



## **Theme papers on consistency in the ISSAI framework**

**(Updated 14/7 2009 – for information of the PSC)**

## Content

Introduction	3
1. Purpose of this document	3
2. The two theme discussions	4
3. Organisation of the work and timeline	5
Theme paper 1: The purpose and challenges of revising the fundamental auditing principles at level 3 (ISSAI 100-400)	7
1.1 The purpose of the fundamental auditing principles at level 3	7
1.2 The gap between the Lima Declaration and the auditing guidelines	12
1.3 Main issues to be settled	13
a. The three branches of public auditing	13
b. Principles for financial, performance and compliance auditing	17
c. The “old” concepts of regularity and legality audits	19
1.4 Ensuring applicability for all SAIs	21
Theme paper 2: Issues to be considered in the initial assessment	26
2.1 Phase 1 - Ensuring overview of SAIs’ auditing assignments	26
2.2 Phase 2 – Considering other standards	31

## Introduction

In the current phase of developing the ISSAIs and INTOSAI GOVs, the PSC has decided to put a number of issues concerning the clarity and consistency of the ISSAIs and INTOSAI GOVs on the back burner.

However, in 2010, the PSC will present to the INCOSAI a comprehensive set of ISSAIs and INTOSAI GOVs which will largely complete the framework. Subsequently, the PSC will be leaving the development phase and in 2010 start addressing the challenges of ensuring consistency in the framework.

The main task for the PSC Steering Committee in 2010-2013 will be to eliminate overlaps and ensure clarity between the many documents at the different levels of the framework. The recommendations on auditing at level 3 (the fundamental auditing principles (ISSAI 100 – 400)) represent the key to consistency in the framework. The official decision endorsed by INCOSAI to establish the ISSAI framework foresaw that the present content of the fundamental auditing principles would have to be revised. A revision of ISSAI 100-400 is therefore the most urgent issue to deal with in the efforts to improve consistency in the ISSAI framework.

At the next PSC Steering Committee meeting in the spring 2010, the PSC Chair is therefore planning to propose, that the Steering Committee members establish a common project with participation from all relevant subcommittees in order to review the fundamental auditing principles at level 3 of the INTOSAI framework in the next term 2010 - 2013.

### 1. Purpose and status of this document

Reviewing the fundamental auditing principles (ISSAI 100 – 400) at level 3 will be a very demanding and challenging task. To prepare the ground for a project proposal, the Steering Committee engaged in a theme discussion at its meeting in June 2009 on the needs and concerns involved in a revision of the fundamental auditing guidelines at level 3. The discussion was based on this document which had a two-fold purpose:

1. To initiate a first discussion in PSC on the purpose and challenges of revising the fundamental auditing guidelines at level 3 to improve consistency in the ISSAI framework.
2. To decide on the issues that need to be considered in the initial assessment, which will precede the decision to launch a project and is meant to be conducted before the next Steering Committee meeting.

It is important to emphasize that the final decision on the establishment of a project for the review of the fundamental auditing guidelines at level 3 in the framework will not be taken before the PSC Steering Committee meeting in the spring 2010 has considered a project proposal based on the initial assessment.

A possible PSC Steering Committee decision to establish a project in order to review the fundamental auditing guidelines at level 3 should be included in the PSC mandate which will be presented for approval by INCOSAI 2010.

At the PSC steering committee meeting 17-19 June 2009 it was decided to circulate this document within the PSC. For this purpose the document has been updated with the wording of the directions which was agreed on by the committee during the theme discussion. These are found in blue boxes at the end of each section.

The document is circulated for information. Any observations, comments or suggestions in relation to the suggested revision of the fundamental auditing principles (ISSAI 100-400) may be sent to [psc@rigsrevisionen.dk](mailto:psc@rigsrevisionen.dk) or Kristoffer Blegvad at [kb@rigsrevisionen.dk](mailto:kb@rigsrevisionen.dk). All inputs to the present document will be valuable in the continued work and remain relevant throughout 2009. There will be further possibilities to provide comments at a later stage of the process.

## 2. The two theme papers

This document is comprised of two theme papers prepared by the PSC Secretariat to facilitate the discussion.

Theme paper 1 (page 7-25) concerns the purpose and challenges of revising the fundamental auditing guidelines at level 3 (ISSAI 100 – 400) to improve consistency in the ISSAI Framework. It outlines the overall purpose of the fundamental auditing principles at level 3 and the current gaps between the Lima Declaration and the new guidelines at level 4. It also considers some of the key concepts and recommendations which could be defined in the fundamental auditing guidelines at level 3 in order to fill the gaps. Finally, it considers the need to ensure that the fundamental auditing principles are applicable to all auditing assignments performed by SAIs around the world.

The discussions of the Steering Committee covered the following issues:

- 1) The overall purpose of the fundamental auditing principles at level 3 (ISSAI 100-400) and the need to provide a “common language” for INTOSAI.
  - *The paper proposes that the principles at level 3 should provide a “common language” which can be used for explaining and comparing the tasks of SAI’s across their different national settings. This will be relevant for the SAI leaderships’ considerations of auditing strategy and for SAIs’ communications to government, parliament and other external stakeholders on their auditing practices. It will also provide a starting point for peer reviews and other cooperation on capacity building and knowledge sharing within the INTOSAI community.*
  
- 2) The existing gap between the concepts stated in the Lima Declaration and the auditing guidelines at level 4.
  - *The paper proposes that the further work of the PSC should be to bridge the gap between the Lima Declaration and the guidelines of FAS, PAS and CAS by providing a coherent definition of public auditing and its three branches - financial, performance and compliance auditing*
  
- 3) The main issues which will have to be settled by the fundamental auditing principles in order to fill the gap between the Lima Declaration and the auditing guidelines at level 4:
  - a) Key definitions of the concept of public auditing and the 3 branches of auditing

b) How a brief presentation of the key principles of financial, compliance and performance auditing may be provided

c) How a link to the “old” concepts of regularity and legality audits can be provided

*- The paper proposes among others that the further work of the PSC should be to provide a brief statement of the most important general recommendations contained in the over 800 pages of implementation guidelines on financial, performance and compliance auditing.*

4) How level 3 can be used to ensure that the ISSAIs are applicable to the many different auditing tasks assigned to SAIs around the world by their mandates.

*- The paper proposes that the further work of the PSC should be to ensure that the ISSAIs are applicable and useful in the context of many different public auditing assignments, which SAIs’ in the different regions of the world have been given by their legal mandates. This requires however a thorough knowledge of the different mandates and tasks of SAIs and the proposal is therefore also to conduct an initial assessment, described in theme paper two.*

Theme paper 2 (page 26 – 34) concerns the further issues which will be considered in the initial assessment. This paper focus on the following issues:

1) The definitions to be used in phase 1 of the initial assessment in order to gather information on the audit assignments of SAIs.

2) The criteria to be used in phase 2 of the initial assessment to determine the possibilities of drawing on other standard setting bodies.

To support the considerations the PSC Secretariat has also prepared and attached the following documents:

**Appendix 1** summarises the existing recommendations on auditing in the Lima Declaration and the main principles stated in the current versions of ISSAI 100, 200, 300 and 400. ISSAI 100 and 200 contain principles which mainly concern the powers under the auditing mandate, ethics and audit quality control rather than auditing practices. ISSAI 300 and 400 provide recommendations on auditing practice and reporting.

**Appendix 2** contains the result of a pre-study of the mandates of 15 SAIs. The pre-study has been conducted by the PSC Secretariat based on information on the general legal mandate on the SAI’s websites. The pre-study classifies the different kind of public auditing assignments the mandate of each SAI provides for.

### **3. Organisation of the work and timeline**

The initial assessment will be carried out by the PSC Chair, the regional representatives of the PSC Steering Committee and the chairs of FAS, PAS and CAS. The regional representatives will be responsible for providing information on the mandates of the SAIs within their own region.

