

ENHANCING THE STAKEHOLDERS' CONFIDENCE: AUDIT MANAGEMENT INTEGRITY, ACCOUNTABILITY AND THE TONE AT THE TOP

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Distinguished colleagues,

Ladies and gentlemen,

I express my gratitude to Mr. Chairman of the Chamber of Control of Georgia, Mr. Lasha Tordia, for his kind invitation to participate in this conference. I am delighted to participate in the celebration of the 20th Anniversary of the Chamber of Control of Georgia. On my behalf and on behalf of the Turkish Court of Accounts, I would like to congratulate the Chamber of Control of Georgia on its anniversary.

PART 1- INTRODUCTION

Transparency and accountability are the two main principles of good governance in public sector and the main responsibility of SAIs is to contribute to the transparency and accountability of the management of public funds. To fulfil this responsibility an SAI should carry out quality audits and produce quality audit reports. This is the only way SAIs can gain and sustain credibility and confidence. Thus, the main and paramount issue for SAIs is to maintain a high level quality in their audit activities and maintain this level so that they can both lead by example and justify their *raison d'être*.

International organisations such as INTOSAI, EUROSAT, ASOSAI and many international and regional working groups have handled this issue of audit quality until now and it is clear that this topic will continue to be discussed in the future due to its importance. As external audit bodies of each country, SAIs need to adhere to quality standards and at the same time auditors should hold the banner of objectivity, independence, professional scepticism and accountability to the public by performing quality audit work. (IFAC Transnational Auditors Committee, 2007:5)

In consideration of the theme, it is worth discussing how an SAI and especially head of an SAI can ensure quality work. What are the means to achieve this goal? When it comes to this question, the answer lies beneath the concept of 'tone at the top'. As stated in one EUROSAT Report, quality within

any organisation is not achieved spontaneously; but requires a specific approach led by management. (EUROSAT Working Group Report, 2010: 33) Management should be aware of the importance of and be committed to achieving the highest quality standards. Of course, there are certain means of achieving the highest quality standards which management can apply. However, before mentioning these means and their relation to each other, it would be useful to discuss the terms of stakeholders' confidence, audit management integrity, accountability and tone at the top and their relevance for an SAI to ensure a common understanding.

PART 2- CONCEPTS

To begin with, it is necessary to mention stakeholder confidence as an overarching term of the whole presentation. SAIs have so many stakeholders: auditees, citizens, civil society organizations and obviously the Parliament as the principal stakeholder. So, stakeholders' confidence for an SAI means the trust of the parliament and public, in general, to the outputs of SAI. It is important that SAIs' work remains relevant, credible and useful to its stakeholders, especially the Parliament. (EUROSAT Working Group Report, 2010: 31) In private sector, a company's ability to build and maintain the confidence of their stakeholders is central to their business. This is also the case for public institutions. Especially, as an institution working on behalf of the parliament and thus public, an SAI's ability to build confidence of their stakeholders is of crucial importance.

Secondly, audit management integrity is another term that needs to be clarified considering its importance in terms of enhancing the confidence of stakeholders. Citizens would like to learn about how public funds are being spent by public institutions and how the institutions are performing. An SAI works as a mediator in this context, auditing the institutions and reporting about their accounts and transactions to the parliament and citizens. Audit management integrity means conducting these audits with competent and independent staff, who adopt a well-established code of conduct and execute the audits in accordance with laws and professional standards. So there are some conditions to meet to ensure audit management integrity: The auditors should be qualified, the code of conduct to be adopted should be clear, the audit procedures should be open and well-defined, the management of the SAI should make sure the monitoring process for assessing the audits and audit reports is in place. Audit management integrity term embraces many elements, which are all related with and leading to audit quality.

