to withdraw from an engagement even though the possible effect of an inability to obtain sufficient appropriate audit evidence due to limitation of scope of the audit imposed by management is pervasive as outlined in ISSAI 2706.A10. In this circumstance, the ~~public sector~~ auditor may consider it necessary to include an Other Matter Paragraph in the auditor's report citing the mandate for audit and that it is not possible to withdraw from the engagement.

- 33.5. Restrictions on distribution or use of the auditor's report suggested in ISSAI 2706.A14 may not be an option in the public sector. Further guidance on restriction on distribution or use is provided in ISSAI 2800.A21.

### **Communication with Those Charged with Governance**

- 33.6. ISSAI 2706.12 requires the auditor to communicate with those charged with governance if the auditor expects to include an Emphasis of Matter or an Other Matter paragraph in the auditor's report. Auditors may be required to or decide to communicate with other intended users, such as the legislature, in addition to those charged with governance.
- 33.7. When considering ISSAI 2706.A18, auditors may be expected to communicate with those charged with governance on all matters included in an Other Matter paragraph, even those matters that are recurring. Auditors may also decide to communicate recurring matters to other parties such as the legislature.

## **Section 34 - ISSAI 2710 - Comparative Information - Corresponding Figures and Comparative Financial Statements**

### **Content of this Section**

- 34.1. This Section provides additional guidance for auditors related to audit reporting.

### **Audit Reporting**

- 34.2. Normally the situations described ISSAI 2710.13, 17 and 18 may be less likely to occur in the public sector as the responsibility to audit the financial statements may reside with the auditor as defined in its mandate. Situations where the concept of predecessor auditor may be relevant include nationalization and privatization. When the audit of the financial statement is outsourced<sup>1</sup> and the responsibility of the audit remains within the auditor, the concept of a predecessor auditor will not be relevant. It is also less likely that situations described in ISSAI 2710.14 and 19 involving an unaudited prior period, would occur.

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<sup>1</sup> An outsourced audit is a financial statement audit performed by a separate audit organization (e.g. a national accounting firm) on behalf of a SAI. The audit report resulting from the audit engagement is issued by the SAI.

## **Section 35 - ISSAI 2720 (Revised) - The Auditor's Responsibilities Relating to Other Information**

### **Content of this Section**

35.1. This Section provides additional guidance for auditors related to:

- (a) Definition of Annual Report
- (b) Withdrawal From the Engagement

### **Definition of Annual Report**

- 35.2. In compliance with law, regulation or custom, public sector entities may publish further reports such as annual activity reports or documents reporting on the sustainability of their finances or activities.
- 35.3. Auditors are advised to obtain an understanding of the scope, contents, purposes and intended addressees of any documents published annually by the auditee (whether on traditional media or electronically). On the basis of this understanding, auditors may identify, in liaison with management, the entity's annual report(s).
- 35.4. Auditors may consider whether it is necessary to issue guidance within their organization to ensure that the identification of entity annual reports is performed on a consistent basis across all of the audited entities.

### **Withdrawal from the Engagement**

- 35.5. When circumstances surrounding a refusal to correct a material misstatement of the other information cast such doubt on the integrity of management and those charged with governance as to call into question the reliability of representations obtained from them during the audit, withdrawal from the engagement may be appropriate.
- 35.6. ISSAI 2720.A47 provides that where withdrawal from an engagement is not possible in the public sector, the auditor may issue a report to the legislature providing details of the matter or may take other appropriate actions. Other appropriate actions may include reporting under Other Matter Paragraph in accordance with ISSAI 2706 highlighting management's refusal to correct material misstatements of the other information. Alternatively, the auditor may also conclude that a disclaimer of opinion on the financial statements is the appropriate response in the circumstances. More than one action may be necessary depending on the circumstances encountered.



## **Section 36 - ISSAI 2800 (Revised) - Special Considerations - Audits of Financial Statements Prepared in Accordance with Special Purpose Frameworks**

### **Content of this Section**

- 36.1. This Section provides additional guidance for auditors related to:
- (a) Definitions of Special Purpose Frameworks
  - (b) Considerations When Accepting the Engagement
  - (c) Forming an Opinion and Reporting Considerations

### **Definitions of Special Purpose Frameworks**

- 36.2. 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 that perform an oversight function) that can demand financial statements tailored to meet their specific information needs. In some environments such financial statements are the only financial statements prepared by the public sector entity. ISSAI 2800.A4 provides that even when such financial statements are the only financial statements prepared by the public sector entity, they are considered to be special purpose financial statements. Auditors, therefore, are advised to examine whether the financial reporting framework is designed to meet the financial information needs of a wide range of users (“general purpose framework”) or the financial information needs of specific users.
- 36.3. ISSAI 2800.A1 provides examples of special purpose frameworks. Other examples may include the financial reporting provisions of a grant facility or a specific public sector program.

