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LEGALISTIC AI APPROACH IN ANALYZING THE FACTORS AFFECTING TAX ADJUSTMENT OF LEGAL ENTITIES IN THE TAX JUDICIAL SYSTEM (CASE STUDY OF SOUTH KHORASAN TAX AFFAIRS)



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1. INTRODUCTION

The tax collection process in Iran generally begins with the unit finding and the process of reviewing, determining and determining the tax, and finally enters the tax litigation process with the payment or in case of a material objection to the relevant tax, which in the end leads to tax collection. The process of tax litigation and litigation as one of the most important elements of any tax system and part of the recognized rights of taxpayers and at the same time it is necessary to protect the rights of the tax authority (Mousavi & Ebrahimi, 2019).

Timely collection of taxes in Iran is one of the main challenges of the tax system. There are various reasons for the delay in collecting taxes, and without a doubt, the slow speed of the process of resolving tax disputes is one of the main reasons for such delays. (Yavari & Idrisian, 2019).

One of the most important problems of the Iranian tax system is the high volume of cases referred to judicial authorities. From an economic point of view, on the other hand, a major part of the votes issued by tax dispute resolution boards results in adjusting taxpayers' tax revenues (Mousavi & Ebrahimi, 2019).

However, using concepts such as tax avoidance, tax evasion, tax compliance, tax risk, withholding tax disputes, and definitive tax and tax litigation, similar studies can be obtained, which are summarized as follows:

1. Contradiction of accounting standards with tax laws and regulations(X1);
2. Non-compliance with accounting principles and standards(X2);
3. Failure to comply with the quorum of express costs(X3);
4. Lack of connection between the declared expenses(X4);
5. Lack of evidence regarding the costs of expression(X5);
6. Non-observance of the regulations for writing legal offices(X6);
7. Concealment of revenues by taxpayers(X7).

2. MATERIALS AND METHODS

In this study, the factors affecting the adjustment of the diagnostic tax of legal entities in the tax litigation system have been studied through the legal-oriented artificial intelligence approach in order to reduce the tax dispute and timely collection of taxes. In the present study, valid and related Latin and Persian articles and dissertations have been used to explain the theory and literature of the research. Then, the research data has been collected through the databases available in the Tax Affairs Organization of Iran, the headquarters of the comprehensive tax plan and referring to the tax files of taxpayers.

The statistical population of this study includes those legal entities in South Khorasan province that have submitted their performance tax return in one of the years 2012 to 2016 and its tax has been finalized by the end of 2019 in one of the tax dispute resolution authorities. Screening method was used to select the sample.

3. CONCLUSION

In general, the research findings show that there is no significant relationship between tax differences due to "lack of connection between the issue of declared expenses" and "concealment of revenues by taxpayers" and adjustment of diagnostic taxes in the tax litigation system. But there is a significant relationship for other variables. Accordingly, tax disputes arising from the above two factors by taxpayers in the tax litigation system will not to a large extent cause the adjustment of the tax assessment and is often done with the aim of tax evasion by taxpayers.

Also, the research findings show that tax differences are due to the variables of "non-compliance with the rules of writing of legal offices", "lack of evidence regarding reporting costs", "inconsistency of accounting standards with tax laws and regulations", "non-compliance with principles and accounting standards" and "non-compliance with the quorum of declared costs", more than other variables, cause the adjustment of diagnostic taxes in the tax court system.

Accordingly, the filing of tax disputes due to "non-compliance with the rules of writing of legal offices" and "lack of evidence regarding the costs of expression" by taxpayers in the tax procedure to a large extent will lead to adjustment of diagnostic tax.

Therefore, in order to optimally address the tax issue and early certainty and timely receipt, it is recommended that the tax administration first conduct the necessary research and investigations, and if it is not possible to extract tax evidence from the books and documents, by visiting the workplace or Production and, if necessary, to third parties and conduct sufficient research to determine the appropriate counterpart or evidence, and then according to the status and subject of the activity of the counterpart or the evidence and their number with sufficient justification in tax assessment and even possible to avoid tax assessment implicitly.

In this regard, tax processes should be redesigned in such a way that the proceedings are based on accurate and transparent information and lead to a reduction in revenues of the tax court system. This can be achieved through the transparency and simplification of tax laws, the promotion of tax culture, the design of a comprehensive tax information network and the provision of strong enforcement guarantees.

In addition, the research findings show that the tax disputes caused by "inconsistencies in accounting standards and tax rules and regulations" in the tax litigation system by taxpayers can to some extent lead to the adjustment of diagnostic taxes.

AUDIT OF INCREASING GOVERNMENT ACCOUNTABILITY ON ENVIRONMENTAL ISSUES

Introduction

General consensus is achieved on the issue that private sector by itself is incapable of protecting the environment from the negative environmental consequences of economic activities. Therefore, the government on behalf of its people is basically considered the main responsible body for protecting the environment as a kind of public asset. In the fourth chapter of the Constitution of Islamic Republic of Iran, entitled "Economy and Financial affairs", through the two articles 45 – 50, the legislative directly deals with this issue

Executive Bodies and Accountability to SAC of Iran

The role of SAC of Iran in increasing governmental accountability in the field of environment:

- **Preparation and Compilation of Upstream Legal Documents**

Before 2015 environmental auditing had no place in the country's upstream documents.

