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INTOSAI

Guidance for Reporting on the Effectiveness of Internal Controls: SAI Experiences In Implementing and Evaluating Internal Controls

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Issued by The Internal Control Standards Committee

PREFACE

In June 1992, the Internal Control Standards Committee of the International Organization of Supreme Audit Institutions (INTOSAI) issued Guidelines for Internal Control Standards. The standards set forth in the guidelines were intended for use by government management to implement an effective internal control structure and by government auditors to help evaluate those structures.

Five years later, the committee invited INTOSAI members to share their countries' experiences in developing, maintaining, and evaluating internal control structures based on the guidelines. This document provides an overview of the responses from

- Bolivia, Office of the Comptroller General;

- China, National Audit Office;

- Costa Rica, Office of the Comptroller General;

- Egypt, Central Auditing Organization;

- Iceland, National Audit Office;

- Japan, Board of Audit;

- the Netherlands, Netherlands Court of Audit

- New Zealand, Audit Office;

- South Africa, Auditor-General;

- Tonga, Audit Office;

- the United Kingdom, National Audit Office; and

- the United States, General Accounting Office.

The committee appreciates the participation of these INTOSAI members in this project. Their experiences in using INTOSAI's internal control standards can help to further guide all INTOSAI members in building or enhancing their capacity to design high-quality internal control structures and adequately assess them and thus, strengthen public sector financial management and accountability.

Arpad Kovacs, President

State Audit Office of Hungary

Chairman, Internal Control Standards Committee

Chapter I

INTRODUCTION

INTOSAI's June 1992 Guidelines for Internal Control Standards defines an internal control structure as the plans of an organization, including management's attitude, methods, procedures, and other measures that provide reasonable assurance that the following general objectives are achieved:

- promoting orderly, economical, efficient, and effective operations and quality products and services consistent with the organization's mission;

- safeguarding resources against loss due to waste, abuse, mismanagement, errors, and fraud and other irregularities;

- adhering to laws, regulations, and management directives; and

- developing and maintaining reliable financial and management data and fairly disclosing that data in timely reports.

The internal control standards prescribed by INTOSAI form a framework for an internal control structure that meets these objectives. INTOSAI's general and detailed standards are reiterated in chapters II and III, respectively. These chapters also highlight the viewpoints on implementing the standards that were provided by INTOSAI members. Their enlightening perspectives are presented in the context of both control practices that have worked well and examples of control weaknesses that have been identified.

Also, the information furnished by INTOSAI's members for this study was valuable in identifying practices that Supreme Audit Institutions have found to be most useful in creating and monitoring a strong internal control framework. These common practices include

- having a constitutional or a legislative provision that establishes in law an overall basis (or a requirement and objectives) for maintaining effective internal controls;

- prescribing internal control standards to be followed when designing an internal control structure and which can be patterned after or adopted from INTOSAI's standards;

- focusing management's attention on its responsibilities for implementing effective internal controls and continuously maintaining a positive internal control environment;

- emphasizing the prevention of internal control breakdowns - rather than detecting and correcting them - through such means as requiring managers to periodically undertake self-evaluations of internal control operations;

- stressing the role of internal auditors as a critical part of an organization's internal control structure; and

- ensuring that Supreme Audit Institutions play a key role in (1) establishing internal control standards, (2) creating a solid internal control framework, (3) working with internal auditors, and (4) evaluating internal controls as an integral part of both financial and performance audits.

These overarching elements of a sound internal control structure are further discussed in chapter IV. They reinforce guidance in these areas that the INTOSAI Internal Controls Committee promulgated in June 1992.

Chapter II

EFFECTIVELY IMPLEMENTING GENERAL STANDARDS

To provide the proper control environment within an organization, INTOSAI has established internal control general standards in the following areas: (1) reasonable assurance, (2) supportive attitude, (3) integrity and competence, (4) control objectives, and (5) monitoring controls.

REASONABLE ASSURANCE

INTOSAI's first internal control general standard states that internal control structures are to provide reasonable assurance that the general objectives will be accomplished. Reasonable assurance equates to a satisfactory level of confidence under given considerations of costs, benefits, and risks. This means that the cost of internal control should not exceed the benefit derived. INTOSAI member countries have had experience in applying this standard.

