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New trends in the international professional regulations pertaining to external audit organisations

Incessant global changes and the subsequent competitiveness challenges force audit institutions assume newer and newer tasks on a regular basis. As a result of ever-widening international cooperation financial audits cross the national borders, wherefore – corresponding to the globalisation process – a gradual standardisation process has started in this field too, which is universal in terms of the basic principles, yet preserves the values of the national practices.

An important precondition for standardisation is that the activities of the audit organisations should be harmonisable and linkable with one another. This goal is served by the coordination of the audit techniques, methods and procedures, the establishment of international standards, as well as the application and further development thereof. Said process is coordinated and encouraged by the International Organisation of Supreme Audit Institutions (INTOSAI), which integrates the supreme national or state audit organisations, and coordinates the professional development thereof – today increasingly in conjunction with the International Federation of Accountants (IFAC).

The new expectations to be set against the new situations are primarily mediated by the regulatory systems, within which – in addition to legal regulations – the periodic renewal of professional regulations comes up as a key issue. The legal reg-

ulations primarily answer the questions “what?” or “why?”, which are necessary but not sufficient preconditions. In contrast with this, the professional regulations also deal with the problems of “how, with what methods?”, with standard solutions – methodologies – in the centre.

Within the professional regulatory system the professional standards of auditing are currently linked to fundamental terms such as materiality, risk, sampling, assurance, etc., which appear as the main threads of quality in this respect. The standards are not legal regulations, since they are based on the principle of voluntary adherence, however, they clearly indicate the expected quality level. Apart from this, during the audits the professional standards are used as a benchmark, or measurement tool, wherefore they must be considered as indispensable elements in the audit quality management systems, too. Apart from the general standards, the guarantee values of the national economy and public finances, such as the transparency and accountability of the utilisation of public funds, the enforcement of which requires the consistently good quality of the audit activity, have by today become key factors. It results from all this that it is impossible to develop and operate the quality management systems of external audit organisations without the continuous modernisation of the professional (methodological) regulation of audits.

The following is an attempt to identify the global professional processes that have been increasingly taking shape in the past years, as well as to identify the possible directions of development, with special regard to the professional regulatory tasks that can currently be set for the State Audit Office, the external audit institution of Hungary. However, when keeping track of the international trends it is unavoidable to systemically review the professional audit documents produced in the past years, which are continuously accessible on INTOSAI's website and which form the number one subject of this study.

THE PROFESSIONAL REGULATORY ACTIVITY OF INTERNATIONAL ORGANISATIONS

From among the international organisations engaged in activities of the audit profession reference is made to seven institutions the professional methodological activities of which must inevitably be inspected for the development of the internal regulations of the supreme audit institutions (SAIs). These institutions are the following:

- the International Organisation of Supreme Audit Institutions (INTOSAI),
- the International Federation of Accountants (IFAC),
- the Institute of Internal Auditors (IIA),
- the European Association of Supreme Audit Institutions (EUROSAI),
- the European Court of Auditors (ECA),
- the Internal Audit Service (IAS) of the European Commission, and
- the European Organisation of Regional External Public Finance Audit Institutions (EURORAI).

From among the above mentioned organisations, the most relevant for the State Audit Office of Hungary (SAO), the supreme audit

institution of Hungary, is the professional regulatory activity of INTOSAI founded in 1953 as a consultative body of the Economic and Social Council of the UN.

The INTOSAI

The objective of the international professional organisation, which operates within the cooperation system of the UN with 189 full members, is to support the operation and professional development of the member institutions and the harmonisation of their professional activities.

One of the most often cited basic INTOSAI documents is the Lima Declaration adopted at the Congress of INTOSAI in October 1977. The experiences gained to date from the application of the professional regulatory system, which is based on the aforementioned document (also cited as the constitution of SAI audits) also verify that it is both necessary and possible to formulate audit principles and rules crossing the boundaries of various traditions, cultures and political regimes. Another important stage of development after the Lima Congress was the INTOSAI congress held in Washington in 1992, at which the member states approved the INTOSAI Auditing Standards.¹

Since then the world organisation has continuously shaped and modernised the system of international audit standards at each of its subsequent congresses. For example, the XVIII Congress held in Budapest in 2004 adopted the Strategic Plan 2005–2010 serving the modernisation of INTOSAI, the number one goal of which is to foster accountability and the adoption of adequate and successful professional standards. Within the framework of the strategy, the three standards committees (*accounting, audit, and internal control standards committees*), which had been functioning since 1984,

were reviewed and reorganised. By today these committees have developed several policies and guidelines.

Activities aiming at the development of professional rules and standards meeting the requirements of our age have accelerated since the Budapest Congress held in 2004. Thus, for example, the XIX Congress held in Mexico City in 2007 approved the novel structure of the audit regulations (audit standards) modified in accordance with the Strategic Plan. Furthermore, the participants specified the tasks required for the renewal of the system – including those that support the implementation of the so called “good governance”.

Professional work within INTOSAI is carried out in *committees*, as well as *working groups or task forces*. In important issues that affect the supreme audit institutions of all member states – such as the development of audit standards, or the issuance of directives – INTOSAI usually sets up “committees”. For special issues – such as privatisation or environmental audits – “working groups” are established. In addition, the results of the standard-setting work are reviewed at congresses (International Congress of Supreme Audit Institutions – INCOSAI) organised every three years and attended by all member states.

Pursuant to INTOSAI's Strategic Plan 2005-2010, the Professional Standards Committee incorporated all of the existing and new INTOSAI standards and guidelines in a new, standard framework, under the title ISSAI (International Standards of Supreme Audit Institutions). In parallel with this, the Professional Standards Committee prepared a plan for the period until 2010 for the further development of the INTOSAI Audit Standards. This plan extensively enforces the requirements of the International Standards of Auditing (ISA), too, which can be applied among the conditions for SAI audits.

