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Integrated Financial Management Systems

Auditing Integrated Financial Management Systems

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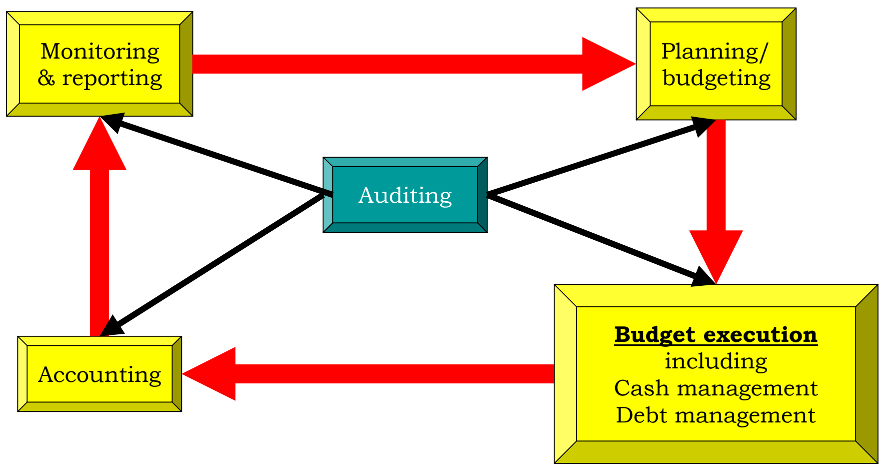
LIST OF ABBREVIATIONS

IFMS	Integrated Financial Management System
IMF	International Monetary Fund
INTOSAI	International Organisation of Supreme Audit Institutions
NAO	National Audit Office (UK)
SAI	Supreme Audit Institutions
VFM	Value for Money

1 Introduction and overview of paper

This paper advances the proposition that the audit of Integrated Financial Management Systems (IFMS) should embrace the whole of such systems, and furthermore that the audit should embrace not only financial propriety, compliance with legal and regulatory requirements, and the proper recording of transactions, but also extend to reporting on the performance of the entity (value for money), and expressing an opinion on the financial statements prepared by the entity. This approach places audit at the centre of the IFMS, as indicated in Exhibit 1, below.

Exhibit 1: Audit at the centre of the IFMS



It will further be argued that this approach to the audit of an IFMS, as indicated above, provides the maximum benefit from the audit, and significantly increases the potential value of the IFMS itself. These are important arguments with implications not only for audit, but also for the design and development of an IFMS. To support these arguments this paper will examine:

- The nature of accountability and the role of audit
- Different concepts of audit
- New public management approaches and IFMS
- New approaches to audit of IFMS
  - Audit of the IFMS cycle
  - Audit of the entity of government
  - Audit of performance
  - Audit, accountability transparency and against corruption.

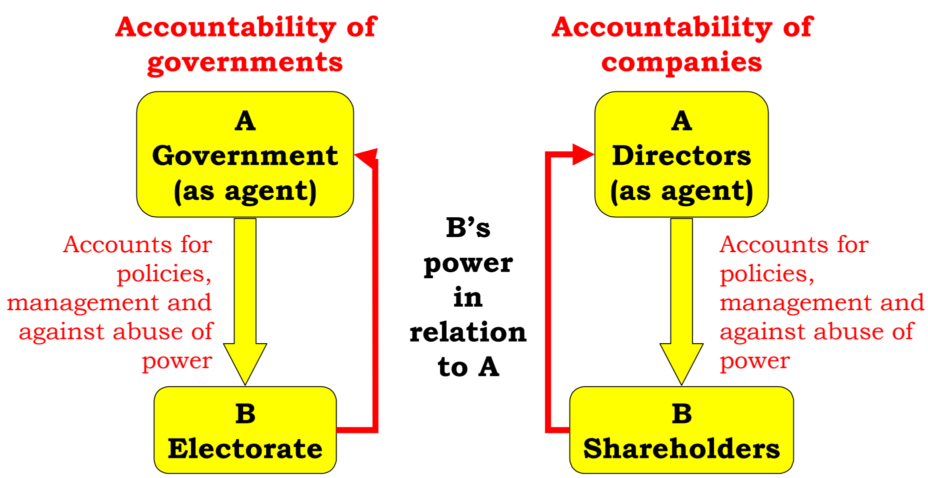
2 Concepts of accountability and audit

2.1 Accountability

Accountability requires the existence of two parties, "A" who gives an account, and another party, "B", receiving the account[i]. In the public sector, concepts of accountability are linked to the "agency" theory of government[ii], in which the public entrusts their money to government (their agent). Thus within this model, the Government is "A" and acting as an agent renders an account to the Public "B". In a democracy, the government accounts to the electorate for its policies, management, and as a check against abuse of power.

A similar concept of accountability can be applied to companies. In the case of companies, the Board of Directors accounts to the shareholders for the use of the latter's funds. This model of accountability is represented in Exhibit 2, below.

Exhibit 2: Accountability and agency theory



To be effective accountability must imply some power of B (the electorate or shareholders) over A (the government or Board of Directors). Whilst this power exists for both governments and companies through the democratic process, their limited access to information makes it almost impossible for individual electors or shareholders to apply accountability in relation to specific policies or management actions. Hence, this model of accountability is difficult to operationalise effectively.

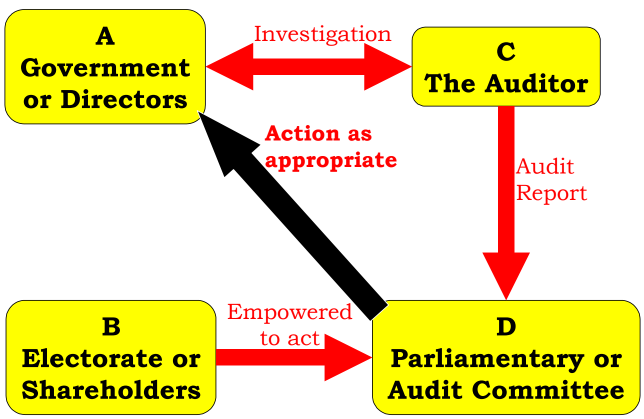
Much of the work on achieving accountability both within the public and private sectors revolves around the problem of B achieving some form of control over the actions of A. The audit is one of the mechanisms by which effective accountability can be achieved.