### **Timeline for the initial assessment**

Q2 2009	Discussions at PSC SC meeting in Brasilia
Q3-Q4 2009	Initial assessment: Phase 1: Information gathering on the mandates of SAI's (PSC Chair + regional representatives)
Q1 2010	Phase 2: Feasibility - Possibilities to build on other standards - Organization of the project (PSC Chair + chairs of FAS, PAS and CAS)
Q2 2010	Phase 3: Consultations Comments from all members of PSC
Q2 2010	Project proposal: PSC's mandate discussed at the PSC SC meeting in Copenhagen Decision on whether or not to go ahead (approval of project proposal)
Q3 2010	INCOSAI – mandate based on the project proposal/initial assessment

## Theme paper 1: The purpose and challenges of revising the fundamental auditing principles at level 3 (ISSAI 100-400)

The purpose of this paper is to consider how the ISSAIs at level 3 can be revised in order to achieve consistency and clarity in the ISSAI framework.

All members of the PSC are welcome to provide their views and suggestions in relation to the concepts and directions proposed by this paper. This will help the PSC Secretariat to identify the key issues, which will require further consideration before the next meeting of the Steering Committee in the spring 2010.

The paper is considering the following themes:

- 1) The overall purpose of the fundamental auditing principles at level 3 (ISSAI 100-400) and the need to provide a “common language” for INTOSAI.**
- 2) The existing gap between the concepts stated in the Lima Declaration and the auditing guidelines at level 4.**
- 3) The main issues which will have to be settled by the fundamental auditing principles in order to fill this gap:**
  - a) Key definitions of the concept of public auditing and the 3 branches of auditing**
  - b) How a brief presentation of the key principles of financial, compliance and performance auditing may be provided**
  - c) How a link to the “old” concepts of regularity and legality audit can be provided**
- 4) How level 3 can be used to ensure that the ISSAIs are applicable to the many different auditing tasks assigned to SAIs around the world by their mandates.**

### 1.1 The purpose of the fundamental auditing principles at level 3

#### **The principles at level 3 ...**

The ISSAI framework established by INCOSAI in 2007, was developed by the PSC in order to accommodate the different requirements for professional standards among INTOSAI’s members. Level 3 of the framework (ISSAI 100-999) includes the *fundamental principles in carrying out auditing of public entities* (cf. ISSAI classification principle 2)

#### **-should contain key recommendations on auditing practice...**

The purpose of level 3 is to express INTOSAI’s fundamental recommendations regarding auditing practices. This could include a set of concepts describing and classifying the various tasks which a SAI might perform as well as recommendations on how the individual tasks should be carried out.

**-and the use of standards from other bodies...**

When the ISSAI framework was established, it was foreseen that it might at some point include recommendations on the use of standards issued by other standard setting bodies as well as direct recommendations concerning auditing and reporting practices. Both kind of recommendations belong to the framework if they are endorsed by INCOSAI as an official document (cf. ISSAI classification principle 1)

**...which are further elaborated at level 4.**

At present INTOSAI's key recommendations on carrying out auditing work are found in ISSAI 300 and ISSAI 400. These are supplemented by the auditing guidelines at level 4 of the ISSAI Framework (implementation and specific guidelines). The purpose of level 4 is to translate the fundamental auditing principles into more specific, detailed and operational guidelines that can be used on a daily basis for auditing tasks (cf. ISSAI classification principle 2).

As further detailed in table 1 these guidelines will by 2010 cover over 1000 pages bringing the total volume of the ISSAIs up to approximately 2000 pages. Therefore, the revised fundamental auditing principles should also serve as a basis for alignment (updating, editing or withdrawal) of the specific guidelines on various topics in the coming years.

**Table 1 – Number of pages**

<b>Level 3 - Fundamental Auditing principles</b>		<b>31 pages, total:</b>
Basic Principles	ISSAI 100	7 pages
General Standards and Standards with ethical significance	ISSAI 200	10 pages
Field standards	ISSAI 300	8 pages
Reporting Standards	ISSAI 400	6 pages
<b>Level 4 – Implementation guidelines</b>		<b>1000-1200 pages:</b>
Financial Auditing Guidelines	ISSAI 1000-1800 (existing and planned)	600-800 pages (ISAs approx. 400 pages)
Performance auditing guidelines	ISSAI 3000 (existing) Appendix New guidelines planned	142 pages 68 pages 20-50 pages
Compliance Auditing Guidelines	ISSAI 4000-4200 (exposure draft)	148 pages
<b>Level 4 – Specific guidelines</b>		<b>797 pages, total:</b>
International institutions	ISSAI 5000-5099	44 pages
Environmental audit	ISSAI 5100-5199	160 pages
Privatisation and PPP	ISSAI 5200-5299	171 pages
IT-audit	ISSAI 5300-5399	311 pages
Public debt	ISSAI 5400-5499	111 pages

**They are widely used,...**

Many SAIs have emphasized the necessity and usefulness of level 3 in the framework. A PSC survey conducted among INTOSAI's members in 2007 showed that the existing fundamental auditing principles (ISSAI 100-400) are used by 3/4 of INTOSAI's members.

**- for many purposes,...**

According to the survey, the ISSAIs are serving very different functions for SAIs. The different ways in which the standards are being used require different document formats.

Purposes which may call for brief documents outlining the key principles rather than long detailed guidance:

- Describing the tasks and obligations of the SAIs to external parties (50 % of the SAIs)
- Reference for evaluation of the SAI, e.g. in peer reviews (30 % of the SAIs)
- Establishing the legal framework of the SAI (38 % of the SAIs)

Purposes which may call for more detailed and operational guidance:

- Applied directly by auditors (58 % of the SAIs)
- Referred to in audit reports (49 % of the SAIs)
- Describing obligations to other auditors (subcontractors) (36 % of the SAIs)

Purposes which may call for both kinds of documents - general principles which are further elaborated on in documents providing detailed guidance:

- Developing audit strategy and methodology (69 % of the SAIs)
- Formulation of national standards and guidelines (56 % of the SAIs)
- Education and/or certification in public sector auditing (54% of the SAIs)
- International donors (24 % of the SAIs)

**- and should give recommendations on tasks which are specific for SAIs...**

Approximately 50 per cent the members are also using IFAC standards, and generally the respondents agreed to PSC's dual approach. Further, a vast majority answered that INTOSAI should continue to develop guidance on public auditing in areas where SAIs' status and mandates are implying differences compared to private sector auditing.

70 per cent of INTOSAI's members found that the need for specific INTOSAI guidance should concern auditing and not only institutional differences.

**- in a brief format.**

In order to meet these needs, level 3 of the framework is targeted at a different audience than level 4. The fundamental auditing principles at level 3 should be useful for SAI leaderships and in the relations between SAIs and legislators or other external stakeholders, and recommendations should be **brief and general with focus on the most important principles**. Guidance at level 4, on the other hand, should be operational and detailed.

Even though the ISSAI's are made available by INTOSAI to address the needs of SAIs they may also be used and referred to by other auditors. The scope of applicability of ISSAI 100-999 should thus be defined in terms of the tasks to be performed (public auditing) rather than the kind of auditors performing them. Developing fundamental auditing principles and implementation guidelines which may also be applied by other Public Auditing Authorities or engaged auditors when

performing engagements in the public sector is considered relevant for INTOSAI for the following reasons:

- Many SAIs draw upon the work of other auditors in various ways. The fundamental auditing principles should provide a set of concepts that can be used for defining and describing the tasks to be performed by these auditors.
- If the SAI is to base its own conclusions and reporting partly on other auditors' work, this will generally require that the same standards are applied in the assignment by the SAI and the other auditors.
- The SAI represents the highest professional authority in the field of public auditing and no other international body is providing guidance for public auditing authorities.
- The cooperation between INTOSAI and IFAC means that the two organisations have mutual commitments towards each others constituencies. IFAC's international standards on auditing recognise that audit engagements in the public sector may have a broader scope than what is provided for by IFAC's standards and states that the auditors' responsibilities in that regard may be defined by INTOSAI.

Table 2 illustrates how the division between different levels of the ISSAI Framework may work to accommodate different needs.

**Table 2 – The differences between level 2, 3 and 4.**

	<b>Subject</b>	<b>Scope</b>	<b>Format</b>	<b>Target group</b>
Level 2 ISSAI 1-99	Institutional issues	SAIs	Brief	Legislators, general public and SAI leadership
Level 3 ISSAI 100-999	Auditing practices and standards ("firm level")	Public auditing	Brief	Legislators, general public, SAI leadership and other auditing authorities/firms
Level 4- implementation guidelines ISSAI 1000- 4999	Auditing practices and standards ("assignment/engagement level")	Public auditing	Detailed	Developers of standards and methodology Auditors

**They should facilitate cooperation...**

Working with professional standards is only one of the four goals indicated in INTOSAI's Strategic Plan. All goals contribute to realise the motto of INTOSAI "*Mutual Experience Benefits All*". Reaching a common understanding across national boundaries of the similarities as well as the differences that characterise the tasks and challenges of SAIs is difficult and often a barrier in international cooperation on capacity building and knowledge-sharing.