- **Pathology of Environmental laws and Regulations and also Comments on environmental bills.**

Establishing transparent and unambiguous laws in the field of environment is one of the components of good governance and paving the way for accountability and responsibility.

- **Determining Environmental Audit Reports and Distributing Audit Reports to Stakeholders;**

By conducting its continuous audits, especially environmental audits, SAC plays a significant role in creating accountability and trust between the government and citizens regarding the development of the country's policies, including environmental policies.

- **Establishment of a Committee on Environmental Audit and Sustainable Development in SAC**

Environmental audit is highly regarded with the aim of ensuring the adaptation and implementation of appropriate and sufficient processes and policies to achieve sustainable development, as well as to increase the government's accountability for its decisions and measurements on environmental issues.



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- **Compilation of Books, Articles, and Instructions**

In order to increase systematization and transparency in SAC mechanisms and to raise awareness of the auditees, SAC has translated and localized many of INTOSAI standards, including the standard (ISSAI 20) Principles of Transparency and Accountability; (ISSAI 5110) Essential Elements of Environmental Audits, etc. and uploaded them on its website.

- **Holding Environmental Audit Courses in Executive Bodies**

With the aim of increasing the level of awareness in the executive bodies as well as their familiarity with environmental duties and also auditing approaches, SAC- after assessment of their educational needs and according to environmental problems revealed in different regions of the country – holds training courses to prevent violations and make them accountable.

Conclusion

By preparing reports and presenting them to its stakeholders, SAC creates a free flow of information and a transparent atmosphere. This transparency is primarily preventing misuse of the rules by pathology and eliminating ambiguous spaces, and in the second step, the preventive measures of SAC help to institutionalize environmental laws, regulations and standards and stop the occurrence of environmental violations.

AUDIT OF COVID-19

EXPENDITURE – SAI PAKISTAN EXPERIENCE

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INTRODUCTION

The outbreak of COVID-19 pandemic and its persistent waves disturbed the political, social, economic and financial structures of the whole world. The global crisis caused by COVID-19 increased the role and responsibilities of the national governments and they were compelled to respond to the pandemic by taking a wide range of emergency measures and initiatives involving key policy interventions and huge spending to control the pandemic. During time of emergencies there is a risk of weak internal controls and possibility of bypassing of rules and regulations, which increase the responsibility of the Supreme Audit Institution (SAI) to properly audit the expenditure incurred by the entities dealing with emergency.

Spending during emergency situations poses extra challenges to the public sector auditing around the world including increased reliance on digital mediums for auditing due to social distance and lockdown requirements. Experience from previous disaster audits also indicate the extraordinary risk which emanates from such rapid emergency expenditure responses due to hasty procurements and mismanagement etc. at a time when governmental agencies are comparatively less vigilant and preventive internal controls are relaxed.

Like all other countries, in Pakistan also the COVID-19 challenged the country's economy ever since the identification of first case in February 2020. The pandemic led to urgent actions on part of the government as well as huge spending by the concerned agencies on purchase of emergency medical equipment / supplies and establishment of isolation and quarantine centers etc. This in turn necessitated the need for a comprehensive audit of the governmental operations to ensure transparency and accountability.

The Department of the Auditor General of Pakistan (DAGP) being Supreme Audit Institution of the country responded to this challenge on a timely basis and decided to carry out audit of COVID expenditure at federal and provincial government levels. The objective of the audit activity was to ensure accountability and transparency in spending related to COVID-19, besides assisting the government in effective decision making during the pandemic.

RISK ASSESSMENT

During Covid-19 pandemic the public finance management systems were put to test. Experience shows that these circumstances create opportunities for bypassing of rules, procedures and at times the standards of ethics, which could seriously weaken the effectiveness of governmental initiatives. The Auditor General of Pakistan undertook a comprehensive, multifaceted and risk-based audit of the organizations involved in managing relief activities and implementation of assistance packages.

Extensive desk audit was carried out before execution of field audit activity. The staff from all tiers participated to execute the assignments. Risk based audit approach was used to identify the shortcomings in the process of relief efforts while taking into account the peculiar circumstances. The specific risks identified by DAGP in respect of audit of COVID-19 spending are detailed as under:

- By-passing the requirements of the applicable accounting standards in the light of the circumstances (emergency procedures, large volumes of public expenditure during or after the emergency).
- Weakening of internal control systems and routines, such as approval procedures.
- Audit trail not properly maintained.
- Material misstatement due to uncertainty and unpredictability.
- Non-existent assets and payments to non-available workers.
- Weak banking systems and controls.
- Lack of proper budgeting, oversight and accounting of epidemic-related funding provided by international development agencies aid.
- Gaps and/or duplications in funding between executive units engaged in similar activities.
- Non-reconciliation of funds.
- Non-reporting and distribution of in-kind donation such as masks and ventilators.
- Weak warehouse management.
- Issues in Distribution of relief items.
- Unnecessary procurement without proper need assessment.