2.2 Audit

Audit addresses two of the problems of accountability. Firstly, an audit conducted by a small group of persons overcomes the practical problems of giving every member of the electorate, or every shareholder in a company, access to the information needed for the exercise of effective accountability. Secondly, audit by independent experts addresses the problem of the lack of technical skills on the part of most members of the electorate or shareholders to be able to use and interpret information. Audit provides a structured technical process through which accountability can be rendered. Auditors have both access to information and the technical skills to interpret such information. The auditor becomes a third party, C, in the process of accountability.

However, technical audit skills do not address the other element in the problem of achieving accountability - the requirement for B to be able to exercise effective control over A. Since, as indicated above, this cannot be achieved directly, a fourth actor, D, is required to receive and take action based on reports rendered by the auditor. In the case of the public sector, the concept of separation of executive from legislative roles provides an obvious candidate for the role of D - the Parliament. In many countries, such as the UK, the role is exercised through a committee of the legislature (the UK Public Accounts Committee). For companies, there is also a trend to separate executive and legislative roles, for example German two tier boards and the introduction of Audit Committees. The model in Exhibit 2, above, is expanded in Exhibit 3, below, to include actors C and D.

Exhibit 3: Making accountability effective



Audit has considerable antiquity, for example the early Egyptian civilisations around the Nile valley. In the UK, public sector audit formally commenced with the creation of Auditors of the Imprest Office in 1559. Modern company audit began later, with the industrial revolution and the formation of the joint stock companies in the nineteenth century. In all cases, audit was, and continues to be, based on the concepts of accountability of those controlling resources to those providing the resources. This concept flows through to, and should continue to drive, the audit of IFMS.

Audit is narrower than accountability as a whole. Audit does not seek to question policy decisions, only the consequences of such decisions. In this sense audit is a sub-set of accountability. Nevertheless, by making the consequences of policies more transparent audit can support this wider concept of accountability.

2.3 Different concepts of audit

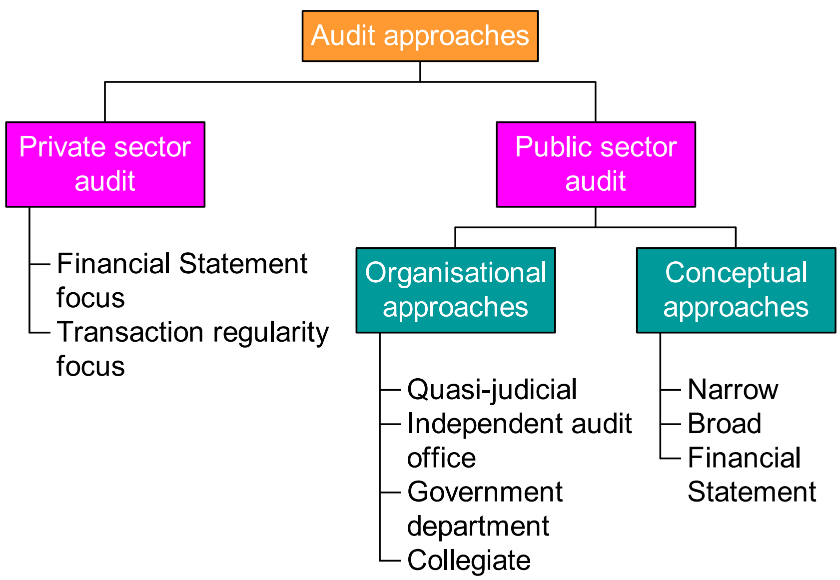
This overview of the concepts of audit and accountability suggests that not only should audit be broadly similar between public and private sectors, but it should not be affected by the accounting system. In all cases, audit should be concerned with the rendering of an account in terms of policies, management of resources, and avoidance of misuse.

In practice, the role and models of audit have diverged considerably, both between public and private sectors, and within each of these sectors, between countries. These differences are more fundamental than is commonly recognised, and lead to many problems that arise when different countries have to develop a common approach, for example in Europe the establishment of an audit process for the European Commission[iii]. These differences need to be identified in order to consider an approach to the audit of integrated financial management systems.

2.4 Models of audit approaches

For simplicity, a taxonomy of audit approaches is used as summarised in Exhibit 4, below, and further developed in the following sections. This envisages a relatively simple model of two polar extremes of audit approaches for the private sector, but a more complex model of four organisational structures, and under these three types of audit, for the public sector.

Exhibit 4: Models of audit approaches



2.4.1 Private sector audit

Traditional approaches to company audit focused on detailed transaction checking, and a concentration on identifying any misuse of funds. This fits with the concepts of accountability identified above, at least in the narrow sense of its stewardship role. In most countries company auditing has moved away from this approach to an approach that focuses on financial statements.

The financial statement audit is a more **modern** audit approach, driven by the demands of investors. Modern company audit has been transformed into a highly formalised expression of opinion on the financial statements. Accounting and auditing standards have enabled this process to become much more objective. Audit firms have had to develop effective risk management techniques for their audit activities, because of their all too real experiences of expensive legal claims. Thus, the product of the commercial audit is the opinion expressed by the auditors on the financial statements. In addition, auditors will normally provide a "management letter" identifying matters not regarded as sufficiently material to affect their opinion.