New Zealand, for example, reports that each chief executive of a government department has an obligation as a responsible manager for establishing and maintaining a system of internal control procedures that provides reasonable assurance as to the integrity and reliability of financial reporting. While this responsibility is normally delegated to the organization's chief financial officer (CFO), both the chief executive and the CFO sign a Statement of Responsibility, which is included as part of the organization's annual report along with audited financial statements and service performance measures.

In Japan, reasonable assurance that internal controls are effectively maintained is affected by public sector activities that have become increasingly complicated and diversified in the past decades and by increasing delegation of authority to lower echelons. But Japan's Constitution provides the overall foundation necessary to create an effective control environment through requirements such as for (1) the Cabinet to annually submit final accounts of State revenues and expenditures to the Diet (parliament) and (2) the Board of Audit to audit these accounts every year.

On the other hand, in the Republic of South Africa, government internal controls are reported to not yet be at a satisfactory level nor effective due to several factors, including the large size of its departments and slack controls. Compounding these problems, management does not always have the knowledge to implement the appropriate internal controls and to maintain them in a working order.

Although the Republic of South Africa's internal control environment does not currently provide reasonable assurance that adequate internal controls are in place and operating as intended, the government realizes this problem and is addressing them by means such as implementing an internal audit function in all government entities. Also, the government has appointed local and international consultants to facilitate the establishment of a professional institute for public finance and auditing.

SUPPORTIVE ATTITUDE

Another general control standard stipulates that managers and employees are to maintain and demonstrate a positive and supportive attitude toward internal controls at all times. INTOSAI member countries have learned first-hand the central role this standard can play in creating an effective internal control environment.

For example, in the early 1990s, Iceland's National Audit Office conducted several audits among major governmental lending institutions that showed serious weaknesses in a range of areas related to controlling, monitoring, and reporting nonperforming loans. In many instance, government managers' lax attitude towards proper controls in lending, collections, risk management, and application of loan loss reserves contributed to the weaknesses. As a result, at the end of 1991, the Development Fund of Iceland ceased operations because its management failed to recognize heavy loan losses. Improvements have been made in some areas, such as properly accounting for loan loss reserves, which is now done on a regular basis by all major governmental funds.

In another example, in the 1980s and 1990s, the United States experienced substantial savings and loan institution and bank failures, which cost the federal government hundreds of billions of dollars. Control weaknesses were a major cause of the failures; a key factor leading to these weaknesses was a fundamental flaw in management's philosophy and operating style regarding internal controls. For instance, at some savings and loan institutions, inadequate board supervision and the presence of a dominant figure had a detrimental effect on the viability of the institution. This led to risk-oriented activities such as excessive growth-oriented practices, unwarranted loan concentrations, and an overreliance on volatile funding sources.

However, INTOSAI member countries, including Iceland and the United States, view internal control as a major and important part of their operations. For example, in response to the savings and loan institution and bank failures, the U.S. Congress enacted legislation, the Federal Deposit Insurance Corporation Improvement Act of 1990, to address the serious weaknesses that contributed to earlier bank failures and to require reporting on the effectiveness of financial reporting internal controls. In another instance, the Kingdom of Tonga's government has demonstrated a supportive attitude toward internal controls by passing legislation and establishing related regulations and policies. These includes (1) laws to establish an internal control framework for disbursing public money and preparing accounts and (2) regulations setting out the internal control points for the receipt, expenditure, custody, and handing over of public funds. Further, the Audit Department emphasizes to government departments the importance of improving internal controls over financial management and programs.

INTEGRITY AND COMPETENCE

Regarding integrity and competence, INTOSAI's general control standards call for the following. Managers and employees are to have personal and professional integrity and are to maintain a level of competence that allows them to understand the importance of developing, implementing, and maintaining good internal controls and to accomplish the general objectives of internal controls. Several INTOSAI countries have found that, when this general standard is not adhered to, the result can be weak internal control situations involving large monetary values.