In the hierarchically structured ISSAI system the number of approved and planned standards and guidelines currently exceeds eighty. These standards and guidelines include all those documents that the INTOSAI congresses have approved as guidelines in relation to the most important professional standards of the supreme audit institutions, such as the basic principles related to the legal, organisational and professional preconditions, as well as guidelines on the performance of audits and other tasks. Where appropriate, the ISSAI documents (may) also describe the applied good practices. Both the approved and draft standards and guidelines can be accessed on the www.issai.org website – organised according to standard classification principles. Apart from this, the website contains the working titles of all documents planned to be elaborated until 2010.

The professional regulatory system of INTOSAI currently contains documents on 4+2 levels, ranging from the Lima Declaration specified on the first regulatory level (ISSAI 1) to the more specific implementation guidelines for IT, environmental, privatisation and state debt management audits identified as the fourth regulatory level. The so called “good governance” guidelines pertaining to the audited institutions, as well as other supplementary documents with no separate ISSAI numbers (forewords, explanations, annexes, attachments, notes) represent a supplementary regulatory level.

The professional regulatory levels of the ISSAI system are described in the following narrative table.

In connection with the regulatory system of INTOSAI described above we find it important to lay down that the Level 1 through 4 documents contain the external normative provisions pertaining to SAI audits. Consequently, they can be regarded as the “international rules for SAI audits”, while the

<p>REGULATORY LEVEL 1 Founding Principles</p>	<p>Level 1 contains <i>the Lima Declaration</i> (ISSAI 1, 1977), which formulates the founding principles of INTOSAI.</p>
<p>REGULATORY LEVEL 2 Prerequisites for the Functioning of Supreme Audit Institutions</p>	<p>Level 2 develops further the founding principles as prerequisites for the proper functioning of SAIs. This level contains</p> <ul style="list-style-type: none"> – the Mexican Declaration on SAI Independence (ISSAI 10, 2007) and independence related guidelines and good practices (ISSAI 11, 2007), – the basic principles on transparency and accountability (ISSAI 20, completed draft), as well as the related good practices (ISSAI 21, completed draft), – INTOSAI's Code of Conduct (ISSAI 30, 1998).
<p>REGULATORY LEVEL 3 FUNDAMENTAL AUDITING PRINCIPLES</p>	<p>Level 3 is based on the documents of Level 1 and Level 2, and contains the general standards for auditing public entities:</p> <ol style="list-style-type: none"> 1. <i>The basic principles of SAI audits</i> (ISSAI 100, 2001) 2. <i>The general standards of SAI audits</i>: they contain requirements related to qualifications, independence, incompatibility, professional competence, diligence, etc. (ISSAI 200, 2001) 3. <i>The field standards in government auditing</i>: they contain more detailed guidelines related to planning, to audit evidences, report analysis and internal control (ISSAI 300, 2001) 4. <i>Reporting standards</i>: they contain standards on financial audit reporting (auditor's opinion), opinion-forming on regularity and performance audits, and reporting (ISSAI 400, 2001)
<p>REGULATORY LEVEL 4 Auditing Guidelines</p>	<p>Level 4 documents present the fundamental auditing principles (Level 3) in more detail - to support implementation – broken down into two groups:</p> <ol style="list-style-type: none"> 1. <i>Implementation guidelines</i>: <ul style="list-style-type: none"> – on financial audits, (ISSAI 1000, draft)² – on performance audits, (ISSAI 3000, 2004)³ – on compliance audits; (ISSAI 4000, draft)⁴ 2. <i>Specific (theme-specific) guidelines</i>: <ul style="list-style-type: none"> – on auditing international organisations (ISSAI 5000) – on environmental audits (ISSAI 5110) – on privatisation audits (ISSAI 5210) – on IT audits (ISSAI 5310) – on the audit of public debt (ISSAI 5410) – on the audit of disaster-related aid (ISSAI 5500)
<p>Guidance for “good governance”</p>	<p>Compared to the four-level norm system of INTOSAI, guideline-type INTOSAI documents pertaining to the administrative audit of the public sector represent a separate – quasi 5th level. Their place, numbering and titles in the current system differ from the other documents of the ISSAI system, however their significance is expected to grow in the future:</p> <ul style="list-style-type: none"> – Guidelines for internal control standards for the public sector (ISSAI GOV 9100), – Guidelines for the accounting standards (ISSAI GOV 9200, 2004.).
<p>Other documents <i>(Appendices, notes and forewords)</i></p>	<p>These materials clearly represent documents outside the INTOSAI standards, wherefore they do not have separate reference numbers. However, they are closely related to normative documents, since they are classified according to INTOSAI numbers:</p> <ul style="list-style-type: none"> – appendices – forewords, – notes.

other INTOSAI documents (such as the guidance on “good governance” and other documents) facilitate the day-to-day application of the provisions contained in the former documents, and as such they mostly contain practical, supplementary guidelines and good practices.

The audit standards of INTOSAI form a system that is being shaped and developed on a continuous basis, and to which the supreme audit institutions of the member states must continuously adjust. The most intensely developing INTOSAI standards include *financial audit* standards that are increasingly approaching the International Standards on Auditing applied by IFAC.

The IFAC

The International Federation of Accountants (IFAC) founded in 1977 is a global organisation for the accountancy profession. It has 158 member institutions in 122 countries, including the Hungarian Chamber of Accountants. IFAC has developed major international standards related to auditing, professional training on auditing, ethics, as well as financial reporting in the public sector, with which it provides continuous support to the audit profession.

The organisation of IFAC consists of boards and committees. A few years ago the International Auditing and Assurance Standards Board (IAASB) of IFAC developed International Standards of Auditing (ISA).⁵ Another internal body of IFAC, the International Public Sector Accounting Standards Board has developed the International Public Sector Accounting Standards (IPSASs), which deal with the audit and the inspection of the financial statements of the governments, local governments and government agencies.

In the past years cooperation between INTOSAI and IFAC has strengthened, especially in relation to the clarification of the criteria of “good governance” and accountability, as well as the formulation and development of audit standards. Standards on financial audits are still developed jointly by the audit standards committee of INTOSAI and the independent standards board of IFAC.