2.4.2 Public sector audit

Public sector audit has until recently developed quite separately from private sector auditing, and indeed in different ways between countries. Some of these models are more appropriate for the audit of integrated financial management systems than others. The audit institutions for countries have collectively adopted the title of Supreme Audit Institutions, but there are also sub-national public sector audit organisations.

Organisational approaches

There are four major models of public sector audit organisation[iv]:

- Quasi-judicial - the Court of Auditors, e.g. European Court of Auditors. However, in many countries whilst retaining the title of court, have moved to a more collegiate approach, e.g. Austria.
- The independent audit office, e.g. the UK National Audit Office.
- The Government Department, e.g. Sweden.
- The collegiate approach, where a group of persons are responsible for the audit without any judicial authority, for example the European Court of Auditors, despite its name, is a collegiate body.

Each of these organisational models can co-exist with any of the audit approaches identified below, but in practice the quasi-judicial approaches have been linked to the narrower approach to audit as characterised below.

Conceptual approaches

The spectrum of audit approaches can be characterised by the two polar extremes of a "narrow" audit approach, and a "broad" audit approach. In addition, there is Government financial statement audit.

Under the **narrow** approach to audit, the accounting procedures are usually prescribed by law, and the role of the auditor is to ensure that such legal procedures are followed. This narrow audit approach, which as indicated tends to coincide with the quasi-judicial audit organisational approach, has tended to be adopted in Southern Europe and other countries influenced by the Code Napoleon. It is a very limited rendering of the function of accountability.

At the other polar extreme, are supreme audit institutions that take a **broad** view of the role of audit. Under this approach, the emphasis of audit is on ensuring proper expenditure for the purpose identified by the legislature, and also with issues of economy, efficiency and effectiveness - value for money. This is the approach adopted, for example, by the UK NAO. It fits with an accounting system that is largely decentralised within a general accrual framework, and where there is very limited central prescription as to accounting procedures. Thus, the broad audit approach will be concerned with two areas of the audit, as identified by the INTOSAI Auditing Standards[v]:

- Regularity audit, and
- Performance (sometime called value for money) audit.

The nature of these two types of audit is examined in more detail in Section 4.1.3, below.

Government financial statement audit treats government as an entity, analogous to the entity of the company, producing a set of financial statements. The SAI provides an opinion on the financial statements based on a similar audit examination, to that provided by the commercial auditor on a set of company financial statements. This is considered in Section 4.1, below.

2.5 Ex-ante, current or ex-post audit?

The financial management cycle begins with the planning/budget process, extends through the budget execution to accounting for transactions that have taken place. Whilst commercial audit has focused on ex-post audit of the financial transactions, public sector audit has always been involved in transactions at an earlier stage. For example, in many countries there is a system of "pre-audit", where transactions receive audit approval before they are accepted for processing.

In Russia, audit involvement has been described as being at three stages of the financial cycle:

- An audit of the budgets
- Audit of ongoing transactions
- Audit of financial statements.

In the UK, the NAO has in recent years[vi] started producing audit reports on budget assumptions. This form of report is recognised by INTOSAI, though not as an audit activity[vii]. The production of a report on audit assumptions has a number of benefits:

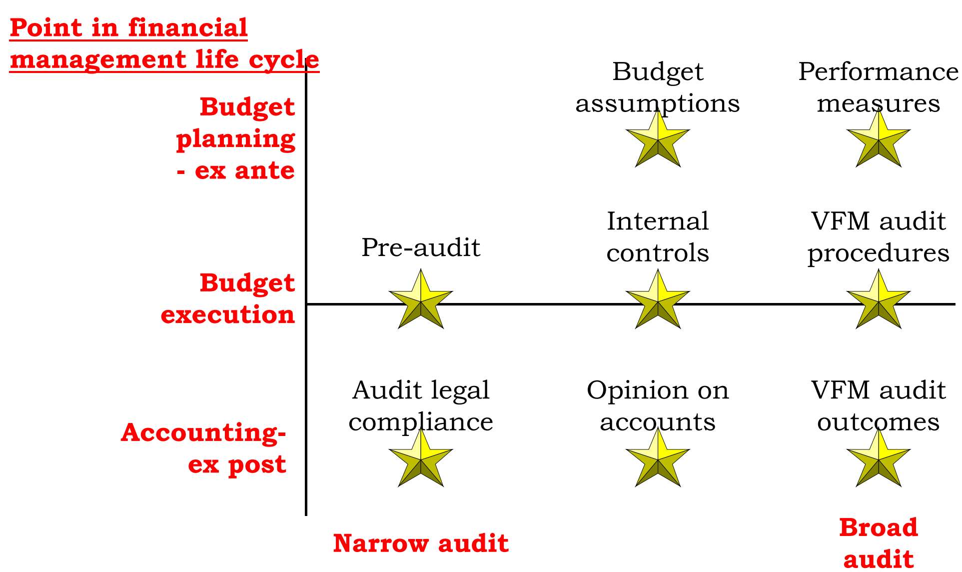
- It is another extension of the use of the auditor to achieve accountability by the executive.
- It enhances the credibility of the budget and the budget process.
- It is likely to improve the quality of the budget process.
- It reduces the risk of unrealistic budgets, and the consequent loss of accountability as the executive has to make the allocation decisions the budget has failed to make.

In addition, it is now normal practice in most countries for the auditor to report on the internal controls and procedures. This may be done at several levels. It may be an examination of internal controls to establish their adequacy, or otherwise, for ensuring that financial procedures are properly carried out and transactions properly recorded. On the other hand, the review may be extended to include the efficiency and effectiveness of the financial processes and procedures.