In one such situation, during a governmentwide review of purchasing goods and services, which represents a significant level of New Zealand's public expenditures, the Audit Office found an array of weaknesses it attributed, in part, to the lack of integrity and competence by purchasing managers. The deficiencies ranged from not documenting the decisionmaking processes for determining purchasing needs and not specifying delegations of authority to not providing adequate review and approval of specific purchases. The New Zealand Audit Office also reports that a recent focus on sensitive areas of discretionary expenditures, such as using credit cards, has resulted in instances of senior officials' integrity being questioned.

Another case in point is the United States government's Department of Housing and Urban Development (HUD), which is the principal government agency responsible for housing, community development, and fair housing opportunities. While HUD has since taken action to change the way the agency is managed, in 1989, major incidents of fraud, abuse, and mismanagement at HUD were found and attributed to internal control weaknesses, including an insufficient mix of properly skilled staff.

On the other hand, INTOSAI member countries also report having internal controls practices designed to help avoid situations such as those just described. For instance, the National Audit Office of the People's Republic of China reports internal controls covering personnel requirements. Applicants for a post go through strict examinations, are assessed and selected in an open and impartial way, and new members are trained. They will not be allowed to go to their new posts before they are able to procure the "Certificate for The Post." Thus, they are recognized according to their abilities. Further, the members are examined regularly and awarded or penalized according to their work performance and contribution to their organization. When necessary, they will be transferred to other posts.

CONTROL OBJECTIVES

INTOSAI's internal control standards also suggest that specific control objectives are to be identified or developed for each ministry/department/agency activity and are to be appropriate, comprehensive, reasonable, and integrated into the overall organizational objectives. The following instances typify the experiences of INTOSAI member countries in establishing control objectives, which in some cases have not yet progressed beyond having overall organizational objectives.

The Republic of South Africa's Auditor-General reports that a primary objective for the government is to prevent errors or irregularities from occurring in management or financial information or, if any have occurred, to detect them. A range of specific overall control objectives have been identified and include (1) properly recording and accounting for business transactions and activities, (2) safeguarding assets and information from misuse and misappropriation, and (3) establishing limits to which various staff can commit an entity.

Also, the Auditor General for the Kingdom of Tonga reports taking the lead to identify and develop specific control objectives for each government ministry and department activity. The Auditor General is in the process of ensuring that the control objectives are appropriate, comprehensive, reasonable, and integrated into the overall organization structure. INTOSAI's internal control guidelines are being used as the foundation for this process.

Conversely, when internal controls and their objectives are not clearly established and understood, internal control breakdowns can result. For example, Japan's Board of Audit found that municipalities improperly included the medical costs of many retired persons in State subsidized National Health Insurance costs. Significant overpayments in subsidy costs resulted. The problem arose, in part, because municipalities did not understand the State subsidy medical cost subsidy system and requirements.

MONITORING CONTROLS

In addition, INTOSAI's standards specify that managers are to continually monitor their operations and take prompt, responsive action on all findings of irregular, uneconomical, inefficient, and ineffective operations. The following cases show the importance of monitoring operations to ensure that controls are achieving the desired results and of building this standard into the methods and procedures used to control operations.

In one case, the Icelandic National Audit Office reports a main internal control weakness to be the lack of understanding of the importance of internal controls among individual agency managers. Along with other problems, this weakness was evident in a lack of adherence to the established internal control structure. The National Audit Office said that, although an Icelandic government agency might have well defined internal controls on paper, the reality can be quite different. The audit office has found that, without the necessary understanding and monitoring, it is more convenient for people to not follow established control practices.

Another case involves the New Zealand government, which commonly uses consultants that represents a significant expenditure. The New Zealand Audit Office reports finding irregular, uneconomical, inefficient, and ineffective operations associated with the use of consultants. Further, the Office's experience has been that the departments have not taken prompt, responsive action on these findings and thus, the standard calling for monitoring controls was not being adhered to.

On a more positive note, the United Kingdom's National Audit Office reports that, when instances of weak internal controls are identified and reported, management responds to the points raised and early corrective action will normally have been taken. The Office's aim is to monitor follow-up action, and to provide further advice to management as necessary. New areas of risk identified as a result of audit will be reflected in subsequent audit planning.