OBJECTIVES OF AUDIT

Broadly, the audit objective included:

- To examine the process of procurement and contract management and comment upon its administration and adequacy.
- To ascertain whether public funds and material goods, procured or received as donations were utilized for their intended purposes and in accordance with applicable public financial management rules and regulations.
- To check the availability of funds, efficient expenditure on purchase of related items, storage of procured items, distribution of the procured items and their availability to the front-line departments and organizations in a timely and efficient manner.

SCOPE OF AUDIT

The following areas were highlighted for undertaking the audit activity:

- Auditing procurement processes in view of economy and efficiency.
- Contract management.
- Auditing disbursement of cash to vulnerable families and daily wage workers in view of transparency and timelines.
- Auditing level of preparedness of organizations involved in disaster management and issues pertaining to storage, distribution and monitoring of electro medical equipment and medicine.
- Auditing of provision of subsidy to the vulnerable segments of the society in view of timeliness and effectiveness.
- Funds and Grants Management
- Stores and warehouse Management

AUDIT METHODOLOGY

A well thought out and comprehensive methodology was evolved to conduct the audit of COVID-19 spending. The salient features of the methodology adopted are as under:

- Application of desk audit techniques which included examining of data related to COVID-19 obtained from different sources along with policies and rules followed by entities.
- Desk review of systems, procedures, environment of entities to identify the high risk areas for detailed scrutiny.

- Development of comprehensive audit questions on different aspects on the basis of identified risks and red flags identified/ audit check-list developed based on international and local experiences in emergency response.
- Tracking of funds on the basis of different aspects of government intervention such as prevention, curative, relief and rehabilitation.
- Conducting Audit by using mixed techniques of regulatory, compliance and performance audit methodology.
- Coordination with different departments, Accountant General Offices and Field Audit Offices during the course of audit for collecting relevant data.
- Keeping in view the restricted movement of the audit teams across the entities to collect data due to COVID-19 threat, it was decided to obtain the data through SAP system besides, obtaining vouchers from concerned Accountant General Offices and District Accounts Offices to smoothly carry out the audit.

TERMS OF REFERENCE (TORs)

Before carrying out the audit of COVID-19 spending, an exercise was carried out to frame pertinent questions and ToRs for the audit activity detailed as under:

- To analyze the organizational objectives, policies, strategies and operational framework with respect to COVID-19 pandemic.
- To assess the demand generation and criteria set for making projections to purchase emergency medical supplies and equipment.
- To check the issues related to need assessment by the procuring agencies.
- What was approved / ratified by Economic Coordination Committee (ECC) and Cabinet for COVID-19 emergency response?
- What was released by Finance Division and to whom?
- Details of the expenditure incurred on medical supplies/equipment and their distribution.
- To check whether the equipment procured and donations (local & foreign) received in kind like ventilators, masks, PPEs, sanitizer, medical store etc. are properly recorded and distributed to the end user in accordance with need assessment criteria. Further, the detail, regarding present existence/ availability, utilization and performance of equipment distributed, may also be obtained and assessed. The audit teams will test check on a sample basis the distribution of the selected items to the end user entity.
- To asses that quarantine facilities built or upgraded have been done with due regard to propriety in emergency situation
- To detect violations of internal controls and misuse of public resources, if any.
- Expenditure was incurred with due regard to the law, economy and efficiency, and were supported by sufficient appropriate documentary evidence?

- Whether the goods and services procured were done in accordance with the rules and regulations?
- Whether the fixed assets procured, donated or inherited were in existence and properly managed?
- The PPEs and other related materials have been distributed in the prescribed manner at quarantine centers and hospitals.
- Comparison of similar items procurements by different agencies.
- To check the composition of technical procurement committees to ascertain the quality of procurement.
- To ascertain the capacity of entities regarding storage of perishable and non-perishable items. Further, proper stock taking and inventory maintenance may also be checked.
- To evaluate the criteria for transfer of funds/ medical equipment's to different public sector health institutions and provincial governments.
- Assess the policies and plans for inter-agency coordination.
- To look for the accounting procedures and SOPs for incurring expenditure related to Covid-19.
- To assess the contingency plan actions and its implementation for the workforce to work remotely without compromising on the quality and scope of work.
- To examine accounting procedures and reconciliation of funds with Accountant General's and DAO's concerned.

IDENTIFICATION OF STAKEHOLDERS

The department also properly identified relevant stakeholders directly or indirectly involved in Government efforts in dealing with Covid-19 pandemic. The same was important so as to take a broader perspective of the audit activity and include all relevant agencies in the exercise. The following stakeholders were identified:

- b. Citizens of Pakistan
- c. Ministry of Finance, Revenue and Economic Affairs
- d. Ministry of National Health Services, Regulations and Coordination
- e. Ministry of Defense
- f. Ministry of Energy
- g. Ministry of Commerce and Textile
- h. Ministry of Climate Change
- i. Benazir Income Support Program

- j. Utility Stores Corporation
- k. Auditor General of Pakistan
- l. Federal Board of Revenue
- m. Donor Agencies
- n. Banks
- o. Provincial Disaster Management Authorities
- p. Provincial Health Departments
- q. Districts Administration as District Disaster Management Authorities

FIELD AUDIT ACTIVITY

Planning for the Covid-19 audit commenced in April 2020. Initially some time was spent to understand various initiatives being undertaken and the funds allocated in order to determine the scope of the audit.