2.6 A model of different audit approaches

From the analysis above, it is possible to develop a two dimensional model of the range audit approaches. Under this model, the X-axis indicates the point in the financial management life cycle where an audit activity occurs. Thus, the audit of budget assumptions and the setting of performance measures is an ex-ante audit activity. Pre-audit, audit of internal controls, and VFM audit financial management procedures is current audit. Audit of compliance with the law, expressions of opinion on the financial statements, and VFM audit of outcomes are ex-post audit. On the Y-axis, the audit becomes broader from left to right. This model will be used as a reference model for identifying suitable approaches for auditing integrated financial management systems. This model is shown in Exhibit 5, below.

Exhibit 5: Model of alternative audit approaches



This analysis, and the resulting model, provides a framework within which appropriate audit approaches for an IFMS can be identified.

3 New approaches to public sector management

3.1 The new approaches

Integrated financial management must be seen in the context of fundamental changes that are taking place in the public sector world-wide. These are referred to as the New Public Management[viii], and seven overlapping characteristics may be identified:

- An emphasis on management
- Explicit standards and measures of performance
- Greater emphasis on output controls
- Disaggregation of units in the public sector
- Greater competition
- Focus on private sector styles of management practice
- Focus on greater discipline and parsimony in the use of resources.

To this list could be added:

- Focus on transparency and accountability, and
- The drive against corruption in public life.

For many countries, especially in the third world, such reforms may seem a distant goal. Nevertheless, significant changes are taking place, and they will affect all countries to some extent. Changes in financial management are part of this process of reform.

3.2 Financial management reforms

Integrated financial management systems are part of a wider agenda of financial management reforms in the public sector. Other key changes include:

- Integration, especially of planning and budgeting, budget execution and cash management, and then these to accounting, reporting and monitoring.
- Shift to an output focus in planning and budgeting.
- The use of non-financial performance measures of achievement of objectives.
- Decentralisation of financial management to match the disaggregation of government.
- Increasing focus on the entity concept, and with it use of accounting approaches drawn from private sector entity accounting, e.g. accrual accounting.
- An emphasis on transparency and accountability, with reports that are more useful for both external and managerial accountability.
- Improved tools for managing cash and debt, for example systems that link budgets and forecasts to available data on receipts and expenditures.

These changes are both enabled and driven by new technology. Communication and information technology provide the opportunity to link different parts of the financial management system together to be able to more effectively to achieve new public management, as defined above. The integration of components of the financial system is essential if the changes above are to be realised, and the potential benefits achieved.

Thus, what is new is the ability to interactively link different parts of the system so that each has access to current data from other parts of the system. For example, cash management can utilise information on the latest budget amendments, revenues received, commitments, invoices received, anticipated interest payments and receipts as well as current cash balances. To realise these benefits, components of the financial management system must be able to exchange data with each other.

4 New approaches to public sector audit

Matching the reforms in public sector management and financial management must be reforms in the approach to public sector audit:

- Audit of the whole life cycle of the integrated financial management system
- Audit of the entity of government
- Audit of performance
- Audit focus on transparency, accountability, and the drive against corruption

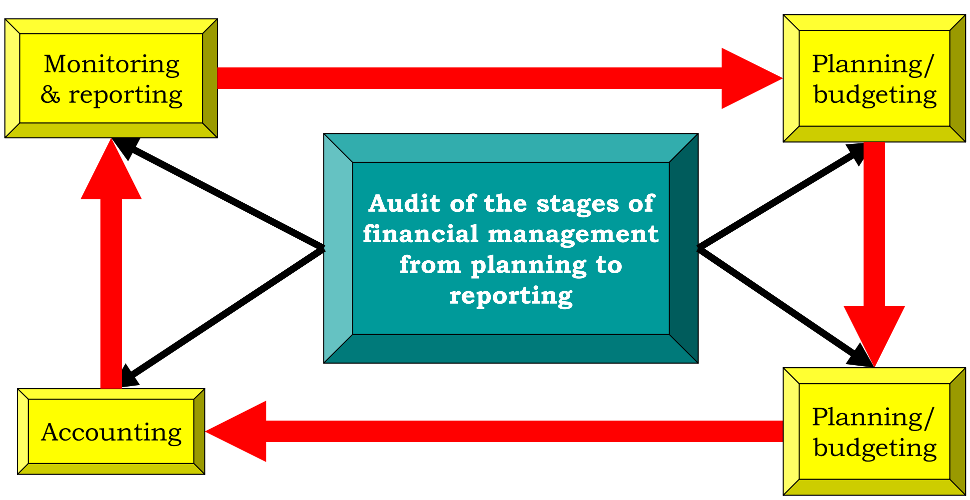
4.1 Audit of the life cycle of financial management

As noted above (Section 2.5 on page 8), traditionally auditing has focused on ex-post evaluation of the accounting information. However, an integrated financial management system has been defined in Exhibit 1, above, to include:

- Planning
- Budget
- Budget execution
- Reporting and monitoring.

Therefore, an audit of an integrated financial management system should embrace all components of the IFMS as defined above. This would include some of the audit approaches already identified above, for example audit of budget assumptions, audit of performance measures. It is also in line with the broad approach to audit encouraged through INTOSAI's Lima Declaration and Audit Standards[ix]. Under this approach there are three elements to the audit - ex-ante relating to planning and budgeting, current relating to systems and procedures, and ex-post relating to financial and performance outturns. These are each examined in more detail below.

Exhibit 6: Audit of the whole IFMS cycle



4.1.1 Ex-ante audit of planning and and budget

As already noted, in some countries the auditors examine the setting of performance measures - part of the planning process - and the assumptions underlying the budget. This is also envisaged within the INTOSAI auditing standards. Therefore, the concepts are not new. The INTOSAI Standards[x] refer to the examination of draft budgets as one of a number of “non-audit activities” and states that such activities “…provide valuable information to decision makers and should be of consistently high quality.” The Standards also state as a basic postulate that “SAIs should works towards improving techniques for auditing the validity of performance measures”[xi].