Chapter III

ACHIEVING CONTROL OBJECTIVES THROUGH DETAILED STANDARDS

To help achieve control objectives and an orderly and effective internal control structure, INTOSAI's internal control guidelines provide detailed standards covering (1) documentation, (2) prompt and proper recording of transactions and events, (3) authorization and execution of transactions and events, (4) separation of duties, (5) supervision, and (6) access to and accountability for resources and records.

DOCUMENTATION

Regarding adequate documentation, INTOSAI's detailed standards indicate the following. The internal control structure and all transactions and significant events are to be clearly documented, and the documentation is to be readily available for examination. Documentation of transactions or significant events should be complete and accurate and should enable each transaction or event (and related information) to be traced from its inception, while it is in process, to after it is completed. A cross section of INTOSAI member countries reported having learned the detrimental effects of not having adequate documentation, as illustrated by the following three situations.

First, the National Audit Office in the United Kingdom reported instances of non-existent or inadequate documentation to support financial transactions having been identified as a result of financial audits. For example, the Audit Office reported instances of

- the lack of documentation being submitted by employees to support payments made for expenses paid by government credit cards;

- the lack of adequate documentation to support legal aid applicants' claims, resulting in insufficient evidence to confirm entitlement and proper payments as authorized by Parliament; and

- the government body being unable to produce documentation to support the decision of its management board to dispense with competitive tendering for a contract.

Second, the government of Tonga's departments, ministries, and statutory bodies have also identified nonexistent and incomplete documentation and records. For instance, at one department, copies of receipts were lost but the accounting officer and the accounts section did not consider this as serious or contrary to laws and regulations.

Third, as a result of examining documentation maintained to support transactions, the Republic of South Africa's Auditor-General identified and reported to Parliament a substantial number of instances involving payments from the government's Department of Labor where beneficiaries had been paid the same amounts based on the same source documents. In other instances, the same amounts had again been paid in respect to the same source documents, although the beneficiaries' names were not exactly identical. The value of the double or multiple payments was substantial.

To help overcome deficiencies such as these, INTOSAI's internal control standards suggest that documentation of transactions or significant events should be complete and accurate. This should enable each transaction or event (and related information) to be traced from its inception, while it is in process, to after it is completed.

PROMPT AND PROPER RECORDING OF TRANSACTIONS AND EVENTS

INTOSAI's detailed standards also provide that transactions and significant events are to be promptly recorded and properly classified. This applies to the entire process or life cycle of a transaction or event, including (1) the initiation and authorization, (2) all stages while in process, and (3) its final classification in summary records. As with documentation, INTOSAI's members reported on the challenges of meeting this standard as well.

For example, because of lapses in internal control in the system used to pay United States Army personnel, some individuals were paid that should not have been paid because they were no longer in the Army. Further, these improper payments were not detected by the payroll system. In a one-month period that the U.S. General Accounting Office reviewed, it determined that about 2,200 Army soldiers were overpaid. Many of these individuals received unauthorized payments for several months, with total overpayments reaching $7.8 million. The improper payments occurred primarily because U.S. Department of Defense personnel did not comply with established procedures. For instance, field-level finance offices did not always enter soldiers' separations from active duty and other personnel transactions in the payroll system in a timely manner and payroll staff could not provide adequate support for some payments.

The United Kingdom's National Audit Office has also reported instances which it has classified as control weaknesses involving transactions not being promptly and properly recorded. In one instance, procedures were not in place to ensure the prompt and secure handling and recording of cash receipts. For example, the Office identified delays of over two weeks in depositing checks, which increased the risks of misappropriation. In another case, the Office reported financial control weaknesses in purchasing, including failures to record the authorization of transactions such as purchase order, inadequate proof of delivery, and inadequate checking of goods received.

Moreover, in New Zealand, a number of government entities have undergone significant system changes that were not fully tested. This has resulted in instances of untimely processing of transactions and lack of reconciliations; a common control deficiency reported by that country's National Audit Office.

To help prevent situations such as these, INTOSAI's internal control standards recognize that prompt and proper recording of information is essential. Meeting this standard is pivotal for assuring the timeliness and reliability--and thus, the value and relevance to management--of all information used by an organization to support its operations and decisionmaking.