### **Considerations When Accepting the Engagement**

- 36.4. ISSAI 2800.8 explains that an understanding of the steps taken by management to determine that the financial reporting framework is acceptable in the circumstances may assist the auditor in determining the acceptability of that framework in line with the requirements of ISSAI 2210. In some jurisdictions, law or regulation may prescribe the financial reporting framework to be used by management in the preparation of special purpose financial statements for a certain type of entity. For example, a regulator may establish financial reporting provisions to meet the requirements of that regulator. In the absence of indications to the contrary, such a financial reporting framework is presumed acceptable for special purpose financial statements prepared by such entity.

### **Forming an Opinion and Reporting Considerations**

- 36.5. ISSAI 2800.11 requires the auditor to apply the requirements of ISSAI 2700 (Revised) when forming an opinion. In the public sector, legislation governing the audit mandate may specify the layout of, or wording to be used in, the auditor’s report. When auditors prepare the auditor’s report

using the layout or wording specified in such legislation, the auditor's report can refer to the audit being conducted in accordance with ISSAIs, and the legislation governing the audit mandate, only if the auditor's report includes, at a minimum, each of the elements specified in ISSAI 2700.50(a) to (o).

- 36.6. Legislation or mandated responsibilities in the public sector may require the auditor's report on special purpose financial statements to address other reporting responsibilities in addition to the auditor's responsibilities under the ISSAIs. Such a description is included in a separate section of the auditor's report. If the relevant legislation or the audit mandate specifies the format for, or wording to be used in this section, auditors may use the prescribed wording but also ensure that the requirements of ISSAI 2700.43 to 45 are met.
- 36.7. When management has a choice of financial reporting frameworks ISSAI 2800.13(b) requires that the explanation of management's responsibility for the special purpose financial statements be expanded to include the responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances. As discussed in paragraph 36.4 above, it is unlikely that, in the public sector, management has such a choice. Auditors may also consider expanding the description of management's responsibility for the special purpose financial statements to include the source that determines the financial reporting framework applied.
- 36.8. ISSAI 2800.14 requires the auditor's report to include an Emphasis of Matter paragraph alerting users of the auditor's report that the financial statements are prepared in accordance with a special purpose framework and that, as a result, the financial statements may not be suitable for another purpose. ISSAI 2800.A21 explains that the auditor may also consider including a statement in the auditor's report that it is intended solely for the specific users and that depending on law or regulation this may be achieved by restricting the distribution or use of the auditor's report. In the public sector this may not be an option as the auditor's report is ordinarily a public document. However, to avoid misleading users of the auditor's report, auditors are advised to include in their report the statement that the financial statements have been prepared in accordance with a special purpose framework. An example of such a paragraph is included below.

**Example of statement to include in the auditor's report**

**Emphasis of Matter: basis of accounting and restriction on the distribution of use**

*We draw attention to note x setting out the Accounting Policies adopted by the [audited entity] in preparing the financial statements. The financial statements have been prepared in accordance with [legislation/government direction/other authority] issued by [Ministry, Agency, Government, Parliament] to assist the [audited entity] in complying with [basis].*

*As a result, the financial statements may not be suitable for another purpose. Our report is intended solely for [Ministry, Agency, Government, Parliament] and should not be used by other parties. We have not modified our opinion in respect of this matter.*

## **Section 37 - ISSAI 2805 (Revised) - Special Considerations - Audits of Single Financial Statements and Specific Elements, Accounts or Items of a Financial Statement**

### **Content of the Section**

37.1. This Section provides additional guidance for auditors related to:

- (a) Considerations When Accepting the Engagement
- (b) Forming an Opinion and Reporting Considerations