As far as is known, there are no examples of auditors reporting on the fiscal risk inherent in predictions of future revenues and expenditures. Since these vary between countries, there could be a case for such an extension, particularly in countries subject to external events outside their control, such as mineral producing countries.

Therefore, there is both precedent and authority for extending the work of the auditor to include ex-ante review of budget and performance measure setting. This sits very comfortably with the approaches of the new public management, and must enhance the value and impact of the audit function. The process of a credible external review should strengthen budget procedures and performance measurement setting processes by independent auditors.

4.1.2 Current audit of systems and procedures

There is a precedent for auditing current systems and transaction procedures. On the one hand, pre-audit or some comparable form of transaction approval (as happens in much of the former Soviet Union Countries with a centralised payment system) is in reality part of the management control process. Although pre-audit is recognised by the INTOSAI Lima Declaration as being required in some countries, we would suggest it does not lie within a proper definition of audit, and is better regarded as part of managerial control.

On the other hand, reviews of operational systems and procedures are clearly part of the audit, and are included within the INTOSAI Auditing Standards. This audit of operational systems and procedures can be at either of two levels:

- A review of internal control procedures to establish their adequacy and the extent to which they can be relied upon by the auditor, and
- A review of management operations and procedures to evaluate them in terms of economy, efficiency and effectiveness.

Under the latter approach, the auditor would review the procedures for budget execution, cash and debt management, accounting, reporting and monitoring in value for money terms. This could lead to recommendations that would involve changes in accounting legislation or regulations, and this would be within the remit of the auditor under the broader approach to the audit.

4.1.3 Ex-post audit of financial and performance measures

The INTOSAI standards state that “the full scope of government auditing includes regularity and performance audit”, and goes on to define these[xii] to include:

- Financial accountability of accountable entities and government administration.
- Audit of financial systems and transactions, including compliance with law and regulations.
- Audit of the probity of administrative decisions.
- Audit of probity and propriety of administrative decisions of the audit entity.
- Performance audit of economy, efficiency and effectiveness.

This is a wide definition of the ex-post audit to include both financial and performance audit. This accords with the approach adopted in many industrialised countries, e.g. the USA, UK, Sweden.

Conclusion 1: audit of an IFMS should embrace an ex-ante review of budget assumptions, current review of financial procedures both in terms of internal control, and also in terms of the performance of the systems, and ex-post audit of regularity and performance.

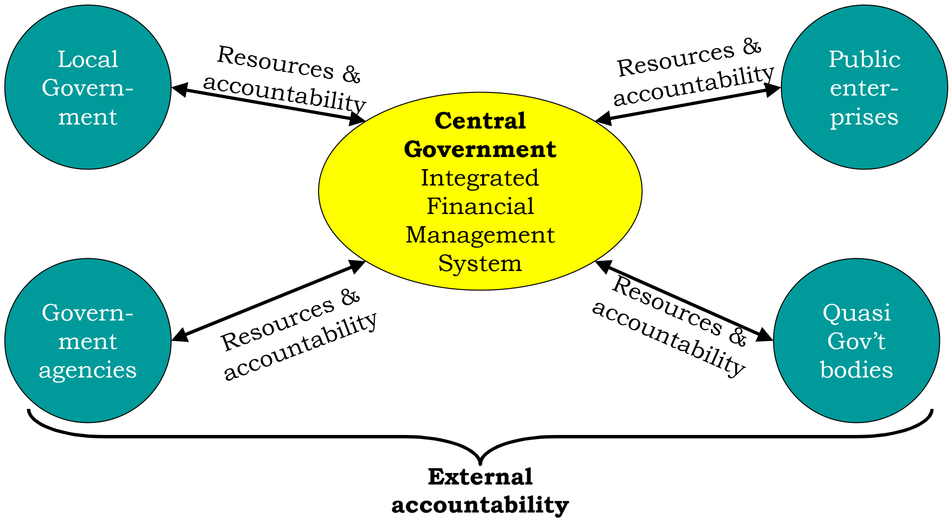
4.2 Audit of the entity of government

Fundamental to the concept of integrated financial management systems is the concept of accounting entities. In private sector accounting the company is a legal entity with clearly defined boundaries with the external world. The boundary of government is less clearly defined. Central government obviously embraces all central government departments, but it is less clear whether organisations funded by central government, e.g. public enterprises, are also part of government. They may be defined to be included or excluded differently for different purposes.

A range of factors is now pushing for a clearer identification of the government entity, and of its boundaries with the external world. The new public management, with its focus on responsibility and performance, requires clear boundaries. So too does a system of integrated financial management - the entity being managed must be defined. Transparency and accountability require a clear definition of the entity that is being audited and reported on. Finally, meaningful financial statements are not possible unless the entity is defined.

Government in a broad sense comprises a series of entities surrounding the one entity of the central government. This is illustrated in Exhibit 7, below[xiii].

Exhibit 7: Entities in financial management



The entity concept of government has important implications for audit:

- With a precise definition of the audit entity of Government, the auditor is able to address his report on that entity to external stakeholders (the legislature or the electors).
- The auditor is enabled to report on relationships of the entity to external parties, and hence certain aspects of fiscal risk.
- Full financial statements become feasible on which the auditor can report.

The INTOSAI standards do not indicate to whom audit reports should be addressed. As under many constitutions the auditor is an officer of the legislature, then his report should be to the legislature. An alternative would be for the report to be made generally to the electors of the country.

Some aspects of fiscal risk should be identified and reported on by the auditor. In particular, liabilities such as unfunded pensions, or contingent liabilities, such as guarantees given by the Government on the loans of public enterprises.

4.2.1 Financial statement audit

Until recently, governments have tended not to produce full financial statements. Government accounts have instead been statements of revenues and expenditures. There are three reasons why financial statements have been more limited, and of less importance, in the public sector as compared to the private sector.