The IIA

The Institute of Internal Auditors (IIA) was established in the United States in 1941, and currently comprises of 165 member states. The IIA promotes the further development of the internal audit profession by issuing standards, guidelines, professional practical guidances, as well by comprehensive professional training. It plays an important role in spreading and publicising the best international practice of internal audits, as well as in the further training of internal auditors.

In relation to the standardisation process of the profession it is a major development that IIA has set up an international examination system that measures the knowledge of the applicants on the basis of general internal audit criteria. The name of the achievable accredited qualification is Certified Internal Auditor (CIA). Apart from this, IIA also provides for a special certification for the internal auditors of the public sector, in which case the name of the accredited qualification is Certified Government Auditing Professional (CGAP).

In order to support the day-to-day task performance of internal auditors IIA has issued its own standards for internal audit practices in the past years (International Standards for the Professional Practice of Internal Auditing – ISPPA). In addition, many references are made to the Code of Ethics of the organisation, which out-

lines those forms of behaviour and conduct that internal auditors must observe in the course of their work.

IIA comprises of national organisations that form regional units. Its Hungarian member organisation is the public benefit organisation called Institute of Internal Auditors, Hungary.

According to IIA's Strategic Plan 2008–2013, the main objective of the institution for 2013 is to make the internal audit profession acknowledged worldwide, to define the professional principles, and to make such principles easy to use worldwide. IIA is engaged in internationally acknowledged professional research projects and analyses in the field of internal audits, the objective of which is to make the professional requirements known to and observed by as many internal auditors as possible. It is important to note that strong cooperation has been established lately between INTOSAI and IIA.

The EUROSAI

The European Organisation of Supreme Audit Institutions (EUROSAI), which was founded in 1990, is the European regional organisation of INTOSAI, wherefore professional and technical cooperation among the member states of INTOSAI is ensured at regional level, too, with the involvement of EUROSAI. The main objective of the organisation is to foster professional cooperation among the member states, promote the exchange of experience, and to deepen the knowledge about auditing in the public sector.

EUROSAI has set up a separate committee (EUROSAI Training Committee) for the fulfilment of professional training tasks, but it also runs several other professional working groups, such as the working group on environmental auditing, the IT working group, or the

working group promoting the good practices of quality management, which is led by the State Audit Office of Hungary. As a result of their work, the professional working groups issue recommendations, guidelines⁶ and practical guidances, they collect the best international practices and make them available for the SAIs.

The European Court of Auditors (ECA)

The European of Court of Auditors (ECA) is one of the EU's independent institutions, which has performed its audit activities in accordance with the Treaty of Rome – which established the European Union and has been amended several times since then – and with the IFAC and INTOSAI International Auditing Standards and Codes of Ethics, in so far as these are applicable in the European Community context. Pursuant to the Founding Treaty in force, the European Court of Auditors must examine all community revenues and expenditures, and must publish its opinion annually. To this end the ECA issues a statement of assurance, generally known as DAS⁷.

The Founding Treaty requires the ECA to examine whether the financial management of the European Community has been sound and whether the activities have been performed in an economic, effective and efficient manner. The related Performance Audit Manual is also accessible on the ECA's website.

In addition to the above written, the auditors of the European Court of Auditors must perform their work in compliance with the audit policy and standards of the organisation, the Audit Manual of the European Court of Auditors, as well as the audit procedures approved by the organisations. In connection with this it is important to note that in 1998

INTOSAI issued – upon the initiative of the European Court of Auditors – its European Implementing Guidelines for the INTOSAI Auditing Standards to facilitate the application of the INTOSAI standards.

In connection with the relationship between the EU member states and the European Court of Auditors it is of utmost importance that the Nice Treaty of 2001 commissioned the European Court of Auditors to establish the so called Contact Committee.⁸ The objective of the Committee, which meets once a year, is to deepen and further develop cooperation among the SAIs – with special regard to the transfer of professional knowledge related to the audit of the EU Funds, and the related exchange of professional experiences. The Committee is headed by the president of the European Court of Auditors, while the members are the heads of the SAIs of the member states. The Contact Committee cooperates with INTOSAI and EUROSAI, and thus contributes to the further development of the financial management of the EU from the aspect of “good governance”. The Contact Committee will hold its annual meeting in Budapest at the end of 2009.

The Internal Audit Services (IAS) of the European Commission

The European Commission consists of Directorates General (DGs), which include internal audit units – often in combination with the internal control units (*directorates*). The Directorates General continuously evaluate and audit the implementation of community policies and objectives, before, during and after implementation. In relation to the management of EU Funds, responsibility is divided between the member states and the Commission. The Commission checks whether the management and control system set up by the member states comply with the legal requirements of the EU.

In addition, the European Commission issues guidelines for the member states on how to conduct the audits, as well as issues manuals, methodological guidelines and other guidances that it regularly publishes on its website.

The Internal Audit Service (IAS), which is one of the internal services of the European Commission, has been functioning as an independent Directorate General since 2001. Its task is to provide an independent audit opinion about the operation and quality of operation of the internal management and internal control system of the EU Commission, as well as to make recommendations for the efficient and effective achievement of the community objectives. IAS performs its activities in accordance with the professional standards and the code of conduct of IIA. Within this framework it conducts risk analysis based horizontal audits, and so called thematic audits in the European Commission. The audit findings are then discussed with the audited entities.

IAS concludes its own audits with recommendations, wherefore its activity helps the Directorates General of the EU Commission better identify control risks and pay a greater attention on the observance of the rules. In addition, IAS organises high level international conferences that provide opportunities for the internal auditors of the public and private sectors to regularly exchange their experiences.

The EURORAI

The European Organisation of Regional External Public Finance Audit Institutions (EURORAI) was established in 1992 with a view to harmonise the various audit methods of the participating countries. Its activity includes the further development of the local governmental and regional audit activities, the promotion of the exchange of experiences and the flow of information among the member states,

the organisation of training sessions and the harmonisation of the audit terminology. Apart from organising meetings, seminars and conferences, the organisation performs its tasks by issuing joint publications,⁹ as well as by fostering expert level meetings.