### **Considerations When Accepting the Engagement**

- 37.2. When considering ISSAI 2805.7 auditors may be engaged to audit single financial statements, specific elements, accounts or items such as to audit projects financed by the government in organizations in which they are not engaged to audit the complete set of financial statements. The guidance set out in ISSAI 2805.A6 to discuss with management whether another type of engagement might be more practicable when an audit in accordance with the ISSAIs may not be practicable, is normally not an option for SAs since SAs may need to determine and agree such issues with the legislature or with those with responsibility to direct the audit organization.
- 37.3. A public sector entity may prepare financial information, including single financial statements, specific elements, accounts or items of a financial statement for other parties (such as governing bodies, the legislature or other parties that perform an oversight function). Such information may fall under the audit mandate of a public sector audit organization. Auditors engaged in such audits are advised to carefully consider the guidance in ISSAI 2805.A5 to A9 in such cases.
- 37.4. When auditors are engaged to report on single financial statements, specific elements, accounts or items of a financial statement in conjunction with an audit of the entity's financial statements, they are advised to determine whether laws, regulations or the audit mandate may prescribe wording for the opinion in the auditor's report that differs significantly from the guidance provided in ISSAI 2805.A8 to A9. ISSAI 2210.18 to 21 also deals with the auditor's additional considerations in engagement acceptance.
- 37.5. ISSAI 2805.8 explains that an understanding of the steps taken by management to determine that the financial reporting framework is acceptable in the circumstances may assist the auditor in determining the acceptability of that framework. In the public sector, however, the financial reporting framework may be prescribed by law or regulation.

### **Forming an Opinion and Reporting Considerations**

- 37.6. In the public sector, legislation governing the audit mandate may specify the layout of, or wording to be used in, the auditor's report. When auditors prepare the auditor's report using the layout or wording specified in such legislation, the auditor's report can refer to the audit being conducted in

accordance with the financial auditing standards (ISSAI 2000-2899), and the legislation governing the audit mandate, only if the auditor's report includes, at a minimum, each of the elements specified in ISSAI 2700.50(a) to (o).

- 37.7. ISSAI 2805.15 requires the auditor to consider whether to modify the auditor's report on an element in a similar manner as the auditor's report on the entity's financial statements. Auditors also consider whether to modify the auditor's report on an element based on modified opinions in the auditor's report on the entity's financial statements that relate to additional reporting responsibilities as described in paragraph 37.6. Even when such modified opinion does not relate to the audited element, auditors nevertheless are advised to consider whether to include a reference to the modified opinion in the auditor's report on the element. Factors that may affect the auditor's consideration include the requirements of relevant legislation or the audit mandate, other specific provisions for the engagement, and whether omission of such reference from the auditor's report on the element might be misleading.

## **Section 38 - ISSAI 2810 (Revised) - Engagements to Report on Summary Financial Statements**

### **Content of this Section**

- 38.1. This Section provides additional guidance for auditors related to:
- (a) Auditor's Report on Summary Financial Statements
  - (b) Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting
  - (c) Auditor Association

### **Auditor's Report on Summary Financial Statements**

- 38.2. In reporting on the financial statements from which the summary financial statements have been derived, auditors might have expressed an opinion in addition to the opinion whether the financial statements have been prepared, in all material respects, in accordance with the applicable financial reporting framework. For example, auditors might have reported on whether they have found any instances of non-compliance with authorities including budget and accountability, or expressed an opinion on the effectiveness of internal control. In such cases, in addition to the requirements set out in ISSAI 2810.16, auditors should include a reference to such an additional opinion in the auditor's report on the summary financial statements.
- 38.3. In the public sector, the elements of the auditor's report, including the form and wording of the opinion may be prescribed by law or regulation or defined by the audit mandate. In such circumstances, auditors are advised to apply the prescribed wording, taking into account ISSAI 2810.10.
- 38.4. ISSAI 2810.19 also applies in circumstances where the auditor's report on the financial statements from which the summary financial statements have been derived includes a qualified opinion, an Emphasis of Matter paragraph, an Other Matter paragraph, a Material Uncertainty Related to Going Concern section, communication of key audit matters or a statement that describes an uncorrected material misstatement of the other information.

### **Restriction on Distribution or Use or Alerting Readers to the Basis of Accounting**

- 38.5. Taking into account ISSAI 2810.22, restricting the distribution or use of an auditor's report is not normally an option as the auditor's report ordinarily is a public document.

### **Auditor Association**

- 38.6. ISSAI 2810.26 to 27 require the auditor to take action to avoid being associated with summary financial statements on which the auditor has not reported. Auditors may also take other action

depending on relevant legislation and the audit mandate. Such action may include formal reports to the legislature.

## Appendix A - ISSAI 2210

### Example of an Audit Engagement Letter in the Public Sector

The following is an example of an audit engagement letter for an audit of general purpose financial statements prepared in accordance with International Public Sector Accounting Standards. This letter is intended only to be a guide that may be used, but will need to be tailored according to individual requirements and circumstances. It may be appropriate to seek legal advice that any proposed engagement letter is suitable.