Fieldwork started in July 2020. Audit teams met numerous challenges as a result of the limitations created by lockdowns. While observing Government instructions during lock downs, auditee organizations were working with minimal strength due to Covid-19, thereby affecting the flow of information and record between auditees and auditors. Many of the officials were also on the frontline of the fight against the virus, and got infected by Covid-19 which made it difficult for them to support and provide information to audit authorities. Access to documents, systems and officials was limited, which made it difficult to gather information and collect evidence.

Despite these challenges, DAGP was able to examine the controls, transactions, payments and procurement processes in the auditee organizations. The effective desk audit, use of ACL and use of smart phones helped audit teams to collect evidences in a timely manner. The INTOSAI Development Initiative (IDI) guidelines (Covid-19 implications for SAI strategic management), along with matrix (3i COVID-19 Response Actions) proved very helpful.

REPORTING OF AUDIT FINDINGS

The DAGP prepared one consolidated report on the expenditure incurred by the federal government and similar reports were compiled in respect of all provincial governments. The reports were submitted to the concerned quarters and were laid before the respective forums and subsequently taken up for discussion in the Public Accounts Committee.

STRATEGIZING AUDIT IMPACT: GETTING RECOMMENDATIONS IMPLEMENTED

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Governance, service delivery, accountability and audit are integrated and intertwined concepts. Governance requires effective service delivery and is impacted by the accountability and audit regimes which are expected to serve as push factors for good governance and seamless service delivery. Audit in the public sector serves as a specific accountability tool that follows up on the utilization of public money on periodic basis. It is part and parcel of the budgetary cycle. Audit reports are meant to give assurance to the stakeholders that budgetary resources have been spent as intended. These also highlight specific cases where the actual conditions fell short of applicable criteria affecting the governance and service delivery, directly or indirectly. Audits are expected to be standardized, efficient and effective. An effective audit, from the audit practitioners view point or internal stakeholders, is usually the one that has achieved its general as well as specific objectives. Audit objectives are a function of audit types and vary depending upon the type of audit undertaken. In the public sector, financial, compliance and performance are the arch audit types.¹These are well established audit brands with marked characteristics, clear and specific objectives, although the occasional over-lapping cannot be ruled out, rather is always expected. These specific audit types, with their specific objectives, may well be of little significance to the external stakeholders. At best, these may be of secondary import to them as their primary interest lies in what happens 'after audit' and 'consequent upon audit'. This may be in sharp contrast with audit focusing on what was found 'during audit'. For instance, audit may say that 'during audit, in Year-A, excess payment of public money was observed which needs to be recovered and systems put in place to avoid its recurrence in future'. This seems fair enough but the stakeholders may like to know as to what happened afterwards and whether the over-spent public money actually found a place back in the exchequer or not and what systems were established by those responsible to avoid its recurrence in future. Is this assurance being provided to them? The problem is aggravated when similar observations find room in the audit reports of Year-B and Year-C and so on. The stakeholders may assume that perhaps audit was ineffective as the client did not listen to it otherwise there cannot be any plausible explanation of the repetition of the previous issues. This however may not be a valid conclusion and audit, on its part, may point out the lack of whip force or the non-existence of a punitive regime that could possibly compel the client pay heed to audit. The truth is what happens 'after audit' depends

¹INTOSAI Development Initiative, *Reimagining SAI Audit Impact A reflection paper*, <https://idi.no/elibrary/relevant-sais/fai/1439-idi-reimagining-sai-audit-impact/file>(accessed 22.2.2022)

upon many factors and is not the exclusive domain of audit. Several factors come into play to ensure that the excess payment pointed out by audit is reversed and systems actually built or

existing ones strengthened to avoid it in future. These factors may include the management's attitude towards audit (e.g. the seriousness with which the client management takes audit findings and recommendations, their overall positive or negative view of audit as a corrective tool and a collaborative partner), the disincentives to the client organization if audit is not heard (e.g. the linkage of future budgetary provisions to the correction of errors and implementation of recommendations), and above all, the overall demand for transparency and accountability in the system. Having said that, it is imperative that audit, as a state institution with responsibilities towards state and society, makes an attempt to go beyond the technical labyrinths of the types of audits and instead focuses on the outcome, results and impact of audit services. This would make sense. Consider. An agriculture research organization may innovate hundreds of different seed varieties and place these at the disposal of farmers, but it will be of little value to the farmers if these do not lead to better yield and usher in prosperity for them. Audit rightly focuses on inputs (e.g., nature and type of audit selected, human-financial-time and logistics deployed, the qualitative checks involved in the audit process) as well as on outputs (e.g., number of initial and final reports produced). However, the spotlight ought to be on actual outcomes, results and impact. This change in focus would entail introspection pondering over some basic questions. Why audit? Why perform audit of X? Why audit of X every year? What is the broader level of utility for the state and the society for audit of X? Why do we have various types of audits? Is audit impact a function of particular audit type? Is some audit type (e.g.

performance audit) better than or more effective or always more effective than other types (e.g., compliance audit)? How can audit deliver on its implicit and explicit promises? Where do we have equilibrium in the demand and supply of audit products? What was wrong in the entity before audit and how did audit make a difference? Was this change noticeable and lasting? How to judge and evaluate the difference? What is it that the stakeholders have actually gained from audit of X? Would they have been better off had there been no audit? These are some deceptively simple questions that we need to understand, discuss, deliberate and possibly answer. Asking the right questions has its own merits irrespective of the possibility of arriving at the right answers or any answers at all for that matter.

