

# **Supreme Audit Institutions – Their Roles in Combatting Corruption and Providing Auditing and Accounting Standards and Guidelines**

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## **1. INTOSAI – ORGANISATION AND AIMS**

The International Organisation of Supreme Audit Institutions (INTOSAI) is an autonomous, independent and non-political organisation established as a permanent institution in order to foster the exchange of ideas and experiences among the Supreme Audit Institutions (SAIs) on government auditing. Participation in INTOSAI and all its organs and functions is open to the Supreme Audit Institutions of all countries which are members of the United Nations Organisation or any of its Specialised Agencies.

SAIs play a major role in auditing government accounts and operations and in promoting sound financial management and accountability in the governments. Citizens, international donor organisations and other entities put increasingly higher expectations into the national governments, and the governments depend on the SAIs to help ensure public accountability. INTOSAI supports its members by providing a platform to exchange experience and information, and in the last years especially taking into account the globalisation.

INTOSAI, founded in 1953, counts today with a membership of 180 SAIs. The INTOSAI Lima Declaration of Guidelines on Auditing Precepts, adopted at the Ninth International Congress of the organisation in 1977, provides the conceptual, philosophical and practical framework for INTOSAI's work.

As the internationally recognised leader in public sector auditing, INTOSAI issues international guidelines for financial management and other audit topics, develops methodologies, provides training and exchange of experiences. As some of the most relevant guidelines in fighting corruption I would like to mention the following five guidelines:

- INTOSAI Code of Ethics for Auditors in the Public Sector, 1998
- INTOSAI Guidelines for Internal Control Standards, 1992

- INTOSAI Auditing Standards, 1995
- INTOSAI Accounting Standards Framework, 1995
- Accounting Standards Framework Implementation Guide for SAIs; Departmental and Government-wide Financial Reporting, 1998

## 2. SAIs – FIGHTING CORRUPTION

The role of SAIs in fighting corruption and mismanagement has been a recurring topic for debate in INTOSAI forums.

At the last Congress of INTOSAI, the XVI INCOSAI held in 1998, one of the two main themes was “Supreme Audit Institutions and the Prevention and Detection of Fraud and Corruption”.

Among the INTOSAI members, there was consensus that corruption has surfaced in all forms of government and that it results in waste of resources and reduces economic growth and the quality of life, undermines government credibility and reduces its effectiveness. It was considered that the socio-economic environment of the population cannot be ignored when analysing and dealing with corruption, since social justice, poverty and violence are often linked with corruption which makes it virtually impossible to isolate corruption as a separate problem.

There is also awareness that a country’s tradition, principles and values influence the nature of corruption. Although a SAI can do little about the structure of society it can influence the approaches used to combat the problem. It is the hope of INTOSAI that SAIs can, through concerted actions, play a role in promoting a culture that rejects waste and values honesty, responsibility and the rational utilisation of economic wealth.

SAIs agreed that it is difficult to detect many acts of corruption and even more to estimate their financial impact as the loss to the state does not always show in the accounting records or the financial statement of the public entity. But there exist statistical indicators that point out a relationship between various indices of public finance and the perceived levels of corruption. It is out of any discussion that laws and regulations along with adequate oversight, enforcement and the largest support of parliaments can deter fraud and corruption.

The main contribution of SAIs regarding the fighting of corruption lies in improving overall transparency and accountability, supporting an environment that limits the opportunity for acts of corruption and creating a climate of good governance. SAIs considered the following issues as of special importance:

SAIs generally agree that fostering strong financial management – based on reliable, sufficient and timely reporting, disclosure of deviations – and effective internal control systems represent the basic elements of the SAI’s role. A strong standards framework provided the basis for it. The establishment of internal auditing and audit committees also contributed to strong financial management.

Most SAIs consider their audit mandate sufficient and that they are provided with sufficient legal provisions in place to prosecute corrupt practices and to notify it to the responsible, specialised public bodies. Nevertheless, some more investigative powers could be practical. Those SAIs that have already investigative authority may expand the audit to collect evidence of improper

behaviour. Furthermore, SAIs should maintain collaboration with investigation and prosecution organisations in order to identify better practices and use these practices as indicators.

SAIs consider the need for honest, able and well-motivated public servants as essential in fighting corruption. SAIs should encourage the selection of public servants according to their integrity and capability. INTOSAI approved in 1998 the “INTOSAI Code of Ethics for Auditors in the Public Sector”. This Code, directed to all levels of audit personnel, has to be adapted by each SAI according to national differences of culture and legal and social systems. Each SAI has the responsibility to ensure that all its auditors acquaint themselves with the values and principles contained in the different national code of ethics and act accordingly. The conduct of auditors should be beyond reproach at all times and in all circumstances. Any deficiency in their professional conduct or any improper conduct places the integrity of the SAI they represent and the quality of their work in an unfavourable light and may raise doubts about the reliability and competence of the SAI itself, specially in the field of fighting corruption.