NEW INTERNATIONAL TRENDS IN PROFESSIONAL REGULATION

Within the processes of international professional organisations utmost significance is attributed to the professional regulatory process at INTOSAI, which accelerated in 2005, and as a result of which the professional regulatory framework called ISSAI will be practically completed by 2010 with documents containing professional guidelines. In accordance with the schedule of INTOSA's development strategy 2005–2010, the implementing guidelines that contain the universally applicable, common professional minimum requirements broken down by the major audit types (financial audit, performance audit, compliance audit) have been available since the summer of 2009.

The requirements stipulated in the documents will not be mandatory in the future either, and have not been prepared with the intention of exerting force either. Yet they provide a standard and transparent picture of the common concepts, interpretation and methodology, on the basis of which the SAIs of the individual countries are advised to formulate their own audit standards, as well as their systems of consistent terminology and internal professional regulation (methodology), transposed into their national languages.

However, the obvious objective of the large-scale international standardisation process, which respects the national characteristics at all times, is to allow for the comparison, approximation and harmonisation of the audit prac-

tices of institutions established in different parts of the world on the basis of different historical and cultural endowments. This is what made joint participation in the international audit programmes possible in the past years, in relation to which in the case of Hungary we can emphasise professional cooperation with the EU member states (e.g. joint or parallel audits) and the establishment of adequate relationships with the EU institutions. In addition to the above written it is reasonable to mention the audit of certain international organisations as a professional challenge that would be practically unsolvable without reference to the common professional standards.

Having examined the standard-setting practice of INTOSAI it can be stated that a real trend seems to be taking shape in that

- after the accentuation of the importance of performance audits, emphasis is (again) placed on financial audits in the standard-setting work,
- the INTOSAI and IFAC standards are being increasingly approximated,
- compliance audits emerge as a quasi independent audit type,
- the importance of “good governance” type guidances grows.

Financial audits gain emphasis again in the standard-setting work

The significance of audit types is in that they determine the rules and methods of audits within their scope. From this aspect it is an interesting fact that at INTOSAI level no professional implementing guidelines with reference numbers have been elaborated on financial audits to date. Historically it happened so that in the professional regulatory system of INTOSAI the general standards related to the fundamental principles and framework conditions of SAI audits were developed first in the

past years, and they were followed by theoretical guidelines pertaining to audit types other than financial audits (performance audits, compliance audits).

After the elaboration and large-scale dissemination of the standard methodology for performance audit in the past decades, which appeared to be a newer and more modern audit approach compared to the traditional financial audit, attention will again be focused on financial audits in the forthcoming years.¹⁰ On the one hand because within the system of SAI standards financial audits represent the greatest, professionally coherent area, and on the other hand because these professional rules (guidelines, practice notes) that are considered to be the most significant in the system of INTOSAI standards are to be completed shortly, but by 2010 at the latest.

As it was referred to above, in the hierarchical system of ISSAI documents pertaining to financial audits the implementing guideline on financial audits – planned to be issued under number ISSAI 1000 – ranks the highest, to which further 36 documents can be assigned.¹¹ Although these (currently) 37 professional documents of different levels, contentual weight and length make up nearly half of the current ISSAI system, their degree of completeness is rather low: while nine documents were approved in 2007, 25 professional materials are still only in the draft stage. At the same time however all of these materials but one have already been offered for public commenting, and the comments of the member states on nine of these materials can already be read on the website of INTOSAI.

Despite the different sizes of the tasks and the different operation of the individual working groups, a strange situation has arisen in that the working groups dealing with the detailed professional rules completed their tasks sooner than the standard-setting bodies formulating the general guidelines of the given audit type.

The material referred to above as an exception is exactly the ISSAI 1000 implementation guideline on financial audit, the provisions of which should in theory be used as a basis for all the other ISSAI documents beginning with one thousand. However, for the lack of this document it is difficult to imagine how the subsequent standard-setting tasks and tasks related to the practical implementation of the completed documents could be carried out.

One of the possible reasons behind the quasi reversed order of task performance in the standardisation of financial audits compared to the elaboration of other professional rules can be that in the standard-setting work financial audit represents the largest field, in relation to which the work of extremely many international working groups must be coordinated throughout many years. The other reason behind this time-intensiveness is that these professional standards must be adequately justified, professionally unquestionable, and practically applicable even when compared to other INTOSAI documents. Especially for these reasons the financial audit standards of INTOSAI are being developed with consideration of the existing or renewing audit standards of IFAC and IIA, with special regard to the different audit criteria (compared to the standards mentioned above) to be enforced during practical application.

Approximation of the INTOSAI and IFAC standards

As it was indicated above, contrary to the methodology development practice of the former years, which focused on performance audits, in the forthcoming period the INTOSAI member states will conduct intense professional discussions primarily about the further development of financial audits. Within the framework of this activity special emphasis will

be placed on the creation of increased harmony with the International Standards on Auditing (ISAs) issued by IFAC. In this respect preparations have already been started for several documents that can be classified under the following three document types (in connection with financial audits):

- implementation guideline, ISSAI 1000, preliminary draft),
- general consideration, ISSAI 1001, 1002, not accessible),
- practice notes, 17 documents).

It is not yet known which types the other 18 documents currently under preparation belong to, however it is probable that they will also be completed as practice notes. Practice notes play an extremely important role in the harmonisation of INTOSAI standards on SAI audits and the IFAC audit standards.

In relation to the approximation of SAI audit standards and standards on auditing we cite the following example: at the beginning of 2009 the Swedish National Audit Office heading the Financial Audit Guidelines Subcommittee of INTOSAI forwarded to the INTOSAI member states the INTOSAI practice notes prepared for ISA standards No. 200, 210, 240, 250, 500, 550, 560, 570 and 580 issued by IFAC for commenting. The numbering of said practice notes is adjusted to the numbering used by IFAC with the difference that the INTOSAI numbers are four-digit numbers due to inserting a thousand digit before the original numbers. Consequently, the ISA 200 standard issued by IFAC on the principles of auditing financial statements was assigned the ISSAI 1200 number in the INTOSAI system.

