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INTOSAI



# *Basic Principles in Government Auditing*

INTOSAI PROFESSIONAL STANDARDS COMMITTEE

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PSC-SECRETARIAT

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1. The general framework of the auditing standards for the International Organisation of Supreme Audit Institutions (INTOSAI) has been deduced from the Lima and Tokyo Declarations, the statements and reports adopted by INTOSAI in various congresses, and the report of the United Nations Expert Group Meeting in Public Accounting and Auditing in Developing Countries.

2. The INTOSAI auditing standards consist of four parts (see chart):

- (a) Basic principles
- (b) General standards
- (c) Field standards
- (d) Reporting standards

INTOSAI has developed these standards to provide a framework for the establishment of procedures and practices to be followed in the conduct of an audit, including audits of computer-based systems. They should be viewed in the particular constitutional, legal and other circumstances of the Supreme Audit Institution (SAI).

3. The basic principles for auditing standards are basic assumptions, consistent premises, logical principles and requirements which help in developing auditing standards and serve the auditors in forming their opinions and reports, particularly in cases where no specific standards apply.

4. Auditing Standards should be consistent with the principles of auditing. They also provide minimum guidance for the auditor that helps determine the extent of auditing steps and procedures that should be applied in the audit. Auditing Standards constitute the criteria or yardstick against which the quality of the audit results are evaluated.

5. Interpretations and explanations of these standards are the prerogative of the INTOSAI Governing Board, while amendments are the responsibility of the INTOSAI Congress.

6. The basic principles are

- (a) The SAI should consider compliance with the INTOSAI auditing standards in all matters that are deemed material. Certain standards may not be applicable to some of the work done by SAIs, including those organised as Courts of Account, nor to the non-audit work conducted by the SAI. The SAI should determine the applicable standards for such work to ensure that it is of consistently high quality (see paragraph 8).
- (b) The SAI should apply its own judgement to the diverse situations that arise in the course of government auditing (see paragraph 15).
- (c) With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a need for the accountability process to be in place and operating effectively (see paragraph 20).
- (d) Development of adequate information, control, evaluation and reporting systems within the government will facilitate the accountability process. Management is responsible for correctness and sufficiency of the form and content of the financial reports and other information (see paragraph 23).
- (e) Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the government, and audited entities should develop specific and measurable objectives and performance targets (see paragraph 25).
- (f) Consistent application of acceptable accounting standards should result in the fair presentation of the financial position and the results of operations (see paragraph 28).
- (g) The existence of an adequate system of internal control minimises the risk of errors and irregularities (see paragraph 30).

(h) Legislative enactments would facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit (see paragraph 32).

(i) All audit activities should be within the SAI's audit mandate (see paragraph 34).

(j) SAIs should work towards improving techniques for auditing the validity of performance measures (see paragraph 45).

7. The following paragraphs discuss the importance of the basic principles for auditing.

8. The basic auditing principles stipulate that

The SAI should consider compliance with the INTOSAI auditing standards in all matters that are defined material. Certain standards may not be applicable to some of the work done by SAIs, including those organised as Courts of Account, nor to the non-audit work conducted by the SAI. The SAI should determine the applicable standards for such work to ensure that it is of consistently high quality (see paragraph 6a).

9. In general terms, a matter may be judged material if knowledge of it would be likely to influence the user of the financial statements or the performance audit report.

10. Materiality is often considered in terms of value but the inherent nature or characteristics of an item or group of items may also render a matter material--for example, where the law or regulation requires it to be disclosed separately regardless of the amount involved.

11. In addition to materiality by value and by nature, a matter may be material because of the context in which it occurs. For example, considering an item in relation to:

(a) the overall view given to the financial information;

(b) the total of which it forms a part;

(c) associated terms;

(d) the corresponding amount in previous years.

12. SAIs often carry out activities that by strict definition do not qualify as audits, but which contribute to better government. Examples of non-audit work may include (a) gathering data without conducting substantial analysis, (b) legal work, (c) an information mission of the elected Assembly as regards the examination of draft budgets, (d) an assistance mission for members of the elected Assemblies as regards investigations and consultations of SAIs' files, (e) administrative activities and (f) computer-processing functions. These non-audit activities provide valuable information to decision-makers and should be of consistently high quality.

