

OCAG technical bulletin: the audit of regularity

September 2020

This guidance note has been developed for staff in undertaking work on the regularity aspect of public audit. It may be shared with contractors undertaking audits on behalf of OCAG, and with client bodies.

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The preparation of financial statements by public sector entities is an important means by which they are accountable for the use of public funds made available to them. The concept of regularity reflects a concern that public money should be used only for those purposes approved by Dáil Éireann and only in accordance with the legal authority governing them. Regularity therefore extends to the substance of transactions and the entitlement of recipients of public funds.

The overall objective of the audit of the regularity of transactions is to gain assurance that moneys have been applied for the purposes intended and in accordance with the governing legal authority. There are analogous objectives in the area of receipts.

The Comptroller and Auditor General (Amendment) Act 1993 defines regularity in relation to government departments and education and training boards is set out in the. As a matter of principle, the concept of regularity is also applied in the audit of all other public sector entities which are within the audit remit of the C&AG.

The financial statements of public sector entities include an implied assertion regarding the regularity of financial transactions.¹

¹ Paragraph A131 of ISA 315 (Revised) 'Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and its Environment' which relates to the requirements of ISA 315, 25(b) on the assessment of risks of material misstatement at the assertion level.

Reference material

Comptroller and Auditor
General (Amendment) Act
1993

Public Financial Procedures
issued by the Department of
Public Expenditure and
Reform's

ISA 315 (Revised) 'Identifying
and Assessing the Risks of
Material Misstatement
through Understanding the
Entity and its Environment'

ISA 250 'Consideration of
Laws and Regulations in an
Audit of Financial
Statements'

ISA 240 'The Auditor's
Responsibilities relating to
Fraud in an Audit of Financial
Statements'

This bulletin sets out practical guidance on the audit of regularity in respect of

- obtaining a sufficient understanding of the regularity framework
- identifying and assessing the risks of material misstatement due to the failure to comply with regularity requirements
- audit responses to assessed risks including testing for regularity
- reporting on regularity
- reporting other non-compliance with laws and regulations.

Obtaining a sufficient understanding of the regularity framework

The auditor needs to identify laws and regulations and the financial framework that are specific to the entity and obtain a broad understanding sufficient to enable identification of transactions or events that may have a significant effect on the regularity of transactions in the financial statements. The governing legal authorities which the auditor considers when obtaining a knowledge of the entity's activities and identifying the regularity framework will be drawn from a variety of sources including

- the founding legislation establishing the functions, powers and limits of the transactions and fee levying authority of the public sector entity
- legislation governing entitlement to funding from a scheme, programme or project administered by the public sector entity
- general legislation governing specific public sector entities including the Ministers and Secretaries Acts and, in particular, the statutory requirements to get Department of Public Expenditure and Reform approval whether in specific form or on foot of global delegation for expenditure
- legislation governing the appropriation of funds including the annual Appropriation Act and the Central Fund (Permanent Provisions) Act 1965
- Statutory Instruments relevant to the entity.

Apart from direct reference to the above, other sources of guidance in identifying the regularity framework include

- the Department of Public Expenditure and Reform's *Public Financial Procedures*
- directions issued under legal authority by the sponsoring department for other entities in central government
- documentation produced by the entity, for example, in a complex environment documents which outline the translation of authorities into relevant rules and procedures

- discussions with personnel in the entity and
- previous experience with the entity or similar entities.

Identifying and assessing the risks of material misstatement related to regularity

To assess the risk of a material misstatement occurring, the auditor uses judgement to evaluate a range of factors. Public sector entities will usually have installed internal controls to ensure regularity in the course of transaction processing. These controls often operate alongside procedures which from the audit perspective provide evidence regarding other assertions. The consideration of controls to prevent or detect irregular transactions involves assessing the general control environment at the entity level and control procedures relating to individual transaction streams. Examples of mitigating controls in relation to specific risks to regularity are set out in the table below.