In the introductory parts of the individual practice notes INTOSAI lays down in every case that the notes shall be interpreted in conjunction with the general consideration No. ISSAI 1002 prepared for the implementation guidelines on financial audits. However, this latter document is expected

to be completed only in 2010, and the first draft is expected to be available no sooner than 2009.

The individual practice notes are developed by expert groups consisting of the representatives of INTOSAI member states. The documents, taken as a whole, contain the IFAC standards (ISAs), as well as those supplements and notes formulated by INTOSAI that must be taken into account during the application of IFAC standards for SAI audits (differences, exceptions, etc.).¹²

Staying with the former example, during public sector audits the ISA 200 auditing standard of IFAC must be used together with practice note No. ISSAI 1200 issued by INTOSAI, and these two documents provide guidance for the auditors during the audit of financial statements inseparably from each other. The differences between the public and the private sectors are formulated by the practice notes themselves. Hence, for example, the contents of the financial statements prepared in the public sector may differ from the contents generally accepted in the private sector. In the latter audit environment the financial statement may contain information not only about the financial situation, financial performance, accumulation or loss of assets, but also about performance, as well as about the utilisation of the budgetary appropriation.

It comes from the above – far-reaching – rule that the auditors of the public sector will by all probability also apply the IFAC standards – similarly to the auditors of the private sector – however they will also be required to take into consideration the comments/supplements formulated in the practice notes issued by INTOSAI. It may also have longer term consequences that if an audit is conducted on the basis of all INTOSAI practice notes pertaining to the public sector, the term audit may refer – even literally – to the application of IFAC standards according to the rule. Finally, reference is

made to the application framework – established consciously in collaboration by INTOSAI and IFAC – according to which the effective dates of the INTOSAI practice notes and the auditing standards of IFAC (ISAs) are identical, i.e. if all goes to plan, both standard types will in theory be applicable from the same date.¹³

From INTOSAI's perspective the SAI audit of financial statements can also be part of a larger financial audit task. For instance, depending on the legal mandates of the SAIs, the financial audit may include the audit of financial statements, the issuance of an opinion (certificate) on the financial accounts (final accounts) of the government, and last but not least the evaluation of internal controls and internal audit functions. In the future the related work of the auditors of the public sector will be aided by INTOSAI's implementation guidelines on financial audits (ISSAI 1000), as well as the system of practice notes linked to these guidelines and to the IFAC standards. And when the SAIs are required to undertake an even greater financial audit task – in compliance with their legal mandates – the application of other professional INTOSAI rules (e.g. the guideline on compliance audit – ISSAI 4000) may become justified.

The wide-scale use of compliance audits:

In relation to the audit types the ISSAI system was formerly characterised by a certain dual structure, which in essence meant that all INTOSAI documents could in theory be classified under two main audit types – financial audit and performance audit.

Yet, at the end of 2008 the Norwegian National Audit Office chairing the Compliance Audit Subcommittee of INTOSAI issued three new draft

guidelines – beginning with number 4000 – to the member states for commenting:

- the General Introduction to Guidelines on Compliance Audit No. ISSAI 4000,*
- the Compliance Audit Guidelines for Audits Performed Separately from the Audits of Financial Statements under No. ISSAI 4100, and*
- the draft of Compliance Audit Guidelines Related to the Audit of Financial Statements under No. ISSAI 4200.*

Having reviewed the documents it can be stated that on one hand compliance audit can be linked to the audit of financial statements, or can be part thereof, when the compliance audit guidelines supplement INTOSAI's Implementation Guidelines on Financial Audit (ISSAI 1000), and in this case compliance audit is also a financial regularity audit (ISSAI 4200). On the other hand, compliance audit can be conducted separately from the audit of financial statements – as a separate audit task or linked to a concrete performance audit (ISSAI 4100).¹⁴

Compliance audits do not necessarily imply regularity audits. During compliance audits the SAIs audit to what extent the activities and operations of the audited entities comply with certain criteria. Naturally, such criteria can be legal regulations (acts, decrees), as well as other rules, guidelines, standards, practical guidances, terms of contracts or agreements, objectives, or even ethical norms. Compliance criteria can be determined even by the auditors, however in this case these criteria must be very precisely and clearly identified in advance.

In the case of compliance audits the subjects of the audits can be both general or specific, or can be *quantitative* factors allowing greater objectivity (e.g. changes in institutional vacancies), or *qualitative* factors (e.g. the audit of ethical conduct) that are more subjective. In addition, compliance audits can also be conducted at the central or local levels of public

finances, just like at institutions – not necessarily budgetary institutions – that use public funds in any form.

In practice, SAI reports drawn up about compliance audits state to which extent the audited entities comply with the pre-determined criteria.

The meaning itself may take various shapes depending on the user's needs. On this basis the following types of reports can be drawn up:

- separate compliance audit report (short or long);
- report containing the compliance opinion as part of the financial audit report;
- report that lists those activities and cases that did not meet the compliance criteria; or report that simply declares that during the audit the auditor obtained no knowledge about activities and cases that failed to meet the compliance criteria;
- opinion on whether the transactions that were examined during the audit complied with the rules (criteria) or not.

The numbering beginning with 4000, as well as the place of the drafts in the system among the implementation guidelines on financial audit (ISSAI 1000–2999) and performance audit (ISSAI 3000–3999) indicate a main audit type. In addition, documents No. ISSAI 4000, 4100 and 4200 describe compliance audit as a separate audit type. INTOSAI itself does not exclude the possibility of developing a new audit type from this audit approach later on, however a relevant decision is expected to be preceded by several professional debates in the INTOSAI committees and working groups.

Just like the activity of every SAI is determined by its own constitutional status and national legal regulatory environment, the application of the future guidelines on compliance audits will not be mandatory for the member states either. The individual SAIs will

decide to what extent the compliance audit approach can be approximated with their audit authorisations and scopes.