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Addressee

[To the appropriate representative of management or those charged with governance of the entity]

Date

Dear Sir/Madam

#### Introduction

The [group] financial statements as of [date] and for the year then ended of the [name of the entity] and the [names of subsidiaries] are subject to auditing by the [Public Sector Audit Organization] in accordance with [relevant legislation].

The purpose of this letter is to outline:

- (a) The terms of the audit engagement and the nature, and limitations, of the annual audit; and
- (b) The respective responsibilities of the auditor and the [appropriate level of management] in the annual audit.

The terms of the audit engagement are set out below. This letter will remain effective until a new audit engagement letter is issued.

#### Objective(s) of the Audit

The objective(s) of the annual audit 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, and to issue an auditor's report that includes our opinion; and
- (b) [Additional objectives e.g. related to compliance with authorities or internal controls].

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with [relevant auditing standards] will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these financial statements.

## **Responsibilities of the Auditors**

### ***The Auditing Standards Applied when Conducting the Audit***

We will conduct our audit in accordance with the [relevant auditing standards]. The auditing standards require that we comply with ethical requirements. As part of an audit in accordance with [relevant auditing standards], we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. However, we will communicate to you in writing concerning any significant deficiencies in internal control relevant to the audit of the financial statements that we have identified during the audit.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the entity's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Company to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the financial statements, including the disclosures, and whether the financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

Because of the inherent limitations of an audit, together with the inherent limitations of internal control, there is an unavoidable risk that some material misstatements may not be detected, even though the audit is properly planned and performed in accordance with [relevant auditing standards].

[When relevant, auditors consider including information on their responsibilities related to any additional audit objectives]

While our audit is not directed to reporting the following, we will report these items if we become aware of them during the course of the audit: [refer to Section 3, paragraph 3.6]

## **Reporting**

The form and content of our report may need to be amended in the light of our audit findings. [Insert appropriate reference to the expected form and content of the auditor's report including, if applicable, the reporting on other information in accordance with ISSAI 2720 (Revised).]



## **Independence**

Our ethical requirements require us to remain independent of the [entity type], and we hereby confirm our independence with respect to this audit. This means we are, in both fact and appearance, free of any interest that, whatever its actual effect, might be deemed incompatible with integrity, objectivity and independence. [Clarify any perceived limitations of independence by describing the threats and safeguards to independence.]

## **Responsibilities of Management and Those Charged With Governance**

[Add the responsibilities of management and, where appropriate, those charged with governance, and identify the applicable financial reporting framework. For the purpose of this example, it is assumed that the auditor has determined that the law or regulation does not prescribe those responsibilities in appropriate terms. The description in ISSAI 2210.6(b) is therefore used. When relevant, information on management's responsibilities related to additional audit objectives needs to be included.]

Our audit will be conducted on the basis that management and, where appropriate, those charged with governance acknowledge and understand that they have responsibility:

- (a) For the preparation and fair presentation of the financial statements (or for the preparation of financial statements that give a true and fair view) in accordance with (applicable financial reporting framework);
- (b) For such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement; whether due to fraud or error; and
- (c) To provide us with:
  - i. Access to all information of which management is aware that is relevant to the preparation of the financial statements such as records, documentation and other matters;
  - ii. Additional information that we may request from management for the purpose of the audit; and
  - iii. Unrestricted access to persons within the entity from whom we determine it necessary to obtain audit evidence.

## **Representation Letter**

As part of our audit process, we will request from management written confirmation concerning representations made to us in connection with the audit.

## **Other Relevant Information**

[Under this heading it may be appropriate to include information regarding for example:

- Statutory reporting deadlines;
- Ownership of working papers;
- Contractual arrangements with auditors doing work on behalf of the public sector audit organization;
- Fees;
- Relevant contact information, staff accommodation and resources; and
- Any other matters to assist in clarifying the expectation gap and to enhance effective communication]

## **Acknowledgement of the Terms of the Engagement**

Please acknowledge receipt of this letter and acceptance of the terms of the audit engagement by signing the enclosed copy of this letter in the space provided and returning it to [insert name].

If you require any further information, or wish to discuss the terms of the audit engagement further before replying, please do not hesitate to contact me.

Yours sincerely,

Signed

.....

Appointed auditor

The terms of this audit engagement are agreed to and acknowledged by [designation of person signing] on behalf of the [name of entity].

.....

Signed

.....