AUTHORIZATION AND EXECUTION OF TRANSACTIONS AND EVENTS

INTOSAI's detailed standards set forth the expectation that transactions and significant events are to be authorized and executed only by persons acting within the scope of their authority. Conforming to the terms of an authorization means that employees execute their assigned duties

in accordance with directives and within the limitations established by management or legislation. But some INTOSAI members have reported instances where stronger controls over the authorization of transactions could have resulted in more effective controls and savings. For instance, in 1992, the Icelandic National Audit Office audited automobile expenses across many sections of the Icelandic government. The audit showed several weaknesses in the overall structure and control in this area, including many contracts that were made with individual employees in an unstructured manner regardless of transportation requirements--thus limiting managerial approval and other controls.

Yet another perspective on this issue was demonstrated by the Comptroller General of the Republic of Costa Rica through an example involving that country's use of State-owned vehicles. An audit detected that, while the use of such vehicles should be properly authorized, they were being used (1) for unauthorized purposes, (2) during non-working hours without authorization, and (3) inappropriately by an official for discretionary purposes.

Based on studies of internal control problems such as these, auditors in China have reported agreement that the concept of internal control must cover control of authorization. They advise that this control is necessary to help ensure that personnel work within the limits of their permitted authority and thus, exert control over business activities at the point at which they are started.

SEPARATION OF DUTIES

As with the other detailed standards, INTOSAI's member countries fully understand the risk of error, waste, or wrongful acts associated with having one person control all key stages of a transaction or event. In this regard, INTOSAI's internal control guidelines direct that key duties and responsibilities in authorizing, processing, recording, and reviewing transactions and events should be separated among individuals. Properly implementing this standard would greatly help to avoid situations like the following episodes reported by INTOSAI members, such as Tonga, which found that separation of duties is a major weakness that is common to departments and ministries of its government.

In more specific examples, the Audit Office in New Zealand has found that risks have arisen as a result of the use of significant numbers of contracting staff in certain government entities. Although the entities may have met their aim of reducing expenditures, there has sometimes been a trade-off in creating a separation of duties risk.

To address these kinds of problems, Japan reports that its control system to prevent accounting errors and fraud incorporates separation of duties, such as those of contract officers and disbursement officers. For example, (1) the Ministry of Finance notifies the disbursement officers of approved disbursement plans, (2) the disbursement officers submit disbursement reports to the Ministry of Finance, (3) the contract officers notify the disbursement officers of contract amounts and contents, and (4) the disbursement officers approve disbursement after checking whether the contract amount is within the budgeted amounts.

However, as the United Kingdom's National Audit Office reports, it is often difficult for small organizations to maintain proper segregation of duties. The Office has found cases where (1) people were able to both authorize and check payments, (2) staff could requisition, authorize, and receive goods, and (3) there was little or no evidence that supervisory checks were done.

In cases where small organizations make adequate separation of duties difficult, INTOSAI's guidelines suggest that management must be aware of the risks and compensate with other controls. For instance, rotation of employees may help ensure that no one person deals with key aspects of transactions or events for an undue length of time.

SUPERVISION

INTOSAI's internal control guidelines prescribe that competent supervision is to be provided to ensure that internal control objectives are achieved. The efforts of INTOSAI members to implement and audit internal controls have underscored the importance of proper supervision of assignments and employees as a fundamental internal control mechanism.

The Comptroller General of the Republic of Costa Rica has provided two excellent case studies involving noncompliance with INTOSAI's supervision standard. The first case relates to a computerized system used by banks that collect Customs revenues for the electronic transmission to Customs offices throughout Costa Rica. Auditors found that the process developed by Customs for confirming, recording, and revising this information allowed for unsupervised modification of electronically transmitted data without any documentary support or verification of its validity and reliability.

The second case relates to an evaluation of the Costa Rican government's resources used to deliver health services--particularly the external consultation service provided by one of the country's largest public hospitals. Auditors reported that medical resources were significantly underutilized because the established work schedule was not complied with, which resulted in the misuse of available equipment and facilities and the absence of timely attention to waiting patients. The underlying cause was attributed to the absence of supervision and subsequent control of work timetables by the heads of medical specialties.