13. Because of the approach and structure of some SAIs, not all auditing standards apply to all aspects of their work. For example, the collegial and judicial nature of the reviews conducted by Courts of Account make aspects of their work fundamentally different from the financial and performance audits conducted by SAIs which are organised under a hierarchic system led by an Auditor-General or a Comptroller General.

14. To ensure that high quality work is done, appropriate standards must be followed. The objectives of the particular type of work or the particular assignment should dictate the specific standards that are followed. Each SAI should establish a policy on which INTOSAI standards, or other specific standards, should be followed in carrying out the various types of work that the organisation conducts to ensure that the work and products are of high quality.

15. The basic auditing principles stipulate that

The SAI should apply its own judgement to the diverse situations that arise in the course of government auditing (see paragraph 6b).

16. Audit evidence plays an important part in the auditor's decision concerning the selection of issues and areas for audit and the nature, timing and extent of audit tests and procedures.

17. The terms of the audit mandate with which the SAI is endowed override any accounting or auditing conventions with which they conflict, and hence have a crucial bearing on the auditing standards that the SAI applies. Consequently, the INTOSAI auditing standards--and indeed any auditing standards external to the SAI--cannot be prescriptive, or have a mandatory application to the SAI or members of its staff.

18. The SAI must judge the extent to which external auditing standards are compatible with the SAI's fulfilment of its mandate. The SAI should recognise, however, that the INTOSAI auditing standards embody a consensus of opinion among government auditors and try to apply them where they are compatible with the SAI's mandate. The SAI should seek removal of incompatibilities where this is necessary to permit the adoption of desirable standards.

19. For some elements of the SAI's mandate, particularly in regard to the audit of financial statements, the SAI's audit objectives may be akin to the objectives of audits in the private sector. Correspondingly, private sector standards for financial statements auditing which are promulgated by official regulatory bodies might be applicable to the government auditor.

20. The basic auditing principles stipulate that

With increased public consciousness, the demand for public accountability of persons or entities managing public resources has become increasingly evident so that there is a greater need for the accountability process to be in place and operating effectively (see paragraph 6c).

21. In some countries, arrangements require the accountable entities to report to a President, Monarch or State Council, but in most they report to an elected legislature, either directly or through the executive branch of government. Certain SAIs have a jurisdictional status. This jurisdictional power is exercised, depending on the country, over the accounts, over the accountants, or even over administrators. The judgements and decisions that these institutions make are natural complements to the administrative audit function with which they are charged. Their jurisdictional actions should be seen as part of the logic of the general objectives pursued by external audit and in particular those objectives which relate to accounting questions.

22. Public enterprises are also required to fulfil public accountability obligations. Public enterprises may include commercial undertakings, e.g., entities established by statute or executive order or in which the Government has a controlling interest. Irrespective of the manner in which they are constituted, their functions, degree of autonomy or funding arrangements, such entities are ultimately accountable to the supreme law-making body.

23. The basic auditing principles stipulate that

Development of adequate information, control, evaluation and reporting systems within the government will facilitate the accountability process. Management is responsible for correctness and sufficiency of the form and content of the financial reports and other information (see paragraph 6d).

24. The correctness and sufficiency of the financial reports and statements are the entity's expression of the financial position and the results of operations. It is also the entity's obligation to design a practical system which will provide relevant and reliable information.

25. The basic auditing principles stipulate that

Appropriate authorities should ensure the promulgation of acceptable accounting standards for financial reporting and disclosure relevant to the needs of the government, and audited entities should develop specific and measurable objectives and performance targets (see paragraph 6e).

26. The SAIs should work with the accounting standards setting organisations to help ensure that proper accounting standards are issued for the government.

27. The SAIs should also recommend to the audited entities that measurable and clearly stated objectives be established and that performance targets be set for these objectives.

28. The basic auditing principles stipulate that

Consistent application of acceptable accounting standards should result in the fair presentation of the financial position and the results of operations (see paragraph 6f).

29. The assumption that consistency in application of accounting standards is a prerequisite of fairness means that an audited entity must comply with accounting standards appropriate in the circumstances, as well as the requirement of applying such accounting standards in a consistent manner. An auditor should not consider compliance with accounting standards in a consistent manner as a definitive proof of presenting fairly the various financial reports. Fairness is an expression of an auditor's opinion that goes beyond the limits of consistent application of accounting standards. Such an assumption emphasises that the auditing standards are no more than the minimum requirements for an auditor's obligation. Going beyond that minimum is for the auditor's judgement.