Independence from the executive branch and at length from the audited entities and other outside interested groups is indispensable for auditors as well as a clear definition of the relationship of government auditing to parliament. In this context the INTOSAI Lima Declaration states that independence of the SAI should be guaranteed by the constitution and by law, and they should have a high degree of initiative and autonomy when they act as agents of parliament and undertake audits on its instructions.

SAIs generally agree that the auditor and the audit work are significant elements in reducing fraud and corruption. They agree that it is more cost effective to deter and prevent rather than to detect and investigate corruption. Some of the significant aspects in this context are:

- SAIs consider it of high importance that audit reports should be made readily available to the public in a timely fashion. Most SAIs publish their reports annually after submitting them to parliament and consider that their main objective is to provide parliament with an independent opinion. Many SAIs maintain and strengthen ties with the press to deter fraud and corruption through public disclosure. Specially in cases related with corruption it is important to avoid excessive time lags between the actual audit and the publication of the report in order to keep it relevant.
- SAIs agree that aggressive follow-ups on recommendations should be more effective and that many SAIs still lack a follow-up system that tracks implementation of recommendations. Here legislature is called upon to provide adequate legal frames.
- SAIs state that some programmes have more inherent control weaknesses than others and that these high risk programmes by their nature and function foster an environment that favours fraud and corruption.
- Fraud indicators are usually difficult to identify. Although generic indicators are almost everywhere present, auditors must rely on technical experience, professional judgement and a good understanding how fraud is committed to successfully recognise these indicators. Often lack of experience and training is the biggest obstacle in this aspect.

SAIs should contribute their efforts in prevention and detection of corruption by improving overall financial accountability and thereby creating a climate of transparency and good governance. SAIs generally see their main goal in preventing corruption rather than in detecting.

For this purpose SAIs identify the following general items:

#### Sound financial management and internal controls

Reliability of financial management systems is essential in preventing corruption. SAIs consider effective internal control systems to have an inhibiting effect on potential perpetrators. SAIs ensure that evaluating the soundness of financial systems and internal control methods is done regularly as an internal part of compliance audits.

#### Focusing audit planning on high risk areas

Only few SAIs determine circumstances that indicate high inherent and control risks of illicit influence on governmental activities. They consider staff skills and abilities, lack of function separation, procurement of goods and services without competitive bidding, weak internal control systems, low managerial capability and political appointments as examples of high risk indicators.

#### Recommendation to legislature

SAIs recognise that nearly all over the world there are sufficient legal provisions to penalise and prosecute corruption and procurement and tendering procedures are governed by rules and regulations ensuring transparency and free competition. Nevertheless, SAIs find loopholes in the frame of regulations and some SAIs do not have adequate mandates to make recommendations to the legislative authorities on perceived shortcomings in the practical implementation of regulations and rules.

#### Expertise in preventing corruption

SAIs state that there are also other institutions like the prosecution, police authorities and parliamentary task forces fighting corruption. SAIs agree that the exchange of information and experiences with these bodies should be improved. Most SAIs have regulations how to proceed in the case auditors uncover indicators of illicit acts, some are obliged by law to refer these suspicions directly to prosecution authorities.

#### Improving public awareness

In general SAIs should play an active role in raising awareness of the risks of corruption and in fostering good governance and standards of conduct. SAIs strengthen their ties with the media as an adequate instrument in drawing the public attention on cases of corruption, brought to light by the SAI and thus producing a deterrent effect against corruption.

#### Create a preventive environment

Key elements in creating a preventive environment against corruption include strengthening financial management systems, evaluating internal control systems to identify and correct weaknesses and heightening the awareness of the public to SAI findings.

### **Recommendations**

SAIs agree that fraud and corruption are significant problems affecting all countries in varying degrees and that the SAIs can and should endeavour to create an environment that is unfavourable to fraud and corruption. As provided in the Lima Declaration (Guidelines in Auditing Precepts),

SAIs agreed that they should be independent and have adequate mandates that enable them to effectively contribute to the fight against fraud and corruption. SAI should:

1. seek an adequate level of financial and operative independence and breadth of coverage coverage;
2. take a more active role in evaluating the efficiency and effectiveness of financial and internal control systems and aggressive follow-up in SAI recommendations;
3. focus audit strategy more on areas and operations prone to fraud and corruption by developing effective high risk indicators for fraud;
4. establish an effective means for the public dissemination of audit reports and relevant information including, establishing good relationship with the media;
5. produce relevant audit reports that are understandable and user-friendly;
6. consider a closer co-operation and appropriate exchange of information with other national and international bodies fighting corruption;
7. intensify the exchange of experiences on fraud and corruption with other SAIs;
8. encourage the establishment of a personnel management procedure for the public service that selects, retains, and motivates honest, competent employees;
9. encourage the establishment of guidance for financial disclosure by public servants and monitor compliance as part of the ongoing audit process;
10. use the INTOSAI Code of Ethics to promote higher ethical standards and a code of ethics for the public service;
11. consider the establishment of a well publicized means to receive and process information from the public on perceived irregularities; and
12. continue work regarding fraud and corruption through INTOSAI's existing committees and working groups, for example the Auditing Standards Committee will consider these issues as part of developing implementation guidance as part of a broader standard framework.