Another country, the Kingdom of Tonga, has also identified supervision, as well lack of training, as an internal control weakness common to most government agencies. The Auditor General has assisted in addressing these weaknesses by starting training programs, identifying supervisors for every level of staff, and stressing the importance of these aspects of internal control systems.

A third INTOSAI member, the National Audit Office of the United Kingdom, has found that adequate supervision is essential in operations such as those related to contracts. It found that monitoring the operation of contracts is key to ensuring that suppliers meet the terms and conditions of the contract for price, standards, and delivery and that the contract remains competitive. The Office found, for instance, that evidence of poor contract monitoring resulted in a final cost of £180,000 on a contract initially worth £25,000 without the required approval for the increase having been made. In another case, a refund was due on a contract but because of poor monitoring, the government was unaware of the potential refund and thus, did not make a claim.

To help ensure proper supervision, INTOSAI's internal control standards state that supervisors are to review and approve, as appropriate, the assigned work of their employees. They must also provide their employees with the necessary guidance and training to help ensure that errors, waste, and wrongful acts are minimized and that specific management directives are understood and achieved.

ACCESS TO AND ACCOUNTABILITY FOR RESOURCES AND RECORDS

The last INTOSAI detailed standard instructs that access to resources and records is to be limited to authorized individuals who are accountable for their custody or use. To ensure accountability, the resources are to be periodically compared with the recorded amounts to determine whether the two agree. The asset's vulnerability should determine the frequency of the comparison. The work of INTOSAI members has demonstrated the effects of failing to effectively implement this standard to reduce the risk of unauthorized use or loss to the government and help achieve management directives.

In one circumstance involving access to records, the United States government's tax collector, the Internal Revenue Service (IRS), has been plagued by poor internal controls over its computer systems. The U.S. General Accounting Office's financial statement audits showed that IRS did not have adequate safeguards to detect or prevent unauthorized employee access to taxpayer information or to prevent employees from changing certain computer programs to make unauthorized transactions without being detected. The fundamental control problems included controls that did not adequately prevent users from unauthorized access to sensitive programs and data files. Also, numerous users had been given authorized access to powerful computer system privileges which could allow existing security controls to be circumvented.

In a situation involving the comparison of resources and records, the Auditor-General for the Republic of South Africa reported finding that the completeness and correctness of the Department of Land Affairs' bank balance could not be confirmed because the Department had not compiled a bank reconciliation for more than 1 year. The difference between the balance according to the Department's accounting records and the bank's statements was great.

INTOSAI's internal control standards point out that restricting access to resources and a periodical reconciliation of records reduces the risk of unauthorized use or loss to the government and helps achieve management directives.

Chapter IV

BUILDING EFFECTIVE INTERNAL CONTROL STRUCTURES

Consistent with INTOSAI's guidelines, member countries have stressed that building effective internal control structures requires the following critical elements: (1) legislative underpinnings, (2) internal control standards, (3) managers who accept primary responsibility for effective controls, (4) periodic internal control self-assessments by managers, (5) internal audits of controls, and (6) a supreme audit organization that is engaged in establishing and reviewing internal control systems.

LEGISLATIVE UNDERPINNINGS

As discussed in the INTOSAI internal control guidelines, in some countries, the legislators will establish the overall objectives that the internal control structures should achieve while leaving the internal control standards to be established to a responsible central organization. In others, the legislators set specific controls for certain operations in legislation.

Indeed, INTOSAI members have found it helpful to have legislation that establishes an overall requirement and objectives for maintaining effective internal controls. For example, in Bolivia and in the Netherlands a legislative foundation for public sector internal control is provided by the 1990 Governmental Management and Control law and the Government Accounts Act, respectively.

In Japan, financial and accounting check and control systems are stipulated in the Public Finance Law and the Public Account Law, as well as regulations based on this law. The financial accounting activities of all the Japanese government's ministries and agencies are governed by these statutory check and control systems.

The United States Congress has also recognized the importance of having legislative underpinning to promote effective internal controls. For instance, it has enacted legislation that requires U.S. government agencies to (1) annually evaluate and report on the status of control systems, (2) have an independent audit function, and (3) annually issue and have audited reports on their financial condition.