**... in the INTOSAI community...**

The ISSAIs are playing an important role as point of reference when INTOSAI's members are to describe and compare their different mandates and how they operate. Therefore, the fundamental auditing principles at level 3 should support the efforts of capacity building and knowledge sharing. The concepts provided by the ISSAIs are, for instance widely used and drawn upon when national mandates are

translated into other INTOSAI languages, when international surveys are conducted and for all kinds of other international and bilateral exchanges. Together with the Lima Declaration the fundamental auditing principles should provide the INTOSAI members with "a common language", which is importance in the context of many other activities pursued by the organisation.

**- by providing a  
"common language"...**

In order to provide an efficient language facilitating the exchange of comparable information, the set of concepts provided should meet the following criteria:

- They should be clear and consistent
- They should cover all key tasks assigned to INTOSAI's members
- They should, at best, have clearly defined relations to any similar concepts which are provided by other standard setters (either identical, different or provide some kind of further specification)
- They should at all times provide an updated description of current practices.

The Lima Declaration is the bedrock of the INTOSAI community. It contains the "founding principles" of the ISSAIs and will remain unchanged for many years. Having a level 3 of the framework, presenting the fundamental auditing principles, will facilitate updating and maintenance in pace with developments within public auditing.

**- in a clear structure of  
ISSAIs.**

The fundamental principles should provide an overview and contain references to the relevant guidelines at level 4 on financial auditing, performance auditing and compliance auditing. Using ISSAI 100 to outline the key concepts and definitions of INTOSAI's "common language" could provide a clear and user-friendly structure. ISSAI 200, 300 and 400 could then deal with the three branches of auditing:

**Possible new outline of level 3**

**ISSAI 100 – Basic concepts of public auditing**

-Defining public auditing and its three branches  
(ISSAI 110-1xx may concern different assignments of public auditing, e.g. assurance statements, assessments in special reports, audit inquiries etc.)

**ISSAI 200 – Fundamental principles of financial auditing**

- Stating the principle that the ISAs should be used for public auditing and other general principles based on the practice notes of ISSAI 1000-1999

**ISSAI 300 – Fundamental principles of performance auditing**

- Stating the most important principles on performance auditing based on ISSAI 3000

**ISSAI 400 – Fundamental principles of compliance auditing**

- State the most important principles on compliance auditing based on ISSAI 4100-4200

It should be noted that this outline is tentative and is suggested only as a point of departure. If, at a later stage, it turns out that a more user-friendly format can be achieved in another way, the outline should of course be revised. The proposed content of the documents is further described in the following section.

***The PSC Steering Committee's directions:***

The fundamental auditing principles should provide a "common language" which can be used for explaining and comparing the tasks of SAI's across their different national settings.

This will be relevant for the SAI leaderships' considerations of auditing strategy and for SAIs' communications to government, parliament and other external stakeholders on their auditing practices. It will also provide a starting point for peer reviews and other cooperation on capacity building and knowledge sharing within the INTOSAI community.

## **1.2 The gap between the Lima Declaration and the auditing guidelines**

### **The Lima Declaration's key concepts...**

In the current set of ISSAIs, the three branches of public auditing are defined differently at the different levels of the framework.

ISSAI 1 The Lima Declaration is making a distinction between the auditing objectives of:

- legality
- regularity, and
- performance audits.

The existing fundamental auditing principles on level 3 are providing a two-fold distinction between:

- regularity (financial) audit, and
- performance audit.

The fundamental auditing principles are not referring to the concepts of the Lima Declaration and the term "legality audit" is not used. Instead the fundamental auditing principles state that tests of compliance with applicable laws and regulations should be part of "regularity audits" as well as "performance audits".

Further, the present wording of the fundamental auditing principles presumes a specific organisational set-up: The SAI's mandate must provide for precisely two different auditing tasks with precisely the scope presumed in the definition provided by ISSAI 100-400 of "regularity" and "performance audit", and the practical organisation of the work is presumed to be divided into these two tasks.

### **-does not define the 3 branches of auditing,...**

PSC has established subcommittees and developed implementation guidelines at level 4 according to a three-fold distinction between:

- financial auditing
- performance auditing, and
- compliance auditing.

The decision taken by PSC to apply the three-fold distinction between financial, performance and compliance auditing was most recently confirmed when INCOSAI endorsed the proposal on the ISSAI framework in 2007.

ISSAI 1/Section 4.

#### **Legality audit, regularity audit and performance audit**

1. The traditional task of Supreme Audit Institutions is to audit the legality and regularity of financial management and of accounting.

2. In addition to this type of audit, which retains its significance, there is another equally important type of audit--performance audit--which is oriented towards examining the performance, economy, efficiency and effectiveness of public administration. Performance audit covers not only specific financial operations, but the full range of government activity including both organisational and administrative systems.

3. The Supreme Audit Institution's audit objectives--legality, regularity, economy, efficiency and effectiveness of financial management--basically are of equal importance. However, it is for each Supreme Audit Institution to determine its priorities on a case-by-case basis

**- so level 3 must provide the link to the new guidelines.**

One main purpose of revising the fundamental auditing principles is to provide a clear and consistent link between the concepts of the Lima Declaration and the updated set of concepts presented in the implementation guidelines for financial, performance and compliance auditing (ISSAI 1000-4999) developed by PSC's subcommittees. The revised fundamental auditing principles should bring the core concepts of the Lima Declaration, including "legality", "regularity" and "performance" auditing and the key concepts of "financial", "performance" and "compliance auditing" now developed by FAS, PAS and CAS into one coherent set of definitions.

#### ***The PSC Steering Committee's directions:***

The fundamental auditing principles should bridge the gap between the Lima Declaration and the guidelines of FAS, PAS and CAS by providing a coherent definition of public auditing and its three branches - *financial, performance and compliance auditing*.

### **1.3 Main issues to be settled**

#### *a. The three branches of public auditing*

**Based on the Lima Declaration,...**

The new coherent definition of the three branches of auditing will also define the scope of applicability of the ISSAIs. At present the ISSAIs do not clearly state, which kind of auditing (or assurance) tasks they apply to.

To ensure coherence the concepts outlined in the Lima Declaration should be used as the starting point. The Lima Declaration contains no explicit definition of the term "audit", "public auditing" or "government

auditing". Instead it states the purpose of SAI's auditing activities in the following way:

**ISSAI 1/Section 1.**

The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust. Audit is not an end in itself but an indispensable part of a regulatory system whose aim is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent--or at least render more difficult--such breaches.

**- public auditing may be defined ...**

It is suggested that the definition of public auditing as well as the three branches of auditing should be based on the notion reflected in ISSAI 1/Section 1 that the role of SAIs is to undertake auditing assignments, where the audit criteria to be applied are of a certain nature: They are in one way or another requirements to those entrusted with the management of public funds. In order to distinguish between public auditing assignments and other SAI functions the following tentative definitions have been used in the pre-study of 15 SAIs presented in appendix 2:

The purpose of **public auditing assignments** is to reach a conclusion supported by sufficient appropriate evidence on whether public authorities and other publicly funded entities have observed the requirements that follow from their responsibility for the management of public funds.

**- as a special kind of auditing, by which..**

In general, auditing and assurance activities may be defined with regard to the three-party relationship between the auditor, the responsible party and the intended users. This starting point can be used for distinguishing assignments of public auditing from other auditing or assurance activities. The Lima Declaration reflects that in the case of public auditing:

**- the authorities in the constitutional system monitoring...**

- the primary intended users are those authorities within the constitutional/regulatory system that are to exercise a monitoring function and take corrective or in some cases disciplinary measures. Depending on the system this may be the parliament or a budgetary or public accounts committee. It may also be authorities with a general responsibility for upholding the constitution such as a king or president. Often the auditing reporting will also be directed to the ministries or other administrative authorities.