Thirdly, accountability is a familiar term for SAIs, but mainly referred in relation to auditees. In most of the countries, SAIs are institutions that are treated as essential for enforcing accountability. For

completing the accountability loop, the SAI should also be accountable to somebody. Accountability of the SAI does not compromise the principle of independence of the SAI. Rather, the two concepts are complementary. Accountability of the SAI reinforces its independence by giving legitimacy to its actions. (Khan, 2007: 11) What is accountability for an SAI? ISSAI 20 deals with this issue. According to the relevant standard; accountability for SAIs stands for their responsibility for planning and conducting the scope of their work and using proper methodologies and standards to ensure that they promote accountability and transparency over public activities, meet their legal mandate and fulfil their responsibilities in a complete and objective manner.(ISSAI 20, 2010: 3) In context of accountability for SAIs; their work processes, activities and products should be transparent and they should communicate openly with their stakeholders.

Finally we come to the concept of 'tone at the top'. Tone at the top is about the leadership responsibilities for ensuring the quality of the products or services institution provides. The term is defined by IFAC as follows:

"The standard set by the organization's leadership whereby performance is measured; the culture within which the members of the organization operate; the tone set by senior management; irrespective of management's documented strategy and policies, it is the force that drives individual professionals; the 'unseen hand' that direct activities regardless of management's proximity to the action; and a commitment to the quality of care clients receive." (IFAC Transnational Auditors Committee, 2007: 8)

Tone at the top is seen by some as a part of and by others as equal to the internal control environment. An example to the first approach defines tone at the top as one element of internal control system, in which the other elements are risk assessment, control activities, information and communication, and monitoring. (Khan, 2007: 7) Managers are responsible for establishing an effective control environment in their organizations. Indeed, the tone managers set through their actions, policies and communications can result in a culture of either positive or lax control. (ISSAI 9210: 1) When considered in the context of this conference and SAIs, the term specifically refers to SAIs' managers' responsibilities to provide accountability by ensuring quality through well-established internal control structure. According to the second approach which sees tone at the top as equal to the internal control environment, elements of tone at the top are grouped into four which are: management, communication, culture and structure. (Bruinsma, Wemmenhove, 2009: 3)

As can be seen clearly, all of the terms that are explained in terms of the theme of the conference are co-related with each other. Actually, it is not possible to think of or handle one without mentioning the other. Therefore, the critical issue is the practical aspect rather than the theory. In other words, it leads to the questions of how an SAI will ensure stakeholders confidence, how will the head of an SAI set the 'tone at the top' to ensure quality audits? With these questions, we come to the second part of my speech in which the means to quality audit are dealt with.

PART 3- MEANS TO QUALITY AUDIT

As SAIs, we are responsible for auditing the public institutions and examining on their accounts, financial statements and internal control structure and making them suggestions in order to contribute to good governance in public sector. But, how about SAIs' own functions and quality of their activities, especially audit? Surely, as an external audit body that leads by example, an SAI should ensure providing quality work. As stated in EUROSAT report, "quality is needed in both the professional work of SAI and its administration" and management of the SAI would be responsible for realization of this aim. (EUROSAT Working Group Report, 2010: 8)

Audit Quality and Tone at the Top

Performing quality audit is a vital issue for SAIs, because it is how SAIs meet accountability principle requirements and ensure stakeholder confidence. Thus, achieving quality audits should be the highest aim of SAIs. In order to realize this aim, heads of SAIs should set the right tone at the top. As stated in IFAC Transnational Auditors Committee Report, culture within a firm, in our case an SAI, is a key driver of audit quality because it has the ability to create an environment where achieving quality in every aspect of the audit process is valued, invested in and rewarded. However, achieving high quality is more compelling for SAIs than other institutions because of the nature of their work: judging the actions of others. (EUROSAT Working Group Report, 2010: 7) That's why maintaining a certain level of quality becomes more and more important for SAIs. The reputation of SAIs is based on the quality of their output. However, quality cannot be achieved spontaneously or randomly. As I have already stated, this is the responsibility of the head of SAI to make sure that audits and audit reports are of high quality.

There are certain means and criteria of achieving good quality audit. At the same time, there are many documents, guides, working group reports and ISSAIs, in which the criteria for quality are set and the ways to meet these criteria are explained for SAIs. Although all of us are already familiar with these criteria, considering the importance of them, I think they are still worth mentioning briefly.