INTERNAL CONTROL STANDARDS

INTOSAI's internal control guidance also points out that, in establishing the framework for internal control structures, a specific authority should be assigned the responsibility for developing and promulgating the standards to be followed when designing an internal control structure. This responsibility could be assigned through constitutional or other legal enactment and given to a central organization with authority across various government organizations.

Several INTOSAI member countries have prescribed internal control standards that are to be followed in establishing and monitoring an internal control structure, and some have patterned their standards after, or have adopted, INTOSAI's standards. For instance, the Office of the

Comptroller General of the Republic of Bolivia used INTOSAI's guidelines to prepare and issue

internal control standards for use in that country. The Office reports that the result has contributed to and facilitated the achievement of control objectives. In the United States, under law, the Comptroller General is charged with developing internal control standards for use by agencies of the U.S. government. These were first issued in 1983 as Standards for Internal Controls in the Federal Government to provide the criteria for establishing and evaluating internal controls. These standards are currently being updated.

Another country, the Peoples Republic of China, has also found that a standard is necessary for assessing an organization's internal controls. The National Audit Office reports that the standard is defined by auditors on the basis of the regulations issued by the Chinese government and related departments. The Chinese National Audit Office advises that such a standard--which is usually referred to as an ideal control standard--embodies the control links and procedures essential for a sound internal control system, and it is used by auditors to impartially assess the target organization to determine whether its internal controls are complete and effective.

MANAGEMENT'S RESPONSIBILITY

INTOSAI's guidelines explain at length management's internal control responsibilities, emphasizing that all managers should realize that a strong internal control structure is fundamental to their control of the organization and its purpose, operations, and resources. INTOSAI member countries that provided information for this study have experienced the need for focusing managers' attention on their responsibilities for implementing effective internal controls and continuously maintaining a positive internal control environment.

For example, the Netherlands Court of Audit reports that the framework of responsibility for internal control, which is a cornerstone of central government in the Netherlands, has been developed by means of close cooperation between Parliament, the ministry of Finance, and the Court. Also in this regard, the Government Accounts Act states that it is the minister who is responsible for pursuing sound financial management and for controlling the effectiveness and efficiency of management, organization, and policy.

Another instance involves Iceland, where the Icelandic National Audit Office reports that the management of individual governmental agencies is responsible for developing and implementing internal controls. Also, agencies within the central government--such as the Central Accounting Office, the Financial Reporting Commission and to some degree the Ministry of Finance--are directly responsible for implementation of financial controls.

Another example comes from Egypt. The Egyptian Central Auditing Organization reports that the senior management of an entity is responsible for developing and implementing internal controls such as by continuously reconsidering the organizational structure that has been created to direct and control its activities.

SELF-ASSESSMENTS

INTOSAI member countries concentrate on preventing internal control breakdowns before they occur. To illustrate, South Africa's Supreme Auditor reports that a primary objective is to prevent errors or irregularities from occurring in management or financial information, or if any have occurred to detect them. Also, in Egypt, auditors evaluate internal control systems to identify their efficiency in preventing or detecting major mistakes.

Several INTOSAI member countries require managers to periodically undertake self-evaluations of internal control operations. INTOSAI's guidelines recognize this practice as useful to ensure that controls for which managers are responsible continue to be appropriate and are working as planned.

For New Zealand, emphasis is given to self-review procedures in each individual government entity. These procedures include a program of self-assessment covering internal audit and financial controls, as well as management review and evaluation of output effectiveness.

In another case, agencies of the United States government are required by law to annually conduct control self-assessments. These evaluations are to be made pursuant to guidelines issued centrally by the U.S. Office of Management and Budget. The results are to be reported to the U.S. President and the U.S. Congress. These reports are to state whether systems meet the objectives of internal control and conform to standards established by the U.S. Comptroller General. Also, U.S. government agencies are required to take actions to correct control weaknesses the self-assessments identify.

In addition, the Bolivian Comptroller General's future plans call for governmental institutions to schedule self-evaluations of the design, operation, and effectiveness of their internal control structures. Bolivia's Comptroller General envisions that the highest responsible officials in each public institution would carry out a self-evaluation and at least annually report their conclusions to the Office of the Comptroller General, which would (1) evaluate the process and outcome and (2) determine the reliability of the data generated by the institution and/or proposed corrective measures.