**- those responsible for the management of public funds...**

- the responsible parties are public authorities or other publicly funded entities entrusted with the management of public funds. Within the national setting there are some requirements that follow from this responsibility. In many countries public funds are administered through a hierarchy ranging from the cabinet or individual minister to the management of the individual public entities. There is therefore

not a single responsible party, but rather a range of different responsibilities at the different levels of the hierarchy.

**...gains enhanced oversight, insight and foresight.**

The fundamental principles may also draw on the proposition made by the Capacity Building Committee that the impact of a SAI may be described as *oversight*, *insight* and *foresight*. In the "maturity model" presented in the guide "Building Capacity in Supreme Audit Institutions" which was endorsed by INCOSAI 2007, SAIs were encouraged to embrace *insight* and *foresight* – identifying how audited bodies can be improved – as well as financial oversight. The overall purpose of public auditing is thus to enhance the oversight, insight and foresight with the use of public funds of those authorities exercising monitoring and corrective functions and encourage continuous improvement in the management of public funds.

**Public auditing concerns requirements..**

Since the auditing criteria of public auditing are requirements that follow from the responsibility for the management of public funds the three branches of auditing may be distinguished in the following way:

**- on accounting,...**

**Financial auditing** is a branch of public auditing where the audit criteria are requirements serving the purpose of ensuring reliable recording and reporting of historical financial information on the use of public funds.

**- economy, efficiency and effectiveness...**

**Performance auditing** is a branch of public auditing where the audit criteria are requirements serving the purpose of ensuring that public funds are obtained and used economically, efficiently and effectively.

**- and compliance with law and propriety...**

**Compliance auditing** is a branch of public auditing where the audit criteria are requirements serving the purpose of ensuring that public funds are obtained and used in accordance with law and propriety.

The definitions of the three branches of auditing will have to be further developed and refined on the basis of the guidelines at level 4.

**- which are defined by the national context.**

It is the specific national requirements to ministries' and other responsible parties' entrusted with the management of public funds which define the audit criteria of public audit assignments. The requirements may follow from the direct management responsibility for the funds as well as more general supervisory responsibilities for the management of funds by subordinated bodies within the public administrative hierarchy.

The audit criteria are therefore not to be defined by the ISSAIs at level 3. Instead the concepts of financial auditing, performance auditing and compliance auditing serves to distinguish between the different kinds of audit criteria, which may be provided for by the mandates within the national context.

**The requirements may concern...**

The PSC Secretariats pre-study of the mandates of 15 SAIs suggests that a further distinction can be made between (cf. Appendix 2):

**- the processes involved...**

**Process requirements:** Requirements to the processes and systems used in the management of public funds. This may include requirements that principles of sound financial management are followed and that appropriate measures are taken to ensure that public funds are used as intended.

**- the outcome achieved...**

**Outcome requirements:** Requirements to the outcome achieved as a result of the measures taken by those entrusted with the management of public funds. This may include requirements on how the public funds may be used.

**- and the reporting by those responsible.**

**Reporting requirements:** Requirements that those entrusted with the management of public funds report information concerning the management and use of the funds. This may be financial or non financial as well as historical or prospective information.

This distinction is important in order to clarify the relationship between the three branches of auditing and the "old" concepts of legality audit and regularity audits in the Lima Declaration and the existing fundamental auditing principles.

Different process requirements, outcome requirements and reporting requirements may serve to ensure reliable accounting, compliance with law and propriety as well as economy, efficiency and effectiveness. Table 3 provides some tentative suggestions on the nature of the processes, outcomes and reported information which may be concerned by the requirements.

**Table 3. Different kinds of requirements which the auditing criteria may concern**

	<b>Proces-requirements</b>	<b>Outcome- requirements</b>	<b>Reporting- requirements</b>
<b>Financial</b> (Reliable accounting)	<ul style="list-style-type: none"> <li>Processes of registration and internal controls</li> </ul>	(Recording in accounts which reflects the financial result)	<ul style="list-style-type: none"> <li>Reporting of historical financial information</li> </ul>
<b>Compliance</b> with law and propriety	<ul style="list-style-type: none"> <li>Procedures for the processing of cases and internal controls</li> </ul>	<ul style="list-style-type: none"> <li>The public funds are obtained and used in accordance with law and propriety</li> </ul>	(Statements on compliance)
<b>Performance</b> (Economics, efficiency and effectiveness)	<ul style="list-style-type: none"> <li>Strategies, planning and target setting on performance</li> </ul>	<ul style="list-style-type: none"> <li>Achievement of the purposes intended in the most cost-effective way</li> </ul>	<ul style="list-style-type: none"> <li>Reporting of non-financial information on performance</li> </ul>

## *b. Principles for financial, performance and compliance auditing*

### **The fundamental principles should be based on the guidelines for...**

A user-friendly division between the brief statements of the fundamental auditing principles and the guidelines at level 4 may be achieved by:

- Using the comprehensive set of implementation guidelines as the basis for developing key principles for each of the 3 branches of auditing.
- Maintaining that the guidelines are providing detailed and operational guidance on frequent, important and recommended assignments.

On the other hand, the fundamental auditing principles should aim for universal applicability, and the guidelines may therefore have a more precise scope.

### **- financial auditing...**

The financial auditing guidelines concern assignments to audit a set of financial statements in accordance with the ISAs (reporting requirement). It is suggested that the fundamental auditing principles should clearly state that:

**All public auditing assignments within the scope of applicability of the ISAs should be conducted in accordance with the ISAs.**

Such a clear recommendation at a prominent place is missing in the current set of ISSAIs.

The careful development of practice notes to the ISAs by FAS and the experts drawn from FAS' reference panel represent a huge investment in terms of time and resources. In order to achieve the full benefit of this work, it should be considered whether some of the specific considerations identified in practice notes amount to general principles on how to apply ISAs in the context of public auditing. If any such principles of relevance to the SAI leadership and external stakeholders can be identified it is suggested that they are included in a brief format in the fundamental auditing principles.

### **- performance auditing...**

The Lima Declaration, the current fundamental auditing principles and the performance auditing guideline (ISSAI 3000) are already consistent in that they all use the term "performance auditing" and define it as concerning economy, efficiency and effectiveness.

However, a main concern of the present guidelines on performance auditing is that parts of the present text of the fundamental auditing principles in ISSAI 300-400 are misstated if the task is to provide an assessment in a long form ad hoc report rather than a yearly audit. It is therefore suggested that the development of fundamental principles for performance auditing should be part of the general PSC project to

redraft the fundamental auditing principles. PAS has already drafted a new brief document which extracts key principles of ISSAI 3000.

The concept of economy, efficiency and effectiveness is not defined explicitly in the Lima Declaration, but in the fundamental auditing principles. In the current text the definition is provided in contrast to “regularity (financial audits)”. Further the definition attempts to define *what* the audit criteria should be.

#### **Current definition of performance auditing (ISSAI 100/40)**

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

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

In line with the previous discussion, it is suggested that economy, efficiency and effectiveness (the three E’s) should be regarded as a categorization of auditing criteria into three different subsets. The three E’s should be defined more rigorously and as different kinds of requirements, which, depending on the circumstances, could be applied to the management of public funds, for example:

**Economy:** Requirements serving to optimize the ratio between the volume or quality of the means of production used for the publicly funded activities and the needs for public funding in order to acquire, maintain and dispose of the means of production.

**Efficiency:** Requirements serving to optimize the ratio between the volume or quality of the goods and services resulting from the publicly funded activities and the volume or quality of the means of production needed.

**Effectiveness:** Requirements serving to optimize the ratio between the degree to which the impact intended by the public funding is achieved and the volume or quality of the goods and services resulting from the publicly funded activities.

In line with the current definition, it might be stated in the new principles that performance auditing concerns outcome as well as process requirements.

A number of countries have over the last years introduced requirements that public entities shall report publicly on their performance, e.g. by using the indicators of economy, efficiency and effectiveness. It could therefore be considered to classify this kind

of non-financial information as “performance auditing” also. This may be done by stating that performance auditing criteria may also include reporting requirements serving the purpose of ensuring that public funds are obtained and used economically, efficiently and effectively.