Firstly, the absence of a clear entity definition of government precludes the production of full financial statements. If central government is to produce a financial statement, there must be a precise definition of what is comprised within the entity, e.g. are agencies, public enterprises, local authorities, etc., part of, or external to, the entity? If the former, their assets and liabilities must be consolidated as part of the government financial statements. An entity concept is essential to enable the production of financial statements for government.

Secondly, a conceptual base for valuing assets and liabilities needs to be established. Although a number of countries have moved to accrual accounting, and this makes the production of financial statements feasible, it is not clear whether there is an adequate conceptual base for valuing certain assets and liabilities, e.g. infrastructure assets, defence assets, unfunded pension liabilities. However, pragmatic solutions to these problems have been identified, leading to the production of financial statements for some governments.

Thirdly, there must be a question mark over the usefulness of any government financial statements. Private company financial statements are needed to establish tax liabilities, dividend capacity, solvency and the performance of the management. None of the first three are relevant to governments, and financial statements do not measure performance because money does not provide an input-output measure for the public sector (this is further addressed below in Section 4.3).

These arguments serve to explain the slow development of comprehensive financial statements for the whole of government, and why these are not mentioned in the INTOSAI Standards. However, New Zealand and Australia have led the way in moving to whole of government financial statements and their audit[xiv]. For the purpose of this paper Government financial statements is used to refer to statements embracing the whole of a national Government as an accounting entity. The form and content of the Government financial statements will need to be defined for each country, but they might be expected to comprise:

- A statement of revenues and expenditures as compared to the budget.
- A balance sheet showing assets and liabilities, with the balance being the balance on government funds.
- A cash flow statement.
- Notes and supporting schedules providing more information and supporting analysis.
- A statement of actual performance against performance targets.

There are four important practical arguments for publishing and auditing government financial statements as part of the audit of integrated financial management systems.

1. The production of government financial statements encourages better accounting practices. Relationships with external entities must be clearly defined and the balances between such entities agreed, invoices captured and recorded in the system immediately on receipt, the distinction between capital and revenue expenditure made explicit.

2. Improved asset and liability management is encouraged. Proper inventory and asset management systems are required to be able to confirm the existence and value of assets, liabilities have to be identified and valued.

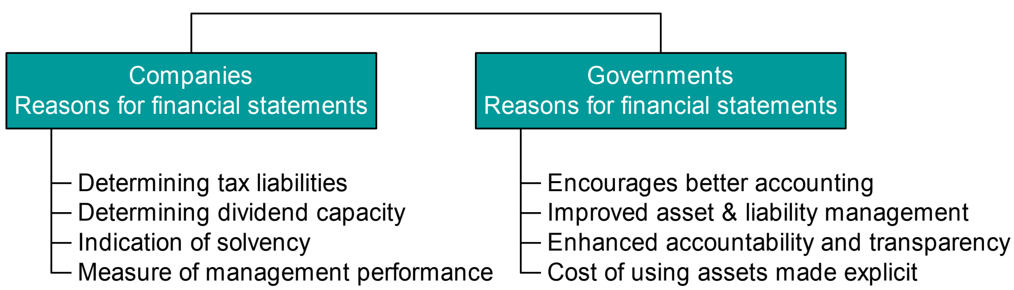
3. Accountability and transparency are significantly increased. Information becomes available on such issues as the extent of unpaid government bills (a significant and often hidden problem in some countries), unfunded pension and other liabilities, the assets held by government, and, if included, performance targets and achievements.

4. Since the real value of assets used by government departments and entities is disclosed, the full cost of the activities of such organisations becomes transparent. This can be a valuable management tool. In many countries, government operations are conducted from inherited buildings of immense value, and the cost of using such buildings or sites is may otherwise never be reflected as a charge on the Departments or Agencies concerned.[*]

Under an accrual approach, the above information is encapsulated within the financial statements and notes. It is equally possible to include most of the important information in financial statements prepared under cash accounting, through supplementary statements on, for example, liabilities, assets and contingent liabilities. However, this latter approach lacks the hierarchical structure and linkage of information available from an accrual based set of financial statements.

Therefore, it is concluded that there are powerful arguments for the production of comprehensive Government financial statements. The arguments are quite different to those for private companies, but equally compelling, as summarised in Exhibit 8, below.

Exhibit 8: Comparison of arguments for the production of financial statements by governments and companies



The arguments for the audit of such financial statements are similar for both companies and governments. Audit lends credibility to the financial statements, and hence increases their value for the purposes identified. Therefore, a logical output from an integrated financial management system must be the presentation of audited financial statements for the government.

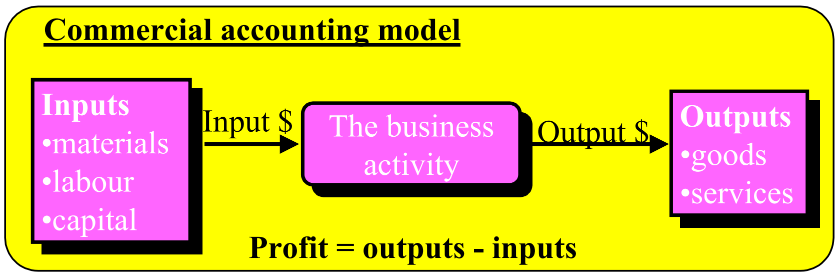
Conclusion 2: audit of an IFMS should include the expression of an opinion on the financial statements of the entity.