INTERNAL AUDITS

Management often establishes an internal audit unit as part of its internal control and self-review framework. In this tradition, most INTOSAI members find the role of internal auditors to be a critical part of an organization's internal control structure. For example, the Supreme Auditors of both Bolivia and Egypt report that internal auditors should evaluate and periodically report on the effectiveness of and deficiencies in internal control structures and the risk that such weaknesses represent for effective government operations and protecting its assets.

The Netherlands is also typical--the audit departments of the ministries audit the financial statements of their ministries and perform specific financial management systems audits. The Netherlands Court of Audit reports that, by advising the minister on internal control weaknesses found during these audits, the internal auditors play an important role in the ongoing improvement of internal (financial) controls. This is reinforced by the performance of specific internal control investigations done at the request of the ministers.

In the United Kingdom, the Accounting Officers within each central government body, who are responsible for the financial management and internal control systems, are assisted in fulfilling these responsibilities by the services of an internal audit function. Internal audit operates as a service to management by measuring, evaluating, and reporting on the effectiveness of the elements of the internal control system.

SUPREME AUDITOR'S RESPONSIBILITY

INTOSAI members have underscored the key role Supreme Auditors play in (1) establishing internal control standards, (2) creating a solid internal control framework, (3) working with internal auditors, and (4) evaluating internal controls as an integral part of both their financial and performance audits. In sum, the Supreme Audit Institution should gear its work toward assessing the adequacy in principal and the effectiveness in practice of existing internal controls in audited organizations.

One nation's Supreme Audit Institution described its internal control responsibilities this way. Control accomplished by the Comptroller General of the Republic of Costa Rica essentially consists of the financial, accounting, economic, operational, administrative and legal examination of public resources and is basically carried out by means of investigations and audits covering financial, operational, legal, computerized and special areas.

Like the process reported in use by many INTOSAI Supreme Auditors, the Costa Rica's Comptroller General

- evaluates the internal control system in the audited institution, which is comprised of the control environment, the recording and information system, and control proceedings;

- verifies the effectiveness of the internal control system and identifies the critical areas in the activity under examination;

- prepares reports to the administration that summarize detected deficiencies and weaknesses and recommend measures to be adopted for their solution and for the prevention of more severe problems; and

- carries out pertinent follow-up studies to determine whether recommendations and measures, which have been jointly agreed upon with the administration, have been adequately enforced.

CONCLUSIONS

In 1992, when INTOSAI's Internal Control Standards Committee issued its guidelines for internal control standards, it called for Supreme Auditors to encourage and support the establishment of internal controls. As envisioned by the Committee, this would encompass (1) educating management as to its responsibilities for implementing and monitoring the control structures and (2) auditing those structures to assure that controls are adequate to achieve the desired result.

In the intervening 5 years, INTOSAI member countries have achieved a wide range of positive results and are making progress--in some cases, substantial progress--in fulfilling this vision. The individual country papers prepared by Supreme Auditors have provided considerable new insights into the use and assessment of internal controls by various INTOSAI members.

Through these papers, the committee has identified several common elements, which this chapter outlines, that are evident in sound internal control structures in all systems of government. These elements parallel INTOSAI's 1992 guidance, which provides a foundation for supporting the prescribed general and detailed control standards.

However, this foundation is not yet fully in place and working smoothly in all of INTOSAI's member countries. Further, preserving the effectiveness of these elements and refining the adequacy of internal controls based on the standards should be a continuous process. Accordingly, each INTOSAI member can learn from the constructive examples and experiences that Supreme Auditors have shared with the committee.

Their individual country papers, which more extensively discuss the areas presented in this overview, will be available at the XVI INCOSAI in Montevideo. Also, additional information may be obtained by directly contacting the contributing Supreme Audit Institutions at the locations listed in appendix I.

APPENDIX I

CONTRIBUTING SUPREME AUDIT INSTITUTIONS

The following is a list of the names and telephone numbers and the mailing and INTERNET addresses for the Supreme Audit Institutions that have provided the information summarized in this overview document and presented in the related country papers.

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