**- and compliance auditing.**

The current fundamental principles do not include a concept of “compliance auditing”. Instead they state the following:

**Current notion of “compliance” in the Fundamental Auditing Principles (ISSAI 300/0.3):**

In conducting regularity (financial) audits, a test should be made of compliance with applicable laws and regulations. The auditor should design audit steps and procedures to provide reasonable assurance of detecting errors, irregularities, and illegal acts that could have a direct and material effect on the financial statement amounts or the results of regularity audits. The auditor also should be aware of the possibility of illegal acts that could have an indirect and material effect on the financial statements or results of regularity audits.

In conducting performance audits, an assessment should be made of compliance with applicable laws and regulations when necessary to satisfy the audit objectives. The auditor should design the audit to provide reasonable assurance of detecting illegal acts that could significantly affect audit objectives. The auditor also should be alert to situations or transactions that could be indicative of illegal acts that may have an indirect effect on the audit results.

The new compliance auditing guidelines will establish compliance auditing as a branch of auditing in its own right. An important purpose of the revision of the fundamental auditing principles is therefore to state this clearly in the principles. Based on the guidelines the fundamental principles of compliance auditing should be stated in a brief document at level 3.

The drafting of the new compliance auditing guidelines has reflected that auditing tasks are organized in a number of different ways by SAIs. Financial, performance and compliance auditing criteria may be combined into auditing assignments in a diversity of other ways than stated by the current ISSAI 300/0.3 above. Many of the concepts provided and the distinctions made in the guidelines are not only relevant for compliance auditing, but will provide a good starting point of more general relevance for the fundamental auditing principles.

*c. The “old” concepts of regularity and legality audits*

**The principles should explain the Lima Declaration’s concepts of...**

In order to “bridge the gap” between the definition of financial auditing provided by ISSAI 1200 and the Lima Declaration the fundamental auditing principles will be required to explain the meaning of the term “regularity audits”.

It should be noted that **the Lima Declaration is referring only to**

**'regularity auditing'**. Financial auditing is not mentioned. Therefore, any definition provided must imply that **financial auditing is at least a part of regularity auditing**.

**- "regularity audit"....**

"Regularity audit (financial audit)" is currently defined in ISSAI 100/39 and ISSAI 300. The Lima Declaration describes regularity audit as the "traditional" task of SAIs. It is therefore suggested that regularity audit may be regarded as one specific "package" of tasks which are carried out in the same working process. In the new text of level 3 regularity auditing may thus be defined as a public auditing assignment combining:

1. Auditing of financial statements, and
2. Application of audit criteria of the following kind:
  - Process requirements concerning systems for accounting and registration, and requirements concerning internal controls.
  - Outcome requirements concerning compliance with law and propriety of the transactions reflected in the historical financial statements.

**Current definition of regularity audit (ISSAI 100/39)**

Regularity audit embraces:

- (a) attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements;
- (b) attestation of financial accountability of the government administration as a whole;
- (c) audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations;
- (d) audit of internal control and internal audit functions;
- (e) audit of the probity and propriety of administrative decisions taken within the audited entity; and
- (f) reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed.

Audits of financial statements may of course also involve audit procedures concerning the processes of accounting and internal controls for the purpose of assessing risks of misstatement of the financial statements. But in a regularity audit the process and outcome requirements are used as audit criteria in their own right – regardless of the implications for the reported financial statements.

It is suggested that the fundamental auditing principles treat "regularity audits" as one particular way of organizing the auditing activities of SAIs. However SAIs may combine different categories of audit criteria in other ways. It is therefore not suggested that this particular "package" is especially recommended by the fundamental auditing principles. Instead ISSAI 4200 developed by CAS will give guidance on assignments of public auditing were the auditing of financial statements is combined with compliance auditing criteria.

**- and "legality",...**

The term "legality" is used by the Lima Declaration but is currently not further defined by the ISSAIs. In order to fill the gap and achieve consistency with the concept of compliance auditing now introduced, it

is suggested that "legality audit" is considered a specific kind of compliance auditing, e.g. audits where the audit criteria are:

- outcome requirements that the use of funds is in compliance with applicable law.

In addition to "legality" criteria the auditing criteria in compliance auditing may also concern outcome requirements of propriety as defined by ISSAI 4100-4200 as well as process and reporting requirements.

**- but will only concern post-audits.**

The Lima Declaration further distinguishes between pre-audits and post-audits. Pre-audit represents a before the fact type of review of administrative or financial activities; post-audit is audit after the fact (ISSAI 1/Principle 2). In line with the present text, it is suggested that the scope of applicability of level 3 is limited to post-audit. For the sake of consistency between the documents this should be stated explicitly in the fundamental auditing principles.

#### ***The PSC Steering Committee's directions:***

The fundamental auditing principles should provide a brief statement of the most important general recommendations contained in the over 1000 pages of implementation guidelines on **financial, performance and compliance auditing**.

"Regularity" and "legality" audits as mentioned by the Lima Declaration should be treated as one particular way to organize the audits (but not be especially recommended over other ways to organize financial and compliance auditing)

## **1.4 Ensuring applicability for all SAIs**

**To combine ...**

A main challenge for the project will be to formulate auditing principles which are as clear as possible and at the same time fully applicable to all of INTOSAI's members. The inherent dilemma in this is:

**- universal applicability...**

- on the one hand the documents should be applicable, relevant and useful for a wide range of different tasks in a wide range of settings

**- with clarity...**

- on the other hand the standards should contain some prescriptions or recommendations on good practice. They are therefore also bound to recommend that certain tasks should be performed differently than what is current practice in some countries.

This dilemma is probably the main cause of the ambiguity of the recommendations made in the present fundamental auditing principles. There are, however, also other ways to solve the dilemma between the need for flexibility to allow for universal applicability and the need for clear recommendations that can effectively guide practice.

**- INTOSAI should learn from others.**

The International Professional Practices Framework (IPPF) by the IIA takes the approach of distinguishing between mandatory guidance (Definition of Internal Auditing, Code of Ethics, Standards) and Strongly Recommended Guidance (Position Papers, Practice Advisories and Practice Guide) which is non-mandatory.

By establishing the ISSAI framework, the PSC has already taken a similar approach. The ISSAI framework defines a hierarchy between the documents in the sense that documents at the superior level have supremacy over documents at the lower levels (though “upper level” documents are not “mandatory” in the same sense in the ISSAI framework as in the IIA framework).

The framework developed by IFAC has similar distinctions. However, this framework is also taking another approach. This framework contains:

1. A set of concepts which classify the tasks which may be performed under the standards into different categories. The IFAC standards thus provide a common language which is available worldwide for describing the various tasks of commercial auditing firms.
2. For each category of tasks (each type of engagement): A set of concepts which provide a language for describing the different roles involved, the different stages of the processes of performing the tasks and the nature of the task which may be performed.
3. For most categories of tasks (engagements): Prescriptions applying in case a practitioner (auditor) has undertaken this particular task. For tasks belonging to the category “audits of historical financial information” there are many and relatively clear prescriptions. For most other tasks there are fewer recommendations (e.g. non-assertion based/“direct reporting” assurance engagements under ISAE 3000).

**Table 4. Classification of different tasks in IFAC’s Standards**

Subject:	Assurance engagements		Related Services
	Reasonable Assurance	Limited Assurance	
Historical financial information	Auditing (ISAs)	Review (ISREs)	Related services: Agreed- Upon procedures and compiling of financial information (ISRSs)
(any)	Other assurance engagements (ISAEs)		

The IFAC standards therefore prescribe *how* the different tasks should be performed, and not *which* tasks should be performed. Seen from the perspective of IFAC’s membership, the great advantage of this

approach is that it makes no recommendations as to which categories of tasks should be offered as part of its services to clients. Whether or not an accounting firm wants to undertake tasks belong to the category of "other assurance engagements" or "related services" is a question of business strategy and not regulated by the standards.

**The different assignments SAI's may have...**

A similar situation exists within INTOSAI. The auditing assignments that SAIs are required to perform differ from one country to the next. The current principles at level 3 are not necessarily very helpful for the many SAIs which are established on the basis of a mandate which use other terms than "regularity auditing" and "performance auditing". For many SAIs the auditing work is organised in other ways than what is supposed by the current definitions of "regularity auditing" and "performance auditing".