As it is mentioned in the general introduction to the draft guidelines – for certain transparency and accountability reasons – SAIs require a wide scope to audit public funds, which thus requires the implementation of more comprehensive audit objectives compared to the auditing inspections. Yet, according to our standpoint, the draft guidelines on compliance audit can be well incorporated into the current audit mandate of the State Audit Office of Hungary, and can be approximated with the legal regulatory environment of the SAO. According to all probability, opinion forming on the bill and the audit of the financial management and operation of the parties can be an area in which the new, compliance audit type professional (methodological) approach of INTOSAI can be used successfully.

The increasing role of “good governance” type guidances

The term *good governance*, which grew out of the foundations of *new public management*, and basically represents a neoliberal economic approach itself, appeared in the documents of the World Bank more than twenty years ago, and has been widely used ever since to define that form of governance that utilises the economic and social resources in an undiscriminatory and transparent manner.¹⁵ Along this concept, in relation to the public sector legal security, transparency and accountability, and last but not least the fight against corruption should be defined as fundamental requirements.¹⁶

The modern concept of the state, which has spread in the past few decades, has left a mark on the professional regulatory activity of

INTOSAI, too since the millennium. The XIX congress, which was held in Mexico City in 2007, approved not only the new system of the international audit standards (ISSAI), but also the first group of documents (5) belonging to the “good governance” guidances. The current places, numbering and names of these documents within the system differ from those of the other documents of the ISSAI system.¹⁷

The professional documents that represent a separate – quasi 5th level – compared to the four-level norm system of INTOSAI include guidelines (ISSAI GOV 9100), guidances (ISSAI GOV 9110, 9120, 9220) and framework systems (ISSAI GOV 9130). Their characteristic feature is that they focus on the administrative audit of the public sector, wherefore their content is primarily related to the internal control standards of the public sector, and the recommended cooperation with the internal auditors. Consequently, compared to the other professional rules of INTOSAI the major difference is that the “good governance” guidances formulate basic principles to be followed not for the external audit organisations, but for organisations they audit. Naturally, these expectations are not binding for the affected organisations, yet they represent a professional minimum that the external audit organisations may take into consideration during their audits.

The “good governance” documents that can be regarded as the latest results of the standardisation work performed within the framework of INTOSAI for the time being occupy a special place in the document system of INTOSAI. However, their importance is expected to grow since there is increasing need for external professional support to the government agencies in almost every country (advisory function). One of the consequences can be that the internal audit standards (IIAs) and INTOSAI's general professional stan-

dards pertaining to external audit organisations (ISSAI) will be significantly approximated.

However, according to a more developed interpretation of “good governance”, the state undertakes an active role not only in creating the conditions for governance, but also in the fulfilment of certain public tasks.¹⁸ In this new approach “good government” plays a proactive and exemplary role in the creation of social solidarity, justice and equity, as well as a value based public administration culture (integrity).

The development of the “good governance” term is also reflected by the professional documents – representing a higher hierarchical level, i.e. not ISSAI GOV type documents – that were forwarded for commenting by the French National Audit Office chairing the Transparency and Accountability Working Group of INTOSAI at the beginning of 2009. The document titled “Principles of transparency and accountability” (ISSAI 20) and the draft “Principles and good practices” (ISSAI 21) prepared for the former document are linked to the second INTOSAI regulatory level that determine the operational principles of the SAIs. This level contains important documents such as the Mexican Declaration on SAI Independence or the Code of Conduct of INTOSAI. The importance of these documents is also augmented by the fact that these INTOSAI audit standards must be used in conjunction with the above mentioned principles.

The professional drafts that have been published together with the opinions of the member states specify the requirements of transparency and accountability in close correlation. Consequently, accountability pertains to the legal frameworks of the organisations – to the organisational structure, the strategy and the activity performed by the organisation –

according to which the operation of a SAI must always be harmonised with the audit mandates, as well as the relevant legal and internal rules.¹⁹ This includes that apart from the preparation of the SAI reports the organisations themselves report on their activities and financial management, evaluate their own performance, and that the managers and staff members of the SAIs do their work responsibly. At the same time transparency means that the SAIs regularly issue information on their mandates, status, strategies, activities, financial management, operation and performance. Furthermore, the SAIs are required to publish their audit findings and recommendations.²⁰

HUNGARIAN CHALLENGES RELATED TO THE CHANGING INTERNATIONAL TRENDS

Due to the above external trends Hungary should also determine – as soon as possible – a common professional standpoint that would take the international changes into consideration, and on the basis of which the people in charge of the institutions of the external and internal audit systems could specify the tasks of the near future in coordination with one another.

According to our standpoint, on the part of the State Audit Office of Hungary the following responsive steps can be taken:

- making the certified Hungarian translations of the international professional documents available as soon as possible,
- further improvement of the harmony between the internal professional regulations of the SAO and the international audit professional standards,
- the further development of the quality management system to ensure better compliance with the transparency and accountability principles deduced from the “good governance” requirement.

Making the translations of the international professional documents available

In the case of the State Audit Office of Hungary one of the first and foremost tasks is to make the professional requirements clear-cut, and known to the staff members. Since the audit related external and internal requirements form a – theoretically logical and consistent – hierarchical system (system of audit requirements), when defining the professional rules it must be ensured that all significant international standards applicable in Hungary are translated into Hungarian, the translations are proof-read from the professional perspective, and that the proofread translations are made available on a continuous basis to all parties concerned.

The application of the INTOSAI standards is first of all the sovereign decision of the supreme audit institution of a given state. This becomes important especially in relation to much more numerous and lengthy materials on the fourth regulatory level of INTOSAI (implementation guidelines). However, if a SAI decides on the use of the INTOSAI standards, it has two options: it must either use the original documents drawn up in the official languages of INTOSAI (English, Arabic, Spanish, French and German), or must prepare certified translations. Otherwise in theory no reference can be made to the ISSAI numbers or the individual sections of the standards.