It is expected of SAIs to demonstrate their relevance to the stakeholders on an on-going basis. They are required to evaluate the changes resulting from their audit activities.²This is called audit impact and is of three kinds: (a) conceptual impact which indicates the changes in learning processes, mentality and behavior of the auditee or society (b) strategic impact i.e. the use of

²INTOSAI, *INTOSAI-P 12- The Value and Benefits of SAIs – making a difference to the lives of citizens, 2019* https://www.intosai.org/fileadmin/downloads/documents/open_access/INT_P_11_to_P_99/INTOSAI_P_12/INTOSAI_P_12_en_2019.pdf (accessed 22.2.2022)

audit reports by stakeholders in political or public debates and (c) instrumental impact which is the direct impact that results through the implementation of audit recommendations.³ Let us elaborate on the last one. In all audits, firstly, some errors and/or irregularities or deviations from the prescribed path are pointed out, and secondly, a number of general and specific recommendations are offered not only to correct the current deviation but also to provide guidelines for the future. In view of the former, we may assess the monetary audit impact by estimating the savings or additional revenues on the audited organization or on society.⁴ One convenient method, albeit somewhat primitive, to do this involves drawing a comparison between what monetary resources audit got from the exchequer (audit budget or cost) and what it paid back to it (benefits from audit). This is done on the premise that had audit not been conducted, these monetary resources, which belonged to the public exchequer in the first place could possibly never have found a place back there. This is audit impact that these are finally in the exchequer. This method may be called 'Hard Cash Recovery Method' (HCRM) and it compares audit budget with the hard cash deposited in the exchequer as the direct result of audit or 'at the instance of audit' as goes the jargon in Pakistan. 'Other things remaining the same', if baseline audit budget-to-audit benefit ratio was 1:5 and subsequently it is observed shifting upwards, it would denote the positivity of audit impact, and vice versa. However, there are many ifs and buts in using this approach to assess audit impact as the 'other things normally do not remain the same'. Besides, evaluating audit result and impact purely in monetary terms may well be superficial, misleading and detrimental to the real impact that might actually have been made by audit. However, assessing this real qualitative impact may be a Herculean task as it is a realm of endless speculation and philosophical projection. What might have been, had there been no audit, is an abstraction and a perpetual possibility, to borrow from T.S. Eliot. The HCRM approach when showing minimum audit input cost to consistent increase in audit benefits, may be very tempting and consoling in the short run but strategically it may be an indicator of sub-optimal governance regimes where audit is operating in isolation of client departments who prefer to remain non-committed to audit recommendations and thus indirectly provide a field day to audit in churning out reports- a classic win-lose situation. It in fact has the characteristics of a vicious cycle. Consider. Year-1: Audit points out less deduction of income tax and hence loss of X amount to the exchequer. Management accepts. The process is initiated and the less deducted amount finally lands in the exchequer. Audit is happy. Monetary audit impact for the time being is crystal clear. The problem arises when in Year-2 there are again the instances of less or non-deduction of income tax and this cycle goes on and on. This affects audit efficiency and leaves the stakeholders wondering about the actual impact of audit. It makes sense then to move somewhat away from the HCRM model to a more holistic one reviewing the strategic importance assigned

³ EUROSAI, *Followup of the implementation of audit recommendations: Best practices guide, issued by the project group, 2021*, <https://www.eurosai.org/en/databases/products/Followup-of-the-implementation-of-audit-recommendations-Best-practices-guide-issued-by-the-project-group-00001/> (accessed 22.2.2022)

⁴ Ibid, page-5

to audit recommendations by the client. It has been pointed out that “even when an audit report is published, key follow-up from the legislature or executive may be lacking.”⁵In fact, the executive response to audit findings has recently been highlighted as the weakest area within the audit and oversight ecosystem.⁶To be fair, all the blame cannot be placed on the client for non-implementation of recommendations as “SAI audit impact is a shared responsibility.”⁷SAIs may be lacking a formal follow-up system to track the implementation of recommendations or may be operating with a sketchy and ineffective one. Globally, some 65% of SAIs have reported to have in place a follow-up system for monitoring the implementation of observations and recommendations.⁸There are some specific risks surrounding the implementation of recommendations. Audit may have developed the tendency to make general recommendations (e.g., strengthen internal controls within the department) and management may not consider these worthwhile and conveniently allow these to be ignored. Audit may come up with quite specific recommendations (e.g., implement separation of duties in the procurement function from the next procurement cycle) and the management may consider these unrealistic having been made in disregard to the human and financial resources available with the entity. At times, not being sure of how much time the implementation of recommendations would take, audit may give an indefinite time-frame (by not giving any time frame at all) and then lose track of it and hence management may exploit this vagueness. Sometimes, intrinsically, ‘auditors are not convinced that their recommendations are of the highest quality and if acted upon will bring about the desired improvements’, if this is the case then it is unlikely that they will ‘devote the extra effort needed to get the recommendations implemented’.⁹It is important for audit not to exhibit any signs of rigidity regarding the practicability of their recommendations as these “could be much more difficult to implement than originally expected.”¹⁰ However once decided that the recommendations will be implemented then audit should establish a formal system of follow up to check the implementation status or to check the achievement or otherwise of the agreed milestones. If auditors are (seen to be) not “determined in the tracking of the implementation