### **3. INTOSAI ACCOUNTING STANDARDS FRAMEWORK**

In 1992, the INTOSAI Committee on Accounting Standards (CAS) undertook to develop a framework of accounting standards appropriate for use by Supreme Audit Institutions (SAIs). This document was issued in 1995. It includes an introduction to CAS, a study report and two statements, and additional products that deal with qualitative characteristics of government financial reports and meeting the objectives of such reports.

The framework has been designed as an audit tool to help SAIs assess the fairness of and encourage improvements in the various financial reports that their governments prepare and publish. CAS recognizes that there are many different forms, levels and organisations of government within the INTOSAI community. Accordingly, the framework is general in nature in order to permit SAIs to develop more specific standards or guidelines tailored for use within their own jurisdictions. More detailed information on many of the issues included in the framework is contained in products published by other professional organisations worldwide, including IFAC's Public Sector Committee. SAIs are encouraged to review these other publications.

### **Objectives of Government Financial Reports**

Objectives of government financial reports have been identified by a number of professional organisations worldwide. CAS recognises that there are many different forms, levels and organisations of government within the INTOSAY community. Accordingly, the objectives set out below are general in nature. They are a base for development by Supreme Audit Institutions (SAIs) of more specific objectives, tailored for use within their own jurisdictions.

Objectives identify the goals and purposes of financial reports and the nature of the information the reports should convey. Agreement on objectives by those who prepare, audit and use government financial reports should help make the reports more understandable and more useful.

For purposes of this Statement, financial reports include those that provide compliance and performance information, departmental financial reports and general purpose financial statements.

It is unlikely that any one type of report will be able to satisfy all of the objectives set out in this Statement. For example, summary financial statements can provide an informative overview of a government as a whole but relatively little about the activities and effects of individual government programmes.

In addition, the objectives that financial reports will be able to satisfy will depend on the accounting basis used to prepare them. For example, reports prepared on the cash basis of accounting can help users understand and forecast how a government finances its activities. However, reports prepared on that basis provide relatively little information to help users study and assess the costs of a government's activities in light of the benefits that the government provides.

#### **Objective 1: To the extent practicable, government financial reports should provide users with the information they need.**

Financial reporting by a government is not an end in itself. It is a way of communicating financial information about the government and its activities to people who need it. User needs are the foundation for developing objectives, accounting practices and financial reports that are useful and justifiable.

#### **Objective 2: Government financial reports should help users understand the size of the government, the nature and scope of its activities and its financial position.**

Economists, policy analysts and special interest groups and the media try to understand the size of a government and the scope of its activities. In doing so, they need information about total revenue, expenditure, assets and liabilities including borrowing.

**Objective 3: Government financial reports should help users understand and forecast how the government finances its activities.**

Lenders forecast a government's cash requirements. They need information about total revenue and expenditure, surplus or deficit, and borrowing. Other information considered useful includes cash, financial claims, total assets, payable and accruals, total liabilities and revenue by source.

**Objective 4: Government financial reports should help users understand and forecast the effects of the government's activities.**

Several groups of people try to understand and forecast the effects of government activity. For example, lenders forecast interest rates and assess economic prospects of industries and corporations. Economists make forecasts of the economy, study the effects of government on credit markets and, together with policy analysts and special interest groups, study the impact of taxation on individuals and firms. Policy analysts and special interest groups, as well as the media, study the impact of government activity on social and economic conditions, and assess the policy choices that a government has available. Information needed to carry out these activities includes revenue in total and by source, expenditure in total and by programme or function, surplus or deficit, and borrowing.

**Objective 5: Government financial reports should help users determine whether the government did what it said it would do and the cost of its activities.**

The media compare what a government did with what it said it would do. They need to know revenue in total, expenditure in total and by programme or function, and surplus or deficit. Such comparisons are also made by politicians during speeches, debates in the legislature or in committee meetings. In carrying out these activities, politicians and their personal staff need information about revenue in total and by source; expenditure in total, by vote and by programme or function; surplus or deficit; and borrowing.

Economists, policy analysts and special interest groups, and the media analyze and study the costs and benefits of government activities and the allocation of government resources to various types of users. Information needed to do these analyses and studies includes expenditure in total and by programme or function.