Due to the above written, INTOSAI formulated recommendations for the translations, too,²¹ with the following elements:

- specifying and conducting a translation process that allows for the production of certified translations – except for the translators' notes – without omissions and supplements
- translation of the key terminology/concepts and maintenance of the key terminology – use of a glossary or a terminology dictionary – by mak-

- ing it clear that for the avoidance of mistranslations the translators wish to understand the intentions of the authors of the original documents;*
- the consistent and standard use of key terminology/concepts during the preparation of subsequent translations with the condition that it can be noted in a footnote if the common meaning of a given expression is different in the given country;*
- the translation of the entire texts of all guidelines within a given category of guidelines;*
- during the translations application of the principle on the basis of which the draft was prepared;*
- use of professional translators in the first place, in close consultation with the organisation ordering the translations;*
- considering – especially in the case of materials on financial audits – whether it is justified to translate the texts (key terminology) of the relevant IFAC standards;*
- establishment of a translation working group – preferably with the involvement of members having a native level of English, and adequate experience in the application of INTOSAI and IFAC standards; after that, the review of the materials of the professional translator by the working group;*
- use of the English terminology in case of translation disputes.*

Improvement of the harmony between the internal professional regulations and the international standards

In the second step it is a serious professional challenge to determine the audit types that are in full compliance with the system of INTOSAI's professional standards, as well as the consistent practical application of these audit types – both during the planning of audit tasks and the quality assurance of the individual

audits. Otherwise it is extremely difficult to compare the SAO's audit practice with the audit activities of other audit systems, countries or international organisations (e.g. EU, OECD, NATO, etc.).

From the perspective of the professional development of the SAO in the past two decades the Audit Manual containing the professional rules of SAO audits, which was issued in 2004 for the first time, and was revised in 2008, can be regarded as a major milestone. The Manual, the application of which was ordered by instruction No. 9/2008 issued by the President of the SAO²², is at the peak of the hierarchical system of the internal professional regulations of the SAO, and is already in full compliance with the renewing professional regulatory system of INTOSAI. As a result of the intense methodological developments of the past years it can be stated that the requirements of the Audit Principles and Standards²³ laid down in the Audit Manual to specify the principles of the work of the SAO fully correspond to the INTOSAI standards.

The major types of SAO audits are specified by the Audit Principles and Standards²⁴. Thanks to the methodological development carried out in the past years, there are currently three major audit types: *regularity audit*, *performance audit* and *comprehensive audit*. In addition to the above written, the Audit Manual specifies *financial regularity audit* as a subtype of regularity audit. The Manual derives the audit types from the INTOSAI standards (the basic principles in government auditing, ISSAI 100).

In relation to the audit types another future challenge can be the further specification of the role and place of the so called comprehensive audits – which play a major role in the audit practice of the SAO – in the professional regulatory system of the SAO. The reason behind this is that the ISSAI 100 document, which describes the major audit types and contains

the basic principles of the auditing of public entities, does not contain direct reference to comprehensive audits focusing on the internal management, regulatory and control system designed to ensure the operation of the individual organisations and the implementation of activities and other tasks within the organisations. However, taking into consideration that in relation to the audit of the operation of the individual budgetary institutions/chapters the external and internal audit systems in Hungary are not always standard coherent, for the time being the methodological approach of comprehensive audits cannot be excluded from the current audit practice of the SAO.

Having examined the current internal professional rules that determine the method of the implementation of the audits it can be stated that the increase of the role of the so called *system audit*²⁵, as a special audit approach within the main audit type of performance audit, is another task to be solved in the near future.

However, in addition to the correlations of the individual documents it will also have to be examined how the internal professional rules on methodology affect the auditors' day-to-day work from the perspective of the quality centred operation of the SAO. The latter makes it possible to approach the professional audit activity in a systemic manner, since in this case the coherent system of methodological documents that comply with the international requirements forms only a single element of a process during which the progressive methods and techniques are incorporated into the everyday practice continuously and efficiently.²⁶

The further development of the quality management system of the SAO

Another challenging issue related to the internal professional regulation is the exploration of the correlations between the performance of

professional regulatory (methodological) tasks, and the coordinated development of these two systems. In connection with this it is still a major starting point that the fulfilment of methodological regulatory tasks forms part of the quality management system.

With regard to the constitutional status – professional, organisational and financial independence – of the SAO, it is of utmost importance to maintain mutual trust among the SAO, the National Assembly approving the individual audit results, as well as the general public. With a view to ensure this trust, and considering the transparency and accountability practice that is gaining acceptance in the supreme audit institutions, the establishment, operation and conscious development of an independent quality management system would be an appropriate response.

The fundamental objective of the quality management system that was established within the SAO in 2005²⁷ – and which can be regarded as an extremely significant result in relation to organisational development, is to ensure the continuous high quality of the SAO reports that can be identified as the end-products of the audit work, as well as that of the individual audit findings, conclusions and recommendations. The concept of quality includes – in addition to compliance with the pre-determined expectations – compatibility with the public interests and the public good as a content element specified for the public sector. Consequently, the SAO shall continue to focus on compliance with the needs of the National Assembly and the citizens in the future, too.

The terms used in the current quality regulations of the SAO have the same contents as defined in the international standards²⁸. Therefore, a distinction can now be made between “quality control”, which is incorporated into the auditing process, and “quality assurance”, which is performed subsequently. In fact, quality within the SAO is “assured” by these

two procedures jointly. However, in relation to the operation and development of the current quality management system quality must play an important role in two areas at the same time: in the institutional operation of the SAO on the one hand (*process side*), and in relation to the process of production of the outputs of the audit activity (reports, opinions) (*output side*).

In the past years the system of internal regulations has been expanded, and these regulations have been consistently applied in the audit practice, too. Therefore, progress can rather be made in the direction of total quality manage-

ment systems, which assign certain quality requirements to each function of an organisation – including the fulfilment of functional, operation-related tasks such as the operation of IT, educational or other external expert systems designed to support professional work. In public administration such total quality management systems have come into being on the basis of the methodological foundations of the Common Assessment Framework (CAF) – which has been gradually gaining space since 2001 – the applicability of which by the SAO is another issue to be investigated in the future.