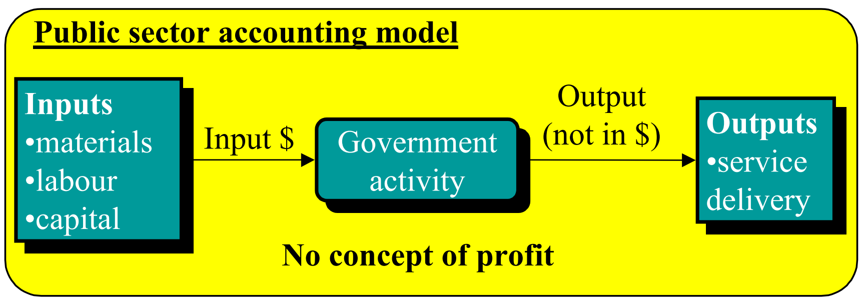
[*] Application of full cost accounting in the UK revealed that whilst the costs of a soldier was £15,000, the cost of training an army bandsman was £300,000 - a consequence of costing the valuable site used for the latter training.

4.3 Audit of performance

A part of the new public management is a focus on outputs, and performance measures of their achievement. One of the problems of public financial management is that accounting is not a complete input-output model. This contrasts with the private sector, where accounting provides a universal input-output model - this is undoubtedly one of the reasons for the pre-eminence of accounting in company management. This contrast is illustrated in Exhibit 9, below.

Exhibit 9: Lack of a financial input-output model for governments





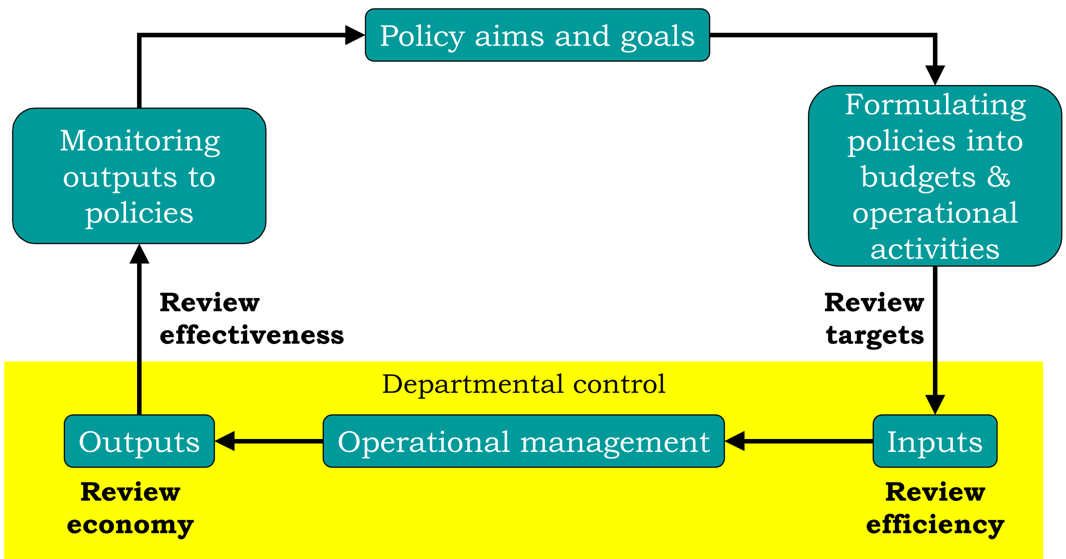
Therefore, the public sector must resort to non-financial measures of performance. Ideally, financial and performance management should be integrated, and the auditor should report on both. Integration at this level requires a number of elements to be in place:

- Strategic target/objective setting is linked to resource allocation.
- Output based budgeting is in place.
- Suitable performance measures exist and are defined at the planning/budget stage.
- Full cost accounting is in place.
- A system exists to record and report on the achievement of performance targets.

These elements should form part of the design of an integrated financial management system. Without them the system would simply be a record of financial flows. If the system exists, then making it subject to external audit has a number of benefits. The setting of performance audits becomes subject to external review (see above Section 4.1.1). This will encourage transparency and the consistent setting of performance targets across government. Processes for recording and reporting on achievement of targets can be examined, and the actual results can have added credibility as a result of audit. The result, is to add transparency and credibility to performance management, and thus to enhance accountability.

Performance, or value for money (the two terms are regarded as synonymous) audit has most succinctly been defined in terms of the "three Es": Economy, Efficiency and Effectiveness. Performance audit should address all three of these, even though the audit of effectiveness can be controversial, in that it comes close to reviewing government policy. In the UK, the NAO audits effectiveness, but the parameter is that it does not question government policy. The relationship between these areas can be seen in Exhibit 10, below[xv].

Exhibit 10: Performance (value for money) audit



An IFMS is introduced to improve the efficiency, economy and effectiveness of government. The audit should also embrace a review of these objectives. It is not sufficient to look only at efficiency and economy, since effectiveness is fundamental to the review of government activities. Therefore, performance audit should form part of the audit of an IFMS, as specifically provided in the INTOSAI Standards[xvi]

Conclusion 3: audit of an IFMS should include performance audit, defined to include audit of economy, efficiency and effectiveness.

4.4 Audit focus on transparency, accountability and against corruption

The analysis above includes under regularity audit the audit of probity and propriety. This should include the identification of misuse of resources, but the issue of corruption within governments is now such a matter of concern that it needs to be addressed specifically as part of the audit of an IFMS.

There is widespread recognition that corruption is a significant problem in many countries, and that it has substantial costs. Corruption increases managerial costs, leads to misallocation of resources, slows investment, and has a negative impact on development objectives.[xvii] There is now international recognition of the problem, and of the need for action, e.g. The World Bank, OECD, the Group of Seven, as well as declared policies by major industrialised countries.

Part of the solution is seen to be through encouraging transparency. If full information is made available, transparency is achieved, and corrupt practices more difficult to hide. Transparency International and the IMF Code on Transparency are indicative of this emphasis on transparency.

Auditors have been ambiguous in their role in relation to identifying and revealing corruption. In a famous UK judgement, it was decided that “the auditor is a watchdog, not a bloodhound”, i.e. it is not the audit role to actively seek out corruption. This has been carried through into audit postulates, which emphasise that the auditor cannot be relied on to identify fraud or corruption when these are in reality the role management.