⁵International Budget Partnership, *Open Budget Survey 2019* (7th Edition), [2019 Report EN.pdf \(internationalbudget.org\)](#), page-63, 2019(accessed 17.2.2022)

⁶IDI/IBP, *All hands-on deck: Harnessing accountability through external public audits*, 2020, <https://internationalbudget.org/wp-content/uploads/ibp-idi-harnessing-accountability-november-2020.pdf>(accessed 23.2.2022)

⁷INTOSAI Development Initiative, *Reimagining SAI Audit Impact A reflection paper*, <https://idi.no/elibrary/relevant-sais/fai/1439-idi-reimagining-sai-audit-impact/file>(accessed 23.2.2022)

⁸INTOSAI Development Initiative, *Global SAI Stocktaking Report 2020*, (P-16), <https://www.idi.no/elibrary/global-sai-stocktaking-reports-and-research/2020-global-sai-stocktaking/1364-idi-global-sai-stocktaking-report-2020/file>, IDI’s Global SAI Stocktaking Report 2020, [file \(idi.no\)](#). (accessed 13.2.2022)

⁹Wadesango, N., Chinamasa, T., Mhaka, C., &Wadesango V.O. (2017). *Challenges faced by management in implementing audit recommendations: A literature review. Risk Governance and Control: Financial Markets & Institutions*, 7(4), 51-61. <http://doi.org/10.22495/rgc7i4art6>(accessed 10.2.2022)

¹⁰Department of Auditor General of Pakistan, *Financial Audit Manual*, <https://agp.gov.pk/SiteImage/Misc/files/Chapter%2014%20070804.pdf>(accessed 23.2.2022)

status, reasserting the need for action or reevaluating ways to get recommendations done then the whole recommendation process becomes irrelevant".¹¹

Conclusion

Audit seeks a visible change in the audited organizations. Using various types of audits, it makes sure that public money is respected and protected. All material errors, significant irregularities, sub-optimal service delivery issues are pointed out and followed up till these are resolved. The state of affairs in the audited entity before and after audit should serve as the litmus test for audit to be labelled effective and for audited organizations to have any claims on good governance. On its part, audit is expected to allocate adequate resources and establish a robust monitoring system that guarantees following up each and every recommendation in a consistent and predictable manner. For audit recommendations to carry weight, these should be carefully worded, meticulously contemplated and discussed with the management with an open mind. The recommendations must stress upon 'what' is expected, and in what 'time frame' leaving the 'how' part to the management. This strategy would 'let the managers manage'¹² and will shield audit from any future conflict of interest when auditing the implementation of recommendations.¹³

¹¹Wadesango, N., Chinamasa, T., Mhaka, C., &Wadesango V.O. (2017). Challenges faced by management in implementing audit recommendations: A literature review. *Risk Governance and Control: Financial Markets &Institutions*, 7(4), 51-61. <http://doi.org/10.22495/rgc7i4art6>(accessed 10.2.2022)

¹²Department of Auditor General of Pakistan, Financial Audit Manual, [https://agp.gov.pk/SiteImage/Misc/files/Chapter%207%20070804%20\(1\).pdf](https://agp.gov.pk/SiteImage/Misc/files/Chapter%207%20070804%20(1).pdf) (accessed 15.2.2022)

¹³ The ambitious readers are referred to '*Facilitating Audit Impact Strategy 2021-2023*' issued by the INTOSAI Development Initiative (<https://www.idi.no/work-streams/relevant-sais/fai>).



REFORMING PUBLIC SECTOR PAYMENT MECHANISM

Hasan Masud (Director General SAI Pakistan)

At the heart of reforming public sector lies the transformation effort needed to implement digital technologies. The government agencies have much to gain from adoption of ERP software. The responsive workflows and data centralization that these systems provide transform archaic infrastructure and improve the citizen experience. transformation a new buzz word is ‘an umbrella term that has come to refer to a variety of types of IT projects, including:

- IT modernization
- Digital optimization
- Creating new digital business models’

Pakistan Audit and Accounts Service has been spearheading reforms in the field of Information Technology. A case in point in this regard is Project for Improvement of Accounting and Auditing (PIFRA) under which centralized ERP based accounting framework was established. This reform over the years has firmed up within the department. However, the need to expand and link it with public sector entities in Pakistan is essential to bring about a transformational change in the payment systems in the public sector.

I. Understanding the Context

Pakistan has a centralized accounting arrangements system under the Office of the Controller General of Accounts. The Field Accounting Offices of CGA organization are responsible for pre-auditing, payment claim processing and accounting of the federal, provincial and district government. These services are provided through a network of accounting offices powered by Financial Accounting and Budgeting (FABS) set up across the country. These offices include Accountant General Pakistan Revenues (AGPR) – for federal budget, Accountant General (AG) offices - for provincial budget, and District Account Offices – for federal, provincial and district budgets at the district level.