| Risk | Description | Mitigating Controls |
|----------------------------------|---|--|
| 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"> ➤ Formal procedures for the translation of statutory requirements into operating instructions. ➤ Formal control plans prepared and monitored by scheme managers. ➤ Review of scheme control plans and operating manuals by internal audit or some other independent audit. |
| 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 regularity. | The controls identified above involving formal procedures for the translation of statutory requirements into scheme rules. Formal control plans and the independent review of operating instructions and control plans will also apply where schemes are introduced following new legislation. |
| European Union Schemes | Where legislation is developed by the EU there is a risk that regulations and guidance may be misinterpreted or omitted from internal instructions. | The mitigating controls identified in connection with the complexity of regulations apply equally to EU funded schemes. |

| Risk | Description | Mitigating Controls |
|---|--|--|
| Services and programmes delivered through third parties | Where programmes are administered by agents, entities lose a degree of direct control and may have to rely on agents to ensure compliance with authorities. | <ul style="list-style-type: none"> ➤ Formal agreements between the entity and the agent defining control procedures to be applied in the administration of services. ➤ Management control and monitoring of third party activities. ➤ Inspection visits by internal audit to third parties to review systems and procedures, including those relevant to regularity. ➤ Independent certification of payments and receipts by the third parties' auditor. |
| Payments and receipts made on the basis of claims or declarations | 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. | <ul style="list-style-type: none"> ➤ Established criteria for making claims, clearly set out in instructions and guidance to claimants. ➤ Requirements for documentation evidencing entitlement to be submitted in support of claims. ➤ Physical inspection of claimants' records etc., to confirm eligibility. ➤ Procedures for assessing the financial standing of claimants before awarding a grant and for monitoring continuing solvency. ➤ Independent certification of the application of grant by external auditor. |

Testing for regularity

Tests on regularity are usually integrated with those relating to the audit of the financial statements and involve tests of detail to detect transactions or classes of transaction where the regularity assertion cannot be sustained and when necessary tests on the operating effectiveness of controls in preventing, or detecting and correcting material misstatements of the regularity assertion. The principles and procedures applied to obtain sufficient appropriate evidence to support an opinion on the regularity of transactions recorded in the

financial statements of an entity in central government are the same as those applied to the audit of any other financial statement assertion.

In general, audit assurance is sought by a combination of ‘top down’ reviews of the regularity framework governing classes of payments and ‘bottom up’ reviews of transactions. In this respect, regularity is a key assertion in the course of all public sector audits. The extent of the audit work on regularity will depend on the nature and complexity of the relevant legislation and other authorities.

In testing controls embedded in the entity’s systems, the auditor considers how the entity’s management ensures compliance with the regularity framework and seeks to mitigate the risk of material irregularity through those controls.

Particular considerations may arise in the design of audit procedures in relation to the regularity assertion. For example

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| Testing controls over regularity may involve examining | <ul style="list-style-type: none"> ➤ the design of the system, the process for translating statutory requirements into rules and operational procedures, and the control activities established within the system |
| | <ul style="list-style-type: none"> ➤ transaction authorisation mechanisms within the entity. |
| Test of details over the regularity of transactions may involve | <ul style="list-style-type: none"> ➤ examining the payment scheme to determine whether the purpose and rules are consistent with legislative and other authorities ➤ examining transaction streams or account categories in order to identify transactions that may be outside the intention of Dáil Éireann ➤ determining that expenditure has remained within specified limits ➤ examining vires and entitlement. |

Regularity of grants

To audit the regularity assertion where the audit is of a public sector entity which has paid a grant to another entity, the auditor may examine the arrangements put in place by the entity to satisfy itself about the use of grant funding. These arrangements include systems and procedures covering the monitoring and reporting on the use of grants by the grantee as set out in Department of Public Expenditure and Reform circular 13/2014 on the Management of and Accountability for Grants from Exchequer Funds.

The auditor may also use the work of the grantee’s auditor and reduce the extent of his/her own audit procedures. In some cases, the auditor does not have a right of access and will use the work of the Local Government Audit Service or other auditors. Examples of this

situation include the grants paid by departments to fund State-sponsored agencies which are not audited by the C&AG and the grants paid by the Local Government Fund to local authorities.

Regularity of receipts

The auditor approaches the audit of regularity of receipts, including revenues from taxation and other sources, in the same way as the audit of the regularity of expenditure. There may, nevertheless, be particular considerations when auditing the regularity of fees and charges levied by public sector entities for example

- reviewing the relevant legislation to confirm that it provides appropriate authority to levy fees and charges
- confirming that fees are in accordance with the Statutory Instrument or other order issued under the governing legislation
- for vote funded activities, confirming that the Appropriation Act provides the appropriate authority for the receipts to be applied in aid of expenditure.