30. The basic auditing principles stipulate that

The existence of an adequate system of internal control minimises the risk of errors or irregularities (see paragraph 6g).

31. It is the responsibility of the audited entity to develop adequate internal control systems to protect its resources. It is not the auditor's responsibility. It is also the obligation of the audited entity to ensure that controls are in place and functioning to help ensure that applicable statutes and regulations are complied with, and that probity and propriety are observed in decision making. However, this does not relieve the auditor from submitting proposals and recommendations to the audited entity where controls are found to be inadequate or missing.

32. The basic auditing principles stipulate that

Legislative enactments would facilitate the co-operation of audited entities in maintaining and providing access to all relevant data necessary for a comprehensive assessment of the activities under audit (see paragraph 6h).

33. The SAI must have access to the sources of information and data as well as access to officials and employees of the audited entity in order to carry out properly its audit responsibilities. Enactment of legislative requirements for access by the auditor to such information and personnel will help minimise future problems in this area.

34. The basic auditing principles stipulate that

All audit activities should be within the SAI's audit mandate (see paragraph 6i).

35. SAIs generally are established by the supreme lawmaking body, or by constitutional provision. In some cases elements of the SAI's role may be by convention rather than by specific legal provision. Commonly, the establishing law or regulation sets out the form of the SAI (such as court, board, commission, statutory office or ministry), the terms and conditions of incumbency, tenure, powers, duties, functions and general responsibilities, and other matters governing the holding of office and the discharge of the functions and duties to be performed.

36. Whatever the arrangements, the essential function of the SAI is to uphold and promote public accountability. In certain countries, the SAI is a court, composed of judges, which has authority over State accountants who must render accounts to it. This jurisdictional function requires the SAI to make sure that whoever is charged with dealing with public funds is accountable to it and is in this regard subject to its jurisdiction.

37. There exists an important complementarity between this jurisdictional authority and the other characteristics of audit. The characteristics should be viewed as part of the logic of the general objectives pursued by external audit and more particularly those which relate to accounting management.

38. The full scope of government auditing includes regularity and performance audit.

39. Regularity audit embraces:

- (a) attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements;
- (b) attestation of financial accountability of the government administration as a whole;

- (c) audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;
- (d) audit of internal control and internal audit functions;
- (e) audit of the probity and propriety of administrative decisions taken within the audited entity; and
- (f) reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed.

40. Performance audit is concerned with the audit of economy, efficiency and effectiveness and embraces:

- (a) audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies;
- (b) audit of the efficiency of utilisation of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies; and
- (c) audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of activities compared with the intended impact.

41. In practice there can be an overlap between regularity and performance auditing, and in such cases classification of a particular audit will depend on the primary purpose of that audit.

42. In many countries the mandate for performance auditing will stop short of review of the policy bases of government programs. In any case the mandate should clearly delineate the SAI's powers and responsibilities in relation to performance auditing in all areas of government activity, among other things to facilitate the application of appropriate auditing standards by the SAI.

43. In some countries the constitution or legislation in force do not always confer on the SAI the authority to audit "effectiveness" or "efficiency" of the financial management of the Executive. In these cases evaluation of the appropriateness or the utility of administrative decisions and the effectiveness of management is for Ministers, to whom is given the task of the organisation of administrative services and who are responsible for their management before the legislative body. The expression which would appear in this case to be the most adequate to describe the audits of the SAI which go beyond the traditional framework of regularity and legality is that of "audit of good management." Such an audit aims to proceed with an analysis of public expenditure in the light of general principles of sound management. The two types of audit--of regularity and of management--can in practice be carried out in one operation, the more so since they are mutually reinforcing: audits of regularity being able to prepare audits of management, and the latter resulting in the correction of situations causing irregularities.

44. Public accountability will be more effectively promoted where the mandate enables the SAI to conduct, or direct the conduct of, regularity and performance auditing of all public enterprises.

45. The general auditing principles stipulate that

SAIs should work towards improving techniques for auditing the validity of performance measures (see paragraph 6j).

46. The expanding audit role of the auditors will require them to improve and develop new techniques and methodologies to assess whether reasonable and valid performance measures are used by the audited entity. The auditors should avail themselves of techniques and methodologies of other disciplines.

47. The scope of the audit mandate will determine the scope of the standards to be applied by the SAI.