The line ministries have historically submitted their manual payment requests, along with the supporting documents, with the respective accounting offices for payments. Although the accounting offices process these requests to issue system-generated cheques, the submission of claims by the line ministries remains manual. The payment claims are submitted manually, along-with paper based vouchers to meet regulatory requirements.

In addition, all public sector claims are not submitted to the accounting offices in the form of vouched claims. In many cases the government has given development schemes cheque books under the assignment account mechanism. These entities submit monthly payment schedule to

accounting office for manual entry in the system. There are also self-accounting entities which process payment claims outside the CGA system and submit accounts with CGA organization manually.

II. Developing relevant digital solutions

An important milestone in this regard has been the development of in-house solution for online submission of claims by line ministries at the federal level. Under this solution line ministries would submit their claims through a web link instead of visiting and submitting physical bills at the AGPR, the federal payment office. The line ministries would send the scanned version of claims supported by necessary documents and shared as an attachment through the system.

Thus, the accounting office would receive claims online and process these online as well. Line ministries would also be provided with online reports to view the status of their claims. Rejection reasons of the claims would also be recorded in the system and reported to line ministries for resubmitting bills after making required changes. It is important to note that these rejection reasons would be based on the Pre-Audit Checklist developed by the office of the Auditor General of Pakistan.

III. Focusing on a digital solution

Working on a standardized and simplified digital (online billing) solution is expected to bring transparency in processes, ease of doing day-to-day business and facilitate reporting. All these changes are at the core of good governance.

Under the digital claim submission mechanism, bills would be submitted by line ministries electronically. Line ministries would scan and attach original invoices, sanction letters and other supporting documentation. During submission of bills, the system should perform following checks and processes on a real time basis:

- i. Budget and release availability check for incurring expenditure
- ii. Authentication of information of DDOs, Vendors, Detailed Objects inserted with system
- iii. Generate electronic token numbers for bills submitted
- iv. Display a list, of the rejection reasons on bills, to DDOs

The claims submitted would be retrieved by dealing officials at the accounting office through the web link/portal. The claims process would be processed using ERP system and would either be processed for payments or rejected on basis of pre-audit checklist preformatted in the online billing solution.

IV. Implementation and the Way Forward

Following factors may be kept in view while implementing digital solutions across the various levels of the government:

- (i) A national level change to digitize payment mechanism completely requires a project environment.
- (ii) The relevant regulations have to be adapted to provide legal cover for digital processing of claims.
- (iii) There is an urgent need to clarify the roles of Accounting Offices, line ministries management and CFAOs posted in these line ministries.
- (iv) The provincial governments must be taken on board to deepen this reform effort at the national level.
- (v) The issues of centralizing the accounting of assignment account holders and self-accounting entities would have to be kept in view while bringing about policy shifts.
- (vi) The contracting arrangement and licensing arrangement for the digitizing payment landscape would require financial resources over and above the existing allocation and HR placement throughout the country. This could best be served under a project environment.

A recent study on digital transformation in Pakistan noted that this journey requires ‘structural changes and a coordinated effort by government entities.’ This is a long term initiative needing capital investment in technology, human resources and sustained policy effort. The dividends, however, would be manifold resulting in a ‘citizen centric’ government ‘built for the digital era’.

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STRATEGIZING THE FORENSIC AUDITING IN THE PUBLIC SECTOR OF PAKISTAN

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The most important objective of auditing is to get straightforwardness and transparency in both the corporate and public domain. As indicated by the International Federation of Accountants (IFAC), an audit is a free examination of a substance where the auditor conveys unprejudiced outcomes about the assignment of assets by the hidden association. One part of the public audit is legal inspection which has acquired gigantic significance, keeping in view the general social and monetary weaknesses in public sector of Pakistan. Forensic auditing and reviewing is a science dealing with the utilization of accounting real factors and thoughts collected through examining systems, strategies, and methods to decide legal issues. This requires the combination of logic, accounting, and assessing capacities.

According to the Global Enterprise Survey conducted in 2015 by The World Bank, approximately 30 percent of the fraudulent practices in Pakistan pertained to the financial transactions and instances of bribery which speaks volumes about the need to strengthen the mechanism for state-of-the-art forensic audit techniques. For the sake of contextual analysis, fraudulent activities in the public sector mean the manipulation in tendering process, creation of artificial pricing pools, leakage of confidential financial information, and nepotism in the public sector accounting.

Keeping up with the top notch of forensic audit, investigation is vital on the grounds that it assists with limiting the organization issue in the public area. An organization issue emerges when the interests of ministries do not match the interest of general society and government. Additionally, it has likewise been found that the functioning conditions in state-claimed divisions are not agreeable for the workers. Auditors' morals to report legal review discoveries, dynamic whistle blowing, and monetary impact of auditee, satisfactory documentation and interaction, familiarity with review significance, individual responsibility, and awareness of others' expectations mostly influence the audit quality.