Name and position

Date

[Appropriate representative of management or those charged with governance]

## Appendix B - ISSAI 2500

### Sources of Audit Evidence Concerning Management of Risks Related to Laws and Regulation

Risk	Description	Possible Sources of Audit Evidence (list non-exhaustive)
Complexity of Regulations	The more complex the regulations the greater the risk of error. This may occur either through a misunderstanding or misinterpretation of the regulation or through an error in application.	<ul style="list-style-type: none"> <li>Formal and documented procedures for the translation of statutory requirements into operating instructions;</li> <li>Formal and documented control plans monitoring activities by scheme managers;</li> <li>Review reports by internal audit or some other independent audit of scheme control plans and operating manuals.</li> </ul>
New Legislation	New legislation may require the introduction of new administrative and control procedures. This may result in errors in either the design or operation of controls required to ensure compliance with authorities.	Formal and documented procedures for the translation of statutory requirements into scheme rules. Formal control plans and the independent review of operating instructions and control plans may also constitute audit evidence where schemes are introduced following new legislation.
International Schemes (funded by the United Nations, EU or other institutions)	Where regulation is developed by such institutions, there is a risk that regulations and guidance may be misinterpreted or omitted from internal instructions.	Sources of audit evidence identified in connection with the complexity of regulations may apply equally to such funded schemes.
Services and Programs Delivered Through Third Parties	Where programs are administered by agents, departments lose a degree of direct control and may have to rely on agents to ensure compliance with authorities.	<ul style="list-style-type: none"> <li>Formal agreements between the entity and the agent defining control procedures to be applied in the administration of services;</li> <li>Documented procedures and outcome of management control and monitoring of third party activities;</li> <li>Reports from inspection visits by internal audit to third parties to review systems and procedures, including those relevant to regularity;</li> <li>An assurance or agreed upon procedures report on payments and receipts, or on controls over payments and receipts, by the third party's auditor.</li> </ul>

Risk	Description	Possible Sources of Audit Evidence (list non-exhaustive)
<p>Payments and Receipts Made on the Basis of Claims or Declarations</p>	<p>An entity's ability to confirm compliance with authorities may be restricted where, for example, criteria specified for receipt of grant are not subject to direct verification.</p>	<ul style="list-style-type: none"> <li>• Departmental instructions and guidance to claimants clearly stating criteria for making claims;</li> <li>• Standard requirements for documentation evidencing entitlement to be submitted in support of claims exist (this may be a condition of payment of grant or a requirement once the activity supported by the grant has been completed);</li> <li>• Reports from physical inspection of claimants' records etc. to confirm eligibility;</li> <li>• Documented procedures for assessing the financial standing of claimants before awarding a grant and for monitoring continuing solvency exist;</li> <li>• Independent certification of the application of grant by external auditor.</li> </ul>

## Appendix C - ISSAI 2580

### Public Sector Considerations for the ~~Management~~ Representation Letter

Appendix 2 of the ISSAI provides an illustrative example of a representation letter. Based on the relevant law or regulation or audit mandate, auditors may choose to include additional items such as:

- Whether the activities and the financial transactions are in compliance with the authorities that govern them;
- Whether the internal control systems have functioned effectively throughout the period covered by the audit;
- Whether the internal audit function has operated effectively throughout the period covered by the audit;
- Whether the government program XYZ has been carried out in an economical, efficient and effective manner;
- Whether management has provided its interpretation of compliance requirements that may have varying interpretations;
- Whether all contracts, grant agreements and other correspondence in regard to agreements involving use of program funds has been made available; or
- Whether management has disclosed all contracts and agreements with service organizations, including any communication with those service organizations relating to instances of non-compliance.

## Appendix D - ISSAI 2701

### Illustrative Example of a Key Audit Matters Paragraph

#### **Key Audit Matters**

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the financial statements of the current period. These matters were addressed in the context of our audit of the financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

#### **Valuation of Special Purpose Properties**

XYZ's holdings of special purpose properties represents XX % of the total amount of material assets. Due to their unique structure and terms, the valuations of these properties are based on an internally developed valuation model and not on quoted prices in active markets. This introduces significant measurement uncertainty in the valuations. As a result, the audit of the valuations of these properties was significant to our audit.

We have involved our valuation specialists and external experts in addressing this matter and we focused our audit work on:

- Evaluating and assessing the appropriateness of the assumptions used by the management;
- Analyzing the results with relevant third-party data as applicable;
- Testing the internal controls within the application used to perform the valuations.

We also evaluated the presentation and disclosure of the transactions within the financial statements.

Disclosures about the valuation of the special purpose properties are provided in Note 10.<sup>1</sup>

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<sup>1</sup> ISSAI 2701.13