NOTES

¹ A significant milestone in methodological development was the Washington Accords adopted at the XIV Congress of INTOSAI in 1992. This document emphasised that contrary to the former practice, audits should preferably stop providing a merely narrative, observing control. Instead they should foster improvement, be supportive, strive to influence the financial management of the states, and should not only detect errors, but should also recommend solutions. This meant that in addition to the regularity audits, performance audits have been given increasing attention since the early 1990s.

² The first draft of the INTOSAI's financial audit guideline has been prepared, however it has not yet been offered to the SAIs for comment. Its content is based on IFAC standards (ISAs), as well as on the so called Practice Notes made by INTOSAI to these standards. It highlights those practical aspects that must be taken into account when auditing public entities.

³ The implementation guideline for performance auditing was approved by the INTOSAI Congress held in Hungary in 2004. The Performance Audit Subcommittee of the Professional Standards Committee is currently – until 2010 – developing guidelines that describe the methods of applying certain qualitative and quantitative aspects during performance audits.

⁴ In 2007, at the XIX Congress of INTOSAI, the Professional Standards Committee proposed the development of guidelines for compliance audits,

too. These guidelines were elaborated by the Compliance Audit Subcommittee of the Professional Standards Committee. The draft document was completed in October 2008, and was offered to the SAIs for comment by 1 February 2009. It is expected to be published in 2009.

⁵ The latter shall be taken into consideration in relation to the “Guidelines on financial audit” to be elaborated by the Financial Audit Guidelines Subcommittee functioning within the framework of the Professional Standards Committee (PSC) of INTOSAI. The new ISSAI number will also contain a unanimous reference to the number of the relevant ISA standard.

⁶ For example the Guidelines for VAT Audit

⁷ The DAS (acronym for the French Déclaration d'Assurance) is the formal opinion of the European Court of Auditors on the reliability of the EU accounts, and on the legality and regularity of the underlying transactions. The methodology of DAS is accessible on the website of the European Court of Auditors.

⁸ Before that the heads of the SAIs of the member states had met since 1960. The European Court of Auditors first attended the meeting of the member states' SAIs independently in 1978.

⁹ Here we can mention the comparative study about the audit of European local governments, or the four-language (English, French, German, Spanish)

glossary, which contains expressions related to the audit of the public sector.

- ¹⁰ The significance of performance audit is not expected to decline in the forthcoming years, however it can be regarded as a routine, generally known audit method, compared to which increasingly specialised forms are expected to gain space. Consequently, it is reasonable to allocate resources for the methodological support of (performance) audits related to IT systems, state debt, as well as cost-intensive environmental and transportation infrastructure investment projects.
- ¹¹ The theoretical starting point of INTOSAI is that the system will be expandable and supplementable on a continuous basis. The website of the organisation contains the schedule of the preparation of another 36 documents in contrast with the list specified in Annex 1 to the preliminary draft of the ISSAI 1000 document, which envisages the preparation of two more – total of 38 – documents in the field of financial audits. The difference comes from the ISSAI 1001 document titled “Bridge between INTOSAI Auditing Standards and International Standards of Auditing (ISAs)” and the ISSAI 1002 document titled “General Considerations when Applying International Standards of Auditing (ISAs) in the Public Sector”, while the latter are not yet presented on the website as scheduled tasks.
- ¹² Upon authorisation by IFAC, INTOSAI has published – together with the draft practice notes – the texts of the IFAC standards (ISAs) planned to be issued in the future, however no comments can be made on the latter.
- ¹³ IFAC is currently revising its standard in this topic. The revised standards will take effect in 2010.
- ¹⁴ The SAIs may be assigned separate audit tasks – depending on their respective legal authorisation and mandate – by the national parliaments, and the SAIs (or their presidents) may decide themselves about the performance of separate audit tasks.
- ¹⁵ See Gábor G. Fodor – István Stumpf: The two meanings of “good governance” – or the programmes and conditions of democratic governance, *Nemzeti Érdek*, 2007/3., Századvég Kiadó, pages 76–95
- ¹⁶ See Gusztáv Báger – Árpád Kovács: A few aspects of the relationship between the political and economic sectors – the foundations of minimum consensus (manuscript), 2007
- ¹⁷ The numbering of good governance documents differs from the other ISSAI documents in that the acronym “GOV” must also be used when referring to such documents (ISSAI GOV). In addition, their numbering starts with 9000 (9100 through 9299), in a distinguishable manner from the other audit types.
- ¹⁸ See Gábor G. Fodor – István Stumpf: A neoweberi állam és a jó kormányzás (The neo-Weberian state and good governance), *Nemzeti Érdek*, 3/2008, Századvég Kiadó, pages 5–26
- ¹⁹ The fundamental questions of accountability are “who?”, “about what?”, “to whom?”. See: the lecture held by Dr. Árpád Kovács under the title “The transparency and accountability of public finances”, at the annual conference of ICGFM (International Consortium for Governmental Financial Management) (USA, Miami, 3 May 2005)
- ²⁰ The fundamental questions of transparency: clear definition of tasks and scopes, wide-scale accessibility of information, publicity of the preparation and execution of the budget, as well as of the report on the execution of the budget, ensuring management integrity. See Dr. Árpád Kovács: “The transparency and accountability of public finances”, ICGFM, USA, Miami, 3 May 2005
- ²¹ See Annex 3 to the Implementation Guidelines on Financial Audit – Introduction, expected to be published under number ISSAI 1000 in 2009, for the Translation Recommendations
- ²² Presidential Instruction No. 9/2008 about the Audit Manual of the State Audit Office of Hungary, effective since 4 September 2008
- ²³ See Volume 4 of the Audit Manual
- ²⁴ Volume 4 of the Audit Manual, Chapter I/3 (page 7)
- ²⁵ Instruction No. 10/2008 of the President of the SAO about the methodology of system audits, effective since 22 September 2008
- ²⁶ The major documents of the audit profession (methodological documents) used by the SAO are available on the SAO's website (www.asz.hu)
- ²⁷ Before that an independent Quality Assurance Department was set up within the organisation in 1998.
- ²⁸ See the European Guidelines on the Implementation of INTOSAI Auditing Standards, Article 51, Quality Assurance