In order to achieve clarity as well as applicability the following approach should be maintained:

**- should be classified in the ISSAIs.**

The fundamental auditing principles at level 3 should *not* describe *which* assignments the SAIs *should have*. Instead ISSAI 100 at level 3 should attempt to categorise the different assignments a SAI may or may not be required to perform.

For each kind of assignment the ISSAIs should give appropriate recommendations on *how* assignments of this category should be performed.

This approach will ensure that the fundamental auditing principles can become a useful tool in the relations between SAIs and legislators or other stakeholders because they will:

- explain clearly the assignments which the SAI has been mandated to perform and which not, compared to the assignments of other SAIs.
- explain or document that the way in which the SAI performs the specific assignments it has been given is in line with INTOSAI recommendations.

In addition, the fundamental auditing principles will provide a starting point for SAI leaderships taking policy decisions within the limits provided by the mandate as to which tasks the SAI should perform. This will be helpful for the development of the overall auditing approach of SAIs and it will accommodate the need to be able to explain the approach taken to external stakeholders.

If INTOSAI were to give explicit recommendations on how the mandate of a SAI should define the auditing tasks of the SAI this would belong at level 1 or 2 of the framework. However, providing such recommendation is outside the scope of the envisaged project and is not considered a realistic ambition at present.

**The ISSAIs should also make it possible..**

One of the main objectives of the PSC's and INCOSAI's decision to establish the ISSAI framework was to make it easier to make clear references to the various INTOSAI documents. The PSC's survey in 2007 showed that the SAIs make references to INTOSAI's standards in their statements or reports. The standards are also used as point of reference for peer reviews and as a basis for national standards or internal audit manuals.

**Example of a claim of compliance – From Statement of Assurance (DAS) in the European Court of Auditors annual report for 2007**

'The Court conducted its audit in accordance with the IFAC International Standards on Auditing and Codes of Ethics and the INTOSAI **International Standards of Supreme Audit Institutions**, in so far as these are applicable in the European Community context'.

**- for SAIs to claim they are in compliance ..**

To ensure that the ISSAIs can be **implemented** it will be important to define clearly what it would mean for a SAI that it has applied the ISSAIs. The Steering Committee has previously touched upon INTOSAI's ability to ensure that SAIs or other auditors claiming to be using the ISSAIs – including the ISAs – do in fact live up this claim in practice. The PSC Steering Committee has thus encouraged the Capacity Building Committee to consider if peer reviews should provide a voluntary mechanism of establishing compliance with INTOSAI standards and guidelines. In line with this, it is suggested that the ISSAIs at level 3 **should not prescribe whether or not SAIs should state that they comply with the ISSAIs.**

**- with the relevant parts of the ISSAI framework.**

However, it is suggested that the revised fundamental auditing principles should define as clearly as possible how such claims *should be understood*. Among the approximately 2000 pages of ISSAIs developed by numerous working groups, task forces and subcommittees over a time span of decades, some are more relevant as point of reference for these claims than others.

It is suggested that an attempt is made to provide a relevant range of possibilities of expressing compliance with the ISSAIs and to define the meaning of these as clearly as possible. It seems relevant to consider at least 4 different types of claims:

**General claims that the SAI performs its duties in accordance with the ISSAIs:** This is as a minimum a claim that the SAI lives up to the prerequisites defined at level 2. It might also imply that the assignment it has been mandated to perform are in general carried out in accordance with the applicable fundamental auditing principles defined at level 3. These kinds of claims could e.g. be made by SAIs in their (annual) reporting on their own activities and performance provided for by the new principles on transparency and accountability of SAIs. It will also strengthen the ISSAIs as a basis for **implementation, capacity building** and **peer reviews**.

**Claims that a set of standards or manuals conforms to the ISSAIs:** This is as a minimum a claim that the standard or manual ensures the fundamental auditing principles. It may further be considered to what extent the claim also implies conformity with the implementation guidelines.

**Claims that a task of auditing has been carried out in accordance with the ISSAIs:** This is a claim that the assignment falls within the scope of application of the fundamental auditing principles and that those principles that are applicable to the assignment in question have been followed. To ensure clarity vis-a-vis the ISAs it may be considered if the reference to ISSAIs should be reserved for assignments which are not confined

to the scope of the ISAs, e.g. because the audit objective (also) concerns compliance or performance audit criteria.

**Claims that a financial auditing task has been carried out in accordance with the ISAs as further elaborated by the financial auditing guidelines:** References to the ISAs in audit statements are regulated by ISA 700 and ISSAI 1700 will define how it may be indicated that the practice notes of the ISSAIs have also been considered. For these assignments the ISAs are applied to the full extent relevant and the practice notes developed provide further "technical guidance" developed by FAS under the reduced requirements of due process allowed for such documents by PSCs terms of reference. For these reasons the statements will refer to the ISAs with some indication that the ISSAI financial auditing guidelines have been considered too.

The approach suggested above should ensure clarity in the framework as well as in relation to the ISAs. This will be in line with the principle stated in the PSC's mandate that when the *task is the same, the standards should be the same, when the task differs the standards should differ.*

In order to reflect this approach in the fundamental auditing principles, the PSC will need to define a process which can:

1. Ensure that the PSC and INTOSAI gain sufficient common knowledge of the diversity of the auditing assignments provided by the mandates of SAIs as well as the scope of flexibility allowed for by the mandates. This overview will be necessary in order to establish the different categories of tasks for the purpose of the principles.
2. Ensure that different principles are provided for different categories of assignments which are relevant for different SAIs. The process should allow SAIs to develop appropriate principles for the assignments they are required to perform even if there are other SAIs which do not have similar assignments and may therefore not recognise the concepts and principles stated.

In theme paper 2 it is therefore further discussed how this can be achieved through the initial assessment.

***The PSC Steering Committee's directions:***

The fundamental auditing principles should ensure that the ISSAIs are applicable to the many different kinds of public auditing assignments, which SAIs in the different regions of the world have been given by their legal mandates.

They should also define how claims of compliance with the ISSAIs should be understood.

## Theme paper 2: Issues to be considered in the initial assessment

The purpose of this paper is to consider how the initial assessment of the proposed revision of level 3 should be conducted.

Theme paper 1 on the purpose and challenges of revising the fundamental auditing principles at level 3 concluded that the initial assessment should ensure that the PSC and INTOSAI gain sufficient common knowledge of the diversity of the auditing assignments provided by the mandates of SAIs as well as the scope of flexibility allowed for by the mandates. This overview will be necessary in order to identify the different categories of tasks to be covered by fundamental auditing principles. This paper explores further how this overview can be provided and is considering the following themes:

**1) The definitions to be used in phase 1 of the initial assessment in order to gather information on the audit assignments of SAIs.**

**2) The criteria to be used in phase 2 of the initial assessment to determine the possibilities of drawing on other standard setting bodies.**

PSC's due process states:

- A steering committee or subcommittee planning to develop new ISSAIs or INTOSAI GOVs which are not part of a previously approved project carries out an initial assessment. The purpose of the initial assessment is to determine the categories of auditing or other tasks that will be covered by the document, to consider the differences among SAIs that must be accommodated and to ensure consistency with existing ISSAIs and INTOSAI GOVs (potential overlaps, use of terminology etc.). In the initial assessment it is examined to what extent it will be possible to build on guidance from one or more other standard setting-bodies (IFAC, IIA or other international, regional or national standard setters) and to what extent the subcommittee will need to develop supplementary guidance in order to meet the needs and concerns of the INTOSAI community.
- Based on the initial assessment, the subcommittee works out a project proposal for approval by the relevant steering committee.

### 2.1 Phase 1 - Ensuring overview of SAIs' auditing assignments

In the first phase of the initial assessment, a common overview of the various assignments of SAIs across the regions of the world should be provided. The overview will provide the basis for an assessment of how the recommendations on performing the different assignments can best be stated while drawing on standards from other standard setters.

#### **Information should be gathered on...**

The relevant features characterising SAI assignments should be defined before the first phase of the initial assessment can be carried out. The pre-study of the mandates of 15 SAIs has served to develop and road test a set of concepts for this purpose.