The role of audit in this regard contrasts with the role of “financial police”, which exist in former Soviet Union and some other European countries. Financial Police are not auditors, but specifically seek out public and private fraud. They have investigative powers, and the ability to initiate criminal proceedings.

Supreme Audit Institutions are not Financial Police, and they should not be seen as the solution to problems of corruption in public life. Nevertheless, SAIs have important roles in relation to transparency and preventing corruption:

- Independent audit by the SAI is the only regular, independent, systematic, examination of government financial transactions, assets and liabilities. As such the SAI is uniquely placed to identify and report on any misuse of public money or resources.
- The Constitutional status and independence of the SAI enables statements to be made public in a manner that is not available to other public servants.
- The specialist technical skills available to the SAI provide capacity to understand transactions that is not generally available.
- The SAI can comment not only on identified malpractice, but also on systems and procedures that provide the opportunity for malpractice.
- The audit report on the financial statements lends them credibility, and by so doing increases transparency and accountability.

No audit function can ever guarantee the identification of fraud, and this limitation must always be made clear. Nevertheless, the SAI as the independent auditor of government is placed in a uniquely powerful position in the fight to improve transparency and ensure the fight against corruption in public life. There is a case for SAIs taking a greater responsibility in relation to these matters that is appropriate for private sector auditors.

Conclusion 4: consideration needs to be given to SAIs taking a more proactive role in the drive for accountability, transparency and against corruption in public life.

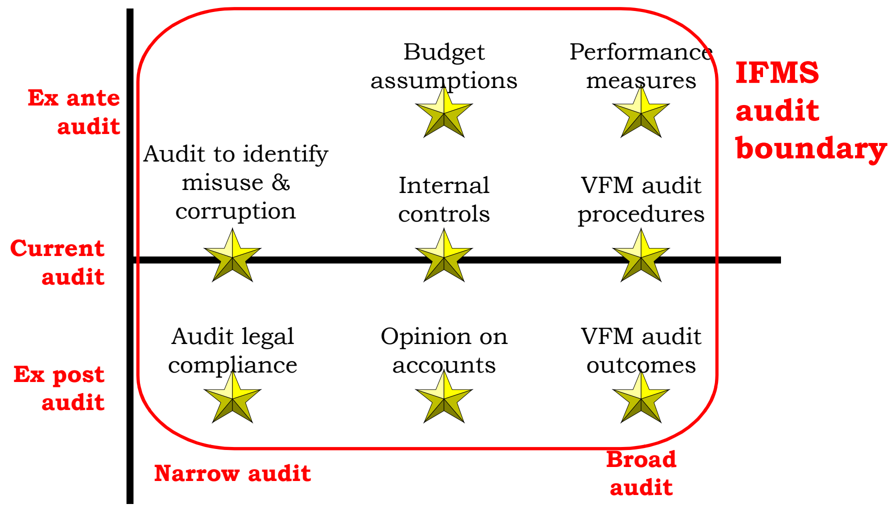
5 Summary and conclusions

It is concluded from this analysis that, in terms of the model in Exhibit 5 above:

- Audit should embrace the whole IFMS cycle (ex-ante, current and ex-post)
- Audit should be of the Government entity (including report on financial statements of Government)
- Audit should include performance of Government (value for money)
- Audit should focus on transparency, accountability and against corruption

These are summarised in the model in Exhibit 11, below.

Exhibit 11: Audit of an IFMS



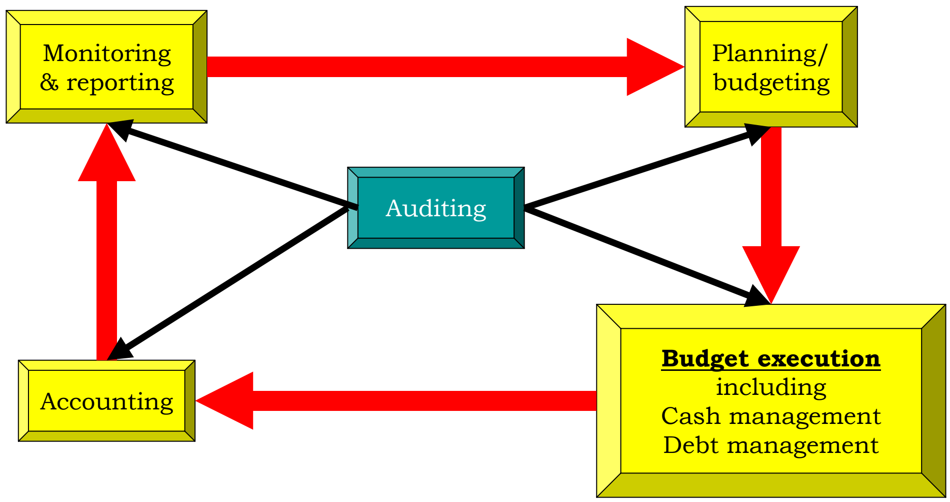
This provides a very wide definition of the audit of an IFMS. Such a wide definition does indicate an audit system with significant advantages:

- Transparency is significantly enhanced, through the audit of budget assumptions and whole of government financial statements.
- It provides a high level of accountability, not just in terms of compliance with accounting rules and procedures, but much wider in terms of the value for money provided by the executive.
- Through this accountability, it encourages a democratic political process.
- It also encourages value for money in government.
- Finally, but not least, the audit provides an effective protection against the financial misuse of power, and especially against corruption.

It is considered that these are significant benefits, not available from any other process. They serve to significantly enhance the benefits derived from an IFMS, and therefore the development of effective audit systems as defined should be conducted in parallel to the development of an IFMS.

Therefore, it is concluded that the model at the start of the presentation, and as repeated below, of the audit at the centre of the IFMS is indeed appropriate.

Audit at the centre of an IFMS (repeat of Exhibit 1)



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