Regularity and Reporting

The C&AG reports in any material case where the entity has failed to comply with regularity requirements. While regularity is a key assertion tested in the course of every public sector audit and a specific statutory obligation in government departments and education and training boards, the form of reporting adopted is 'by exception' in each case. This is based on the existing statutory provisions which require the C&AG to report in the audit certificate any material instance where the entity has failed to apply expenditure recorded in the financial statements for the purposes intended or where the transactions do not conform to the authority under which they purport to have been carried out.

Cases of irregular transactions will usually be reported to the management of the entity to allow corrective action to be taken, for example, by recovering overpayments of grant. In the audit of a government department, the 1993 Act outlines the process to be undertaken including the reporting thereof where the C&AG believes that the department has incurred expenditure not properly chargeable or incurred material expenditure which was not authorised.

For other public sector entities where it is not possible for the entity to take corrective action, the entity may be encouraged to disclose the non-compliance in its financial statements by outlining the circumstances and the possible extent of irregular transactions. Even where a breach of regularity is disclosed, the C&AG will still consider the implications for the audit opinion on regularity and the need to present a separate report on the matter. In doing so, the C&AG considers the materiality of the matter at issue.

Fraud in the context of the regularity opinion

Only a court of law can determine whether a particular transaction is fraudulent. However, the auditor often encounters situations where there is suspicion of fraud, identified by

management, internal audit, third parties or the auditor. Although the auditor does not have the power to determine whether or not a fraud has actually occurred, he/she does have a responsibility to determine whether, in his/her opinion, the transactions concerned are in compliance with the legal authorities that govern them.

Fraudulent transactions cannot, by definition, be regular since they are without proper authority. Likewise, the misappropriation of assets is irregular and risk of material misappropriation of assets due to fraud is considered in accordance with both ISA 240, which places an emphasis on misappropriation by management or employees. Where there is a duty to give a regularity opinion (including 'by exception'), fraud that is material always results in a qualification of the regularity part of the opinion, regardless of the manner or extent of disclosure in the financial statements.

Reporting other non-compliance with laws and regulations

The auditors of private sector entities are also concerned with applicable law and regulations. Nevertheless, the environment within which they work is different, as the operations of private sector entities are generally subject to less detailed regulation than those in central government. Indeed, ISA 250 'Consideration of Laws and Regulations in an Audit of Financial Statements', draws attention to the fact that the auditor of public sector entities may have duties that go beyond those of auditors of private sector entities.

Apart from the auditor's responsibilities in relation to regularity, paragraph A20 of ISA 250 (which relates to the requirements of ISA 250, 29) states that the public sector auditor may be obliged to report on identified or suspected non-compliance to the legislature or other governing body or to report them in the auditor's report. The following situations may arise in the context of public audit.

Consideration of legislation on corruption

Because specific legislation on corruption² covers the public sector, the auditor considers to whom he/she may report suspected or actual acts of corruption, irrespective of whether, in his/her opinion, the consequences of the corruption could have a material effect on the financial statements.

In the first instance, the matter is normally brought to the attention of those charged with governance who have the responsibility to report the matter to the proper authorities. If the auditor identifies a suspected or actual instance of corruption, and if, having reported the matter to those charged with governance he/she is unable to establish whether those charged with governance have reported the matter to the relevant third party, the auditor takes the steps set out in paragraph 44 of ISA 240.

Money laundering

The auditor is also aware of his/her responsibilities in relation to reporting money laundering or terrorist financing transactions, including those relating to 'tipping-off'.³ The auditor

² Criminal Justice (Corruption Offences) Act 2018

³ Section 49 of the Criminal Justice (Money Laundering and Terrorist Financing) Act 2010

ensures that the nominated Money Laundering Reporting Officer is consulted when considering making a report to the Garda Síochána and the Revenue Commissioners.

Other non-compliance

The auditor's responsibility to express an opinion on the public sector entity's financial statements does not extend to determining whether the entity has complied in every respect with applicable legislation, for example tax legislation. In this case, the auditor obtains sufficient appropriate evidence to give reasonable assurance that the amounts included in the financial statements in respect of taxation are not materially misstated. This will usually include making appropriate enquiries of those advising the entity on taxation matters. If the auditor becomes aware that the entity has failed to comply with the requirements of tax legislation, the auditor considers whether to report the matter outside the entity.