Based on the pre-study, it is suggested that the following characteristics of an assignment is used as a starting point:

**- the key characteristics of the auditing assignments...**

1. The **object**: An identification of the organisational units or scope of activities which should be audited, e.g. the "state accounts", "execution of the budget" or "publicly owned companies".
2. The **subject** (subject matter or subject matter information): An identification of what the conclusions of the audit should concern. E.g. "the transactions reflected in the accounts" or "the operations of the entity" or "the financial statements".
3. The **audit criteria**: Any identification of the criteria that the auditor should apply, like for instance financial, performance or compliance auditing criteria (which may include process, outcome and reporting requirements), e.g. "effectiveness", "principles of sound financial management", "integrity" or "law on the state accounting" or "financial reporting standards".
4. The **resolve** (result to be achieved, conclusion): Any identification of the kind of result the SAI should aim to achieve through the audit, e.g. "reasonable assurance", "audit opinion", "verification" or "judgements".
5. The **reporting**: Any identification of the frequency and format of the reporting. For example: "annual report", "certificate".
6. The **intended users**: Any identification of the bodies which are to make use of the SAI reporting, like for instance "parliament" or "the responsible minister".

Using this set of concepts, the "**audit objective**" as the term is used in the Lima Declaration may be defined as a statement identifying the subject and audit criteria as well as the resolve to be achieved by the audit.

**- provided for by the mandates of SAIs.**

A full overview of the different assignments of the 15 countries is provided in appendix 2.

The auditing mandate of any SAI includes a general responsibility for the SAI to audit assignments within a certain scope defined by the above characteristics. The pre-study shows that the mandate only rarely describes all the characteristics of the mandated auditing assignments. Most mandates regulate some of the characteristics of the assignments while others remain undefined. This may provide some room of flexibility for the SAI leadership to decide on the auditing approach. For example, in many systems the powers of the SAI to define the auditing criteria or result to be achieved may be regarded as an important element in the professional independence of the SAI. The pre-study also suggests that the PSC should be very careful presuming that specific objects, subjects, audit criteria, resolve or reporting style and intended users are linked in any particular way.

In many cases such presumptions will be valid only for a limited number of INTOSAI members and the ISSAIs may therefore turn out to be irrelevant for core assignments performed by many SAIs.

Based on the overview of the mandates of SAIs, the auditing assignments will have to be grouped into clear categories in the draft fundamental auditing principles.

### The study of 15 SAIs shows...

The distinction between branches of auditing concerns the types of audit criteria (which by nature are applying to different subjects). However, the kind of result to be achieved by the audit – the **resolve** – is an equally important characteristic of an audit assignment. Based on the Lima Declaration and the compliance auditing guidelines, which are drawing on the IAASB's framework, the pre-study of 15 SAIs is operating with the following distinction between the different kinds of assignments:

### - that SAIs have assignments of different kinds...

**1. Assignments to provide assurance statements:** An assignment with the purpose of expressing an opinion designed to enhance the degree of confidence of the intended users that the subject of the audit is in accordance (in all material aspects) with (specific) audit criteria. The opinion is expressed in a statement in a standardized format. Depending on the result of the audit the opinion may be unqualified or qualified.

**2. Assignments to provide assessments:** An assignment with the purpose of comparing the subject of the audit with the audit criteria considered relevant by the auditor in order to reach conclusions on a set of audit questions of significance to the intended user. Conclusions are expressed in the context of a description of the audits scope and objective, the selected audit questions and the status and nature of the audit criteria applied, as well as the audit evidence obtained. Depending on the final outcome of the audit the conclusion may be of an affirmative or informative nature or point to the need to take corrective action by expressing criticism of current management practice or give recommendations on how it can be improved.

**3. Inquiries (audit investigations):** An assignment with the purpose of comparing the subject of the audit with the audit criteria considered relevant by the auditor in order to provide a foundation for a decision in an individual case on whether to take corrective action, measures to make those accountable accept responsibility, to obtain compensation, or to take preventive steps. (cf. Lima Declaration/Section 1)

#### Different kinds of assurance statements

Assurance statement assignments may be further divided according to the nature of the requirements concerned by the assurance. The statement that should result from the audit may thus provide:

- Assurance that the reported information is in accordance with reporting requirements: The scope of these assurance statements will often be confined to the information reported by the audited entity. This is what

IFAC's standards and the endorsement versions of ISSAI 4100 and 4200 on compliance auditing are referring to as "assertion based assurance engagements".

- Assurance that the subject is in accordance with process or outcome requirements: These assurance statements concern the real conduct by the responsible management and are as such not limited to the information presented by management in a report.

A distinction may also be made according to the "level" of assurance which is to be expressed. This distinction seems to be recognised by a number of SAIs based on the IFAC standards and is reflected in the new guidelines by CAS. The IFAC standards are operating with three concepts:

- "Reasonable assurance", for instance the level that must be achieved in an audit of financial statement.

- "Limited assurance", which may be *any* level below the level of "reasonable assurance". It is not relevant for audits of financial statements.

- "Moderate assurance," which is the level to be achieved in a review of historical financial information according to ISRE 2400.

**- in order to provide oversight, insight and foresight....**

From the point of view of parliament or other intended users, the three kinds of assignments are serving different purposes. **Assurance statements** serve to provide clarity: If it is unqualified, no corrective action is needed. Of course, this clarity depends on the proper understanding of the intended users of the scope of the audit and the level of assurance that has been achieved. In this way assurance statements are facilitating the intended users' *oversight* of the spending of public funds. **Assessments** and **Inquiries** serve to provide further transparency and accountability: They provide independent and authoritative information and conclusions on the management of public funds that are not based on the reporting by those responsible for the management. In addition they are useful in connection with audit questions calling for more elaborate answers than the standardised unqualified or qualified opinion. Inquiries are thus supplementing the oversight function by providing *insight* into individual cases. Assessments may in particular facilitate the *insight* and *foresight*.

The pre-study further suggests that most SAIs have powers to perform more than one kind of assignment, as described above. Moreover, most SAIs will in practices combine assignments of different kinds. This may be done to exploit the *synergy* between the different kinds of assignments. (In some cases and for some tasks the existence of synergy may even be the main cause why a particular task has been given to the SAI by the legislators).

The following combinations of assignments seem to appear frequently:

**1. Added inquiries:** If it is discovered during an assurance statement assignment or an assessment that there may be a need to take decision on corrective action or sanctions this may lead the auditors to open an inquiry of that individual case, i.e. an inquiry added to the original assignment.

**2. Assurance statements combined with an assessment:** Some SAIs are requested in their mandate to provide a report which contains a statement of assurance and assessments concerning certain subjects, and audit criteria.

**3. Consolidated assessments:** The object of SAIs' auditing is often hierarchically organised. States may, for instance be organised into a number of ministerial areas each consisting of a number of underlying departments, offices, services or other entities. The state accounts are likewise organised into sections and subsections or the individual entities may be required to produce separate financial statements. SAIs are often assigned to provide conclusions regarding more than one level of the hierarchy. In some cases the assignment may be to provide statements of assurance regarding a number of organisational entities as well as an assessment at the

aggregated level, e.g. in a report to parliament. The assurance statement and the general conclusions regarding the overall management will thus have to rely on the adequacy of the auditing work performed.

**- and report their results to political bodies.**

One of the key institutional features distinguishing SAIs from auditing firms in general, is the need to be able to report audit results to political bodies. It is therefore suggested that investigating whether principles can be formulated on consolidated assessment assignments and other combined assignments may be an important element in the project.

Arriving at clear principles requires a clear notion as to how these recommendations are differentiated according to the different kinds of assignments.

**Recommendations on auditing should differ...**

A key principle of achieving clarity in the ISSAIs is that if the *assignment* differs the *recommendations* given should differ accordingly. The recommendations found in the present ISSAIs at level 3 and 4 (as well as the prescriptions of the IFAC standards) may be divided into two categories:

**Recommendations concerning auditing procedures:** These are describing the procedures which should or may be used by the auditor in order to test whether the subject is in accordance with the auditing criteria.

**Recommendations concerning the process of auditing:** These are describing the obligations of the auditor and the considerations that the auditor should take into account at the various stages of the process of the assignment in order to arrive at the intended kind of resolve.

Naturally, the recommendation types above both depend on the kind of assignment performed:

**- according to the kind of assignment...**

**Recommendations concerning auditing procedures are likely to depend on the subject and the audit criteria:** Different auditing procedures are applied when conducting financial auditing, compliance auditing and performance auditing. Furthermore, some procedures will mainly concern process, outcome and reporting requirements, respectively.