So, what are the conditions for ensuring audit quality, or the question can be rephrased as: what to do to set the right tone at the top?

First of all, leadership should set strategy, acknowledge and communicate to all staff the importance of meeting ethical standards and quality. Management's commitment to quality should be communicated both internally and externally. In addition, management should set the objective of quality management system and define roles and responsibilities.

Secondly, management should make sure that international standards on quality control are adopted in the SAI and establish an appropriate system to comply with them.

Thirdly, management should make sure that competent and qualified staff are recruited and they adhere to ethical and legal requirements.

Finally, management should regularly review and evaluate the implementation of the quality management system.

So, it is obvious that management of an SAI should establish a quality control system and make sure of its well-functioning. Then, what is a system of quality control? ISSAI 40 and ISQC 1 outline the elements of a system of quality control to be:

- Leadership responsibilities for quality within the firm,
- Relevant ethical requirements,
- Acceptance and continuance of client relationships and specific engagements,
- Human resources,
- Engagement performance, and
- Monitoring.

As clearly seen, the first condition 'leadership responsibilities for quality within the firm' is about the tone at the top. ISSAI 40 states that; "An SAI should establish policies and procedures designed to

promote an internal culture recognising that quality is essential in performing all of its work. Such policies and procedures should be set by the Head of the SAI, who retains overall responsibility for the system of quality control” (ISSAI 40, 2010: 5) As the application of this principle, the Head of the SAI should strive to achieve a culture that recognises and rewards high quality work throughout the SAI and ensure that sufficient resources are available to maintain the system of quality control within the SAI. (EUROSAI Working Group Report, 2010: 33)

The other elements of quality control system may seem not directly related with tone at the top but when considered that head of the SAI is responsible for all the activities of the institution, the other elements may also be regarded as linked with the management and thus, tone at the top. Such perspective can be illustrated with the diagram shown here.

GRAPHIC 1: AUDIT QUALITY



Head of the SAI should explicitly state his/her will on audit quality and have a strategy for providing it. This is the first step for setting a right tone at the top. This strategy should include the objectives and the tools and activities that are going to be realized to achieve the objectives. Moreover, the risks to achieving the objectives thus audit quality, should be determined. These risks need to be assessed and actions to mitigate them should be taken. This is how the Head of the SAI should deal with the strategy for managing good quality.

After having the strategy, it is all about implementing it; but for successful implementation the Head of the SAI should make sure that the necessary systems are in place and well-functioning. The main system mentioned here is the quality control system, which is indeed composed of many sub-systems and elements. The Head of the SAI is the one responsible for overseeing that a system is developed and personnel acts in accordance with the requirements of this system. The quality control system is directly related with internal control, or management control, which helps to provide reasonable assurance that the organization:

- adheres to laws, regulations, and management directives;
- promotes orderly, economical, efficient, and effective operations and achieves planned outcomes;
- safeguards resources against fraud, waste, abuse and mismanagement;
- provides quality products and services consistent with the organization's mission and

- develops and maintains reliable financial and management information and fairly discloses that data through timely reporting. (ISSAI 9120: 1)

Another crucial element of tone at the top is communication. Communication should be handled with its two dimensions; firstly, communication as from top to down internally and secondly, communication of SAIs with their external stakeholders. Communication within the SAI from top to down requires the management to deliver their messages explicitly and clearly to ensure a standardized implementation amongst auditors. In addition, messages about quality should stand out above all other messages. In order to realize this, management should inform all personnel about the strategy for quality audit and the tools that are going to be adopted to achieve the strategy. In this way, management or the Head of the SAI can make sure that each employee is aware of the requirements they need to meet in terms of ensuring quality audit. (IFAC Transnational Auditors Committee, 2007: 15) The second dimension of communication is about the external stakeholders, which is more directly related with gaining their confidence. Stakeholders of an SAI, the parliament, auditees, citizens and the media should be well informed about the concepts of integrity, objectivity, independence, professional scepticism and accountability. External stakeholders should be informed about the strategy of the SAI as well, by the Head of the SAI. The importance of the role and responsibility of audit professionals should be communicated externally so as to enhance stakeholders' confidence. In this way, SAIs would both meet the requirements of accountability principle and at the same time ensure audit quality. It should always be kept in mind that 'a quality audit is the result of internal management checks and external review, good communication with the auditee, and rigorous structure and drafting, which lead to clear messages and effective recommendations'. (INTOSAI Capacity Building Committee, 2010: 6)