**Introduction**

The Introduction to the Committee on Accounting Standards (CAS) identified six broad issues requiring study. The first two issues – users of government financial reports and objectives of government financial reports – were the subject of CAS Statements 1 and 2, respectively. The third issue – qualitative characteristics of government financial reports – is the subject of this statement.

**Qualitative Characteristics of Government Financial Reports**

Qualitative characteristics of government financial reports have been identified by a number of professional organisations worldwide. CAS recognises that there are many different forms, levels and organisations of government within the INTOSAI community. Accordingly, the characteristics set out below are general in nature. They are a base for development by Supreme Audit Institutions of more specific qualitative characteristics, tailored for use within their own jurisdictions.

Qualitative characteristics of government financial reports are attributes, if present, that help the reports provide users with the information they need.

### **Government Financial Reports Should Present Information That Is:**

**Understandable.** Information must be understood before it can be used. Government financial reports should present information clearly and simply. Excessive detail and overly complex reporting formats should be avoided, charts and graphs should be used wherever possible. Explanatory narrative should not only be precise but must be stated clearly and, as far as possible, presented in plain non-technical language. This is particularly so for disclosure of complicated information and interpretations. Care must also be taken to avoid misleading forms of presentation caused by excessive simplification or omission of detail.

**Relevant.** Information is relevant if it helps those who use it carry out their activities. Preparers of government financial reports should take into account the activities and information needs of users when deciding what is relevant to report. Relevance includes many of the other qualitative characteristics set out in this Statement. For example, if information is not timely, it may not be relevant. Reports should cover the full nature and extent of the financial activities presented.

**Reliable.** Reliable information faithfully represents what it purports to represent. It is accurate within acceptable tolerances, free from bias, complete, and verifiable. Reliability does not imply precision or absolute certainty. For example, government financial reports may include estimates of amounts owing to outside parties that are not known with certainty but for which a strong probability of liability exists. Such reports should disclose, to the extent possible, all significant assumptions and uncertainties.

**Material.** Information is material if it could reasonably be expected to influence the activities of those who use it. An item may be material because of its size or because of its nature. Materiality is a matter of judgement. Factors that preparers and auditors of government financial reports may wish to consider when determining materiality would include: the purpose of the report; the activities of users and the nature and type of information they need for decision making and accountability; and the nature of the entity itself.

**Timely.** Government financial reports should be published soon enough after reported events to help users carry out their activities. Timeliness alone does not make information useful. However, the passage of time after reported events generally decreases usefulness. A timely but realistic estimate may be more useful than precise information if the latter takes many months to produce.

**Consistent.** To be understandable, information in a government's financial reports or sets of reports should be presented on the same accounting basis to the extent possible. Consistency allows those who use financial reports or sets of reports about a government to move from aggregate to disaggregate displays of information, and from one report to another, with ease and

confidence. If the basis of accounting and presentation has changed from one accounting period to the next because, for example, a more appropriate accounting policy or standard has been adopted, this fact and the effects on the financial report resulting therefrom should be highlighted and explained clearly.

**Comparable.** Information is comparable when those who use it are able to identify similarities and differences, either between two or more government entities at a point in time or within the same entity over time. As with consistency, the basis of accounting and presentation, and the effects of any changes from one period to the next, should be highlighted and explained clearly.

### **In Applying These Characteristics, Preparers And Auditors Of Government Financial Reports Will Have To:**

**Exercise professional judgement.** Preparers and auditors of government financial reports must exercise professional judgement in deciding the qualitative characteristics to emphasize for any particular report. In doing so, they should consider the purpose of the report and the information needs of those who will use it. The factors set out in the following paragraphs should also be considered.

**Assess benefits and costs.** The benefits of providing users with financial information about a government should be assessed in light of the costs involved. Information is not free. Costs arise on collection of information, storage, retrieval and analysis, formatting and publication. Costs could also include misdirected use of resources if the information provided turns out to be unreliable.

**Make trade-offs.** Some qualitative characteristics may conflict with others, and some may be more important than others, depending on the circumstances. For example, some timeliness may have to be sacrificed to get more precision. Trade-offs will have to be made.

**Consider substance over form.** The principle of substance over form requires that financial transactions be accounted for and reported in accordance with their financial reality. This principle is critically important in government, where legislative spending authority may dictate a particular accounting treatment. If the accounting required by law (form) does not present fairly financial reality (substance), the presentation of information in a government's general purpose financial statements could be distorted. Departmental financial reports and performance information might also be distorted. However, violations of legislative authority to spend, borrow or raise revenues should be clearly highlighted in all such reports.

**Exercise prudence.** Preparers and auditors of government financial reports may be faced with significant uncertainties. In such situations, the principle of prudence requires that they avoid both overly optimistic and overly pessimistic views when preparing and auditing estimated amounts.