**Recommendations concerning the process of auditing are likely to depend on the resolve, reporting and other characteristics of the assignment:** Many of the considerations relevant to, for instance the audit planning, the communications with management (responsible party) and the way in which the auditor is drawing conclusions are dependent on whether the process of auditing is to end by an expression of assurance, a conclusion which may contain criticism and recommendations or a decision with legal consequences for individual persons. To achieve a clear text in the ISSAIs it is important to clarify on what points the auditing processes for assignments to provide assurance statements differs from other kinds of assignments such as assessments and inquiries.

**- and be provided in different ISSAIs.**

The importance of distinguishing between auditing assignments with different resolve (e.g. assurance statements, assessments, inquiries) has already been recognised in the guidelines at level 4. In combination ISSAI 3000, 4100 and the draft standards prepared by PAS therefore provide a very good starting point for the drafting of principles on the process of auditing applicable to assessments. In order to develop a clear set of fundamental auditing principles, a certain range of ISSAI-numbers (e.g. 110-199) may be dedicated to give recommendations concerning the process of auditing for different kinds of assignments (e.g. statement of assurance, assessment and inquiry). These recommendations on the process will provide the basis for the fundamental principles of financial auditing (ISSAI 200), performance auditing (ISSAI 300) and compliance auditing (ISSAI 400). Thus the audit objectives of an assignment (subject, audit criteria and resolve) should determine which of the ISSAIs at level 3 to apply.

***The PSC Steering Committee's directions:***

*At the next meeting the Steering Committee will consider a project proposal on the revision of the fundamental auditing principles at level 3. To define the project an initial assessment should be carried out.*

*Phase 1 of the assessment should be conducted by the PSC Chair and the regional representatives of the PSC Steering Committee. The purpose in this phase is to:*

- Gather information from INTOSAI's regions on the mandates of SAIs on the following characteristics of the auditing assignments: The object, subject, criteria and resolve of the audit and the reporting to intended users.*
- Develop the necessary and appropriate distinctions between different kinds of assignments (e.g. assignments to provide a statement of assurance vs. other assignments).*

## **2.2 Phase 2 – Considering other standards**

**The initial assessment....**

In the second phase of the proposed initial assessment it should be considered how the revision of the fundamental auditing principles can best contribute to the international harmonisation of auditing standards and ensure clarity in relation to other widely recognised standards. The dual approach means that the PSC will *both* draw on standards from other standard setting bodies to the extent possible *and* develop supplementary guidance on the tasks of SAIs when required.

**- should follow the dual approach and consider....**

When the Steering Committee first agreed on the dual approach, it concerned the implementation guidelines developed at level 4. As a working method, the Subcommittees should consider whether national, regional or international standards that are widely recognized among SAIs around the world could form the basis of the Subcommittee's work. The US yellow book (national), the European

Implementation Guidelines to INTOSAI's Auditing Standards (regional) or IFAC or IIA standards (global) were mentioned in the decision and the guidelines could draw on standards from one or more of these sources.

**- different ways to draw on other standards...**

In line with the PSC's due process it is suggested that the initial assessment maintains the dual approach as its working method. The assessment should especially consider *how* guidance from other sources may be incorporated:

**How to draw on auditing guidance from other standard setters**

**"Inspiration"**: Consider a variety of documents from different sources but draw up an original new text.

**"Patchwork"**: Merge concepts and text of standards or guidance documents from more than one source in order to arrive at a new text.

**"Cover version"**: Use the concepts and texts from a single source and elaborate or modify in order to arrive at a new text.

**"Commenting"**: Refer explicitly to a specific set of documents and elaborate further on these by drafting additional and detailed guidance.

**"Gate keeping"**: State a few general principles and leave it to another standard setter to provide further standards which are to apply unless they are in conflict with the principles.

**"Reference"**: State as a principle that any standards supplied by a specific standard setter should apply.

The way in which standards from external sources are integrated into the ISSAIs at level 3 will have consequences in terms of the **level of control by INTOSAI** over the recommendations provided as well as the **workload** to develop and maintain the ISSAIs.

**- in light of the relevant criteria...**

The initial assessment should therefore consider the choice of the sources drawn on as well as the choice of the way in which the standards are being integrated into the ISSAIs. It is suggested that the following criteria should be referred to:

**Criteria for the consideration of standards from other standard-setting bodies**

**Applicability**: The "external" standards should be fully applicable to the category of assignments for which the PSC attempts to provide guidance. If not, it may be relevant to make a distinction between assignments which clearly fall within the scope of application of the "external" standards and assignments that are outside the scope of application.

**Relevance**: The "external standards" should provide a set of concepts which are – at least for the main part - relevant for the formulation of the recommendations that the PSC wishes to give.

**Usefulness**: The "external standards" should also provide recommendations on auditing which are compatible with the recommendations that the PSC wishes to give. The fewer modifications or further elaborations required, the more useful the standards will be as a basis for the ISSAIs.

**Languages and user concerns**: The "external standards" should be as brief and easily understandable as possible in light of the recommendations that the PSC wishes to give. External standards that are available in at least the 5 official languages of INTOSAI are preferable to single language standards. The benefits related to building on standards from other sources are undermined if the PSC has to translate the standards before issue.

**Reciprocity:** The source of the external standards should recognise the ISSAIs to the same extent as the ISSAIs recognise the external standards. If the PSC is to give up full control of the recommendations given by the ISSAIs by referring to other standards, the PSC should in exchange have some level of influence on future revisions of these standards. This may involve extensions of the current MoUs with IFAC and the IIA, as well as considerations of the mutual representation between the PSC and other standard-setting bodies.

**Wide recognition:** The standards should preferably be widely known and recognised within the INTOSAI community as well as among INTOSAI's external stakeholders. This will facilitate implementation as well as the international harmonisation of standards.

#### **- including standards from IFAC.**

With regard to assignments designed to provide **assurance statements**, it is suggested that the initial assessment is limited to consider primarily **IFAC's standards**. At present the Memorandum of Understanding with IFAC concerns only financial auditing (the ISAs). However, the Compliance Auditing Guidelines developed by CAS are largely drawing on the concepts of IFAC's **International Framework For Assurance Engagements** and IFAC's **ISAE 3000** to provide guidance on assurance statements. In light of this development, it is suggested that the initial assessment considers how this should be reflected in the fundamental auditing principles.

For other assignments identified by the mapping of mandates (e.g. assessments and inquiries) it is suggested that the initial assessment is conducted in full alignment with the dual approach, as it has been defined by the PSC Steering Committee in 2006 (Washington), in PSC's mandate (INCOSAI 2007) and most recently in the due process discussed at the meeting in Beijing. This means that international, regional as well as national standards will be considered as well as the different possibilities to draw on either one or more of these sources.

#### **The scope of applicability of IFAC's International Framework for Assurance Engagements**

In IFAC's framework an "assurance engagement" means an engagement in which a practitioner expresses a conclusion designed to enhance the degree of confidence of the intended users about some subject matter information. Subject matter information is defined as the outcome of an evaluation or measurement of a subject against a set of criteria.

Not all engagements are assurance engagements. One of the key characteristic of an assurance engagement is that the practitioner is to express a conclusion that *conveys assurance*. (cf. International Framework for Assurance Engagements, item 12-14 and item 56-59). There are further requirements that need to be fulfilled if the practitioner is to accept the engagement.

#### **The PSC Steering Committee's directions:**

*Phase 2 of the initial assessment should be conducted by the PSC Chair and the chairs of FAS, PAS and CAS. The purpose is to:*

- *Consider the feasibility and organization of the project.*
- *Consider standards from the relevant national, regional and international sources which may be of relevance to the assignments identified ("the dual approach").*
  - *The dual approach will not be fully applied to assignments designed to provide assurance statements. Instead, the consideration of other standard setters will from the outset be limited to the standards of IAASB/IFAC.*

*- The key criteria when considering standards from other standard setters will be: applicability, relevance, usefulness, languages and user concerns, reciprocity and wide recognition.*

*After the completion of phase 2 a consultation process should be carried through within PSC to ensure that sufficient agreement has been reached on the overall directions of the project before the project is launched.*