Human resources issue is another aspect of audit quality that can be managed by tone at the top. When the subject is about ensuring audit quality, it is mostly related with the auditors since they are the ones to execute the work. So, if the Head of the SAI wants audits to be of good quality, he/she should make sure that the staff is competent and qualified so that integrity can be maintained. In addition, the principles of independence, objectivity, impartiality and professional secrecy should be reinforced by the staff. The Head of the SAI should establish an HR management system, which includes job descriptions, code of conduct and staff appraisal. That's how audit management integrity and audit quality can be maintained in terms of human resources aspect.

Ethical requirements are another aspect of tone at the top which is actually interlocked with human resources issue. It is not possible to separate these two concepts but because of the importance of

ethical issues for ensuring audit quality, it is necessary to handle ethics separately. In order to maintain audit management integrity, SAIs should adopt a code of conduct and relevant international ethical requirements. ISSAI 30- Code of Ethics is the fundamental document, which sets the basic ethical principles for SAIs. So, the Head of the SAI should adopt these principles and communicate those to the staff explicitly. It is of crucial importance that the personnel of SAIs comply with ethical requirements because this is how audit management integrity can be guaranteed. In addition, the Head of the SAI should make sure that the SAI and the auditors are independent. The legislation should be adequately and properly established to guarantee the independent functioning of SAIs. As stated in the Mexico Declaration; "Legislation that spells out, in detail, the extent of SAI independence is required". Otherwise, adopting the ethical requirements without having sufficient independence would jeopardize audit management integrity. Good governance includes clearly articulated ethical values, objectives, and strategies; proper tone at the top; and internal control. It should align policies and procedures to encourage behaviour that is consistent with the organization's ethics and integrity values. (The Institute of Internal Auditors, 2006: 3)

After ethical requirements, monitoring aspect of tone at the top comes which is actually related with all the other aspects. Without monitoring or assessment, all the others are meaningless. The Head of SAI should establish a well-functioning monitoring mechanism in order to follow-up the implementation results for strategy, quality control system, communication, human resources and ethical requirements. The results of all activities in these fields should be reported to the Head of the SAI, so that he/she can see the deficiencies or flaws in the system and correct them in a timely manner. Without an assessment system, it would not be possible to understand whether audit quality is maintained or not. Such a monitoring or assessment system may also include external parties commenting on the implementation of the SAI, like peer reviews. For setting the right tone at the top, the Head of the SAI should follow-up the whole system and see the results for himself/herself.

To sum up, tone at the top in an SAI is the responsibility of the management for ensuring audit quality so that the confidence of stakeholders can be enhanced. Management of an SAI sets the right tone at the top by making necessary and adequate arrangements in six aspects which are; strategy, quality control system, communication, human resources, ethical requirements and monitoring. These six aspects, which are interrelated and when combined together as tone at the top, constitute

audit quality. Moving one element away would break the whole structure and put audit quality into risk.

So, until now I have mentioned about the way SAIs should understand the relevant terms and the responsibilities of Head of the SAI to maintain audit quality. Now, I'm moving forward to the last section of my speech in which I will mention the experiences we have on this subject in TCA.

PART 4- TCA EXPERIENCES

The TCA, with 150 years of experience, is now in a process of significant change due to the revision in the TCA Law which aims to improve public financial management and changes the audit methodologies to comply with international audit standards. In the light of this information, it can be said that setting the right tone at the top and ensuring audit management integrity as well as audit quality is of priority importance for the TCA.

First of all, it is worth mentioning one of the most important requirements of audit management integrity: independence. The Turkish Constitution and the TCA Law itself guarantees the independence of the TCA and its auditors. With the safeguard the legislation provides, the TCA functions independently without any political influence. The Article 3 of the TCA Law reads that: "Turkish Court of Accounts shall have functional and institutional independence in carrying out its duties of examination, audit and taking final decision conferred by this Law and other laws". In addition, the Law gives the TCA the authority to make audit reports public. In other words, the TCA is free to publish and disseminate its reports, once they have been formally tabled or delivered to the appropriate authority- as required by law. The article 44 of the TCA Law reads that: "Reports of Turkish Court of Accounts, except for the cases forbidden to be announced by laws, shall be announced to the public by the President of Turkish Court Of Accounts or deputy president assigned by him within fifteen days as of the submission of reports to the TGNA and related public administrations". In addition to these, as another indicator of independence, the TCA has the authority to determine its budget and audit scope. It has the authority to audit the public institutions in its legal mandate every year. However, since this is not technically possible, the TCA determines an audit scope and audit plan every year according to some pre-established criteria like budgetary importance, Parliamentary interest or high risks. This system is one of the means that ensures audit management integrity. Moreover, the TCA has the authority to manage its own budget and allocate it appropriately which is an important indicator for independence and audit management integrity.

The TCA also has a legislative framework that requires and ensures execution of audits within a determined quality control system to ensure audit management integrity and accountability. The TCA Law also regulates the quality control procedures in a general aspect and sets some provisions as to maintain audit quality.

Article 35 reads that:

“... Audit shall be carried out in accordance with the generally accepted auditing standards.

...Turkish Court of Accounts and auditors shall carry out audit activities independently and impartially

...For effective fulfilment of audit function, technical and professional competencies of the personnel of Turkish Court of Accounts shall be developed.

...For maintaining quality assurance, each stage of audit shall be reviewed constantly in terms of its conformity with audit standards, strategic plans, audit programs and professional code of ethics.”

Other than the Article 35, some articles of the TCA Law regulate how the quality control procedures will be applied in a very broad manner. These procedures have been determined in a detailed way in the Audit By-Law and Audit Manual. According to these documents, quality control procedures are grouped into two: hot-review and cold-review.

Hot-review quality procedures are the ones that are performed during the audit. They start from engagement team leader level and lead up hierarchically to the Board of Report Evaluation. One procedure is followed by the other and each of them serves as complementary for the previous one. Cold review procedures, on the other hand, are the ones that are performed after completion of the audits and audit reports and explained in detail in the Audit Manual. Cold-review procedures foresee peer reviews and reviews carried out by a specialised quality assurance unit. The aim of these reviews is to analyse applied audit methodologies and audit reports and to see whether they are in accordance with the legislation and international auditing standards. So, hot-review and cold-review quality control procedures complement each other. First, we implement the quality control procedures during the audit as to make sure audits are conducted in good quality. After the audits are completed, with cold review procedures some kind of a gap analysis is foreseen to be taken to see the differences between our implementations and the international standards, if any. In this way, we aim to improve the audit quality each year.

In recent years, the TCA is working on development of a software program for audit management, which will organize audit work. With the help of this system, auditors will be able to record all their works, tests and findings electronically and the management will be able to keep track of these. This system enables the management to monitor both the audit procedures and quality control procedures. This system also enables the TCA management to take corrective actions when necessary and improve audit quality. In 2012, the TCA has started to use this software program in the execution of audits.

Another good practice example from the TCA is adoption of strategy to develop a communication plan in which both internal and external communication policies will be determined. The importance of communication has already been mentioned. Through these communication policies, the TCA aims at gaining the support and improving the motivation of the staff in terms of application of the quality control procedures already in place. As the Head of the TCA, I pay special attention to deliver the message of importance of audit quality to the staff. I believe that, if the management can make clear the intention and will to adopt quality control standards, the staff will be more eager to implement them. That's why a communication strategy document in which internal communication policies will be determined explicitly plays an important role in ensuring audit quality.

Besides internal communication, external communication is also crucial. Internal communication may help ensuring audit quality but external communication will help communicating the quality outputs to stakeholders and gaining their confidence and ensuring accountability. Then, what the TCA aims to do to improve external communication? As the TCA, we plan to use kind of communication tools as used in private sector in order to increase our publicity for our stakeholders. One tool for external communication is the accountability report that the TCA publishes every year in which TCA's annual activities are indicated. The aim of this report is to account for the public resources the TCA has used for that year by explicitly setting out the activities it carried out. This is one of the ways TCA meets the requirement of 'accountability' principle. Besides the accountability reports that we are obliged to prepare annually, we plan to publish some documents like transparency reports or publicity reports in which TCA's strategies for ensuring audit quality will be stated. Moreover, these reports will include information about the independence of the TCA and auditors, about the audit methodologies and procedures applied and about how audit management integrity has been provided. These reports are planned to be prepared in a more interesting approach which will be attractive and 'to the point'. In this way, the TCA's stakeholders will learn about the procedures and

intentions of management, shortly the 'tone at the top'. Such communication will definitely contribute to enhance their confidence in TCA.

Certainly, TCA's most important stakeholder is the Parliament. So, improving the relations with the Parliament and enhancing the communication between Turkish Grand National Assembly and TCA is a crucial issue. The article 21 of the TCA Law reads that; "The President of Turkish Court of Accounts shall inform the Turkish Grand National Assembly Plan and Budget Committee at least twice a year, and where necessary, the related Committees with regard to the activities of Turkish Court of Accounts". This provision provides a regular communication channel through which TCA can give information to the Parliamentarians about its activities and results.

Another example of good practice from the TCA can be given in the field of strategy. As I have already mentioned, the management should have an explicit strategy for executing audits and producing quality audit reports. This year, we have worked for preparation of the new strategic plan of the TCA for the next five years. Since the TCA Law has been revised by the end of 2010, the new strategic plan proved to be very important to set a new road map for the TCA in accordance with new provisions and new methodologies. Besides, the implementation of new methodologies brought along new risks to audit quality. So, as the management, to make sure that these risks are mitigated we developed an audit plan in addition to the strategic plan, in which the activities are determined in more detail. This plan also includes the activities to be performed in order to mitigate the risks to a minimum level. In addition, in this plan, we have foreseen development of an assessment and monitoring system to make sure that results of implementation are followed up and improved every year. In this way, the management of the TCA will be able to assess the audit quality and take the necessary measures to improve it, or in other words to set the right tone at the top.

CONCLUSION:

In a globalized and rapidly changing world, the importance of SAIs in good governance of public sector rises each and every day. SAIs promote accountability and transparency in public institutions by examining on their accounts and transactions. To make this contribution more valued SAIs should adhere to the principle of accountability themselves and ensure audit quality. If SAIs manage to ensure audit quality, produce quality audit reports and audit management integrity, then their contribution will be valuable and they will ensure enhancing the stakeholders' confidence.

Ensuring the quality of audits is the responsibility of an SAI as a whole but mostly the responsibility of the management or the Head of the SAI. The management is expected to set the right tone at the top

as to discharge this responsibility. Setting the right tone requires ensuring that the right policies are in place for ensuring audit quality. These policies can be classified under six major areas which are: strategy, quality control system, communication, human resources, ethical requirements and monitoring. If the management achieves to place right policies regarding audit quality in all these fields, then it would be possible to say management has set the right tone at the top to ensure audit quality.

If an SAI manages to ensure audit quality and produce quality audit reports then it fulfils the accountability principle and gains the confidence of its stakeholders. As it is seen, this process works like a chain: if you manage to complete one task, you can move on to the other and all tasks are correlated with each other.

Before concluding my remarks, I would like to thank you once again for giving me the opportunity to deliver a speech before such a distinguished community. I would like to conclude my speech with a well-known saying: A chain is only as strong as its weakest link. So here comes the responsibility of the head of an SAI: to strengthen all the chains in the institution to make the structure unbreakable.

Thank you.

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