Despite the repeated revelations regarding the massive financial mishandling in the periodic reports of the Auditor General of Pakistan, National Accountability Bureau, and the print and electronic media, there has still been the absence of actionable forensic audit planning in the public sector. According to the Fraud Triangle Theory coined by Cressy, the presence of pressure, opportunity, capability, and rationalization are the critical elements for any financial fraud in the public sector. Hence, it is deduced that the massive financial irregularities in the public accounting sector of Pakistan are rich as far as all these indicators are concerned. Therefore, this

paper is based on the thought-provoking analysis of the strategies that should be adopted to formulate error-free and foolproof forensic auditing mechanisms in Pakistan.

In Pakistan's context of public sector accounting, the major menace to be curbed through forensic auditing is a white-collar or financial crime. For this purpose, the capability of the forensic auditors needs to be enhanced so that they can detect the manipulative approaches adopted by the third parties during the execution of business within the public sector organization. Moreover, the whistle-blowing mechanism for identifying and communicating information regarding financial fraud should be promoted and incentivized in public sector organizations. There is a need to protect and secure the whistleblowers through legislation and implementation. Since the public sector accounting in Pakistan is heavily dented by financial misappropriation, assets mismanagement, weak internal controls, and financial misstatements, a high level of forensic auditing skill set are required to be developed among the officials for conducting the forensic audit. Another essential aspect for channelizing forensic auditing is to start with the forensic audit of loss-making state-owned enterprises in Pakistan, including Pakistan State oil, National Bank of Pakistan, Islamabad Electric Supply Company, etc. The steps have already been taken for this purpose by the Government of Pakistan.

Apart from the above factors, Fraud Risk Assessment (FRA) is another potent tool in auditing to fight against fraud in any public organization. As per the Association of Certified Fraud Examiners, FRA is a process of foreseeing an organization's vulnerabilities to external and internal fraud. It is an ongoing process of identification, selecting, and prioritizing risks involved in occurring frauds. Therefore, such type of process needs an exceedingly investigative mindset and adherence to the investigative tools and techniques.

In order to strengthen the overall scope and applicability of forensic auditing in public sector accounting of Pakistan, the forensic audit purview must be made the regular component of the statutory audit process. Moreover, the skill set of the forensic auditors should be enhanced regularly to make them part of the forensic audit assignment. For the overall capacity building, the services of the professional training institutes should be regularly attained in the domain of forensic auditing.



THE ACCOUNTS CHAMBER OF THE REPUBLIC OF TAJIKISTAN

The development of the Republic of Tajikistan requires reforming all aspects of the socio like economic and socio-political life of the republic. The subsequent implementation of a number of National Programs and Development Strategies within this framework led to the understanding of the need to create a completely new system of public administration as the basis for the progressive development of society.

One of the key tasks of national development in Tajikistan is the creation of an effective public administration system as a basis for sustainable economic development. The priorities in governance and public administration identified by the Government: increasing the effectiveness of the national development strategy, improving public administration in accordance with the principles of a market economy, increasing efficiency in public finance management, developing a supreme body of state audit, creating a modern professional civil service, forming local self-government capable of providing high-quality services to the population.

The Accounts Chamber of the Republic of Tajikistan in recent years has made some progress in the development of bylaws, including certain regulations and guidelines, as well as a code of conduct for employees, however, given that the supreme body of state audit was established only recently, the development of the external audit service in Tajikistan requires long-term management.

The immediate priorities for the Accounts Chamber of the Republic of Tajikistan are to strengthen the legal framework, develop new audit methodologies and increase the technical capacity of employees through training and technical equipment. At the same time, the efforts of the Accounts Chamber are aimed at gaining trust and reputation, working with the executive

and legislative branches in order to ensure the real independence of the audit service and the culture of acceptance of independent audit, which is one of the priorities of the Government of the Republic of Tajikistan.

In 2015, the International Development Association (MAP) provided a grant for the Public Financial Management Modernization Project - II (PMUGF-II). The Grant Agreement for this Project was signed between the Government of the Republic of Tajikistan and the International Development Association (World Bank) in February 2016. Project activities are aimed at improving the efficiency of public spending, measured by aligning spending with priority policy measures, strengthening strategic planning processes, developing an information system for public finance management in Tajikistan with the aim of introducing additional modules for monitoring obligations, creating a system of electronic interdepartmental document flow, cash management means and asset management, strengthening human resource management processes, including their automation, creating integration between the public financial management information system (FMIS) and other e-government systems, including the e-procurement system, strengthening the state audit system through the organizational development of the Accounts Chamber Of the Republic of Tajikistan, the introduction of international standards for external audit, as well as the automation of the processes of conducting state external him auditing.

Currently, work is underway to implement the developed internal management mechanisms, implement the developed manuals on internal procedures, as well as on effective management in increasing the capacity in the field of audit planning and implementation skills in accordance with INTOSAI standards.

In 2019, the Board of the Account Chamber of the Republic of Tajikistan approved the Development Strategy of the Accounts Chamber for 2019 - 2023, within the framework of which a functional review of the current activities of the Accounts Chamber was carried out, gaps were identified, and the development of information technologies was envisaged in accordance with international audit standards and best world practice.

In the course of implementing this strategy, a phased implementation of ISAIS international standards is being carried out. At the moment, a number ISAIS standards have been implemented and preparations for the implementation of some new standards are in progress. According to this Strategy, pilot financial and performance audits were carried out in 2020 and 2021. It is planned to conduct a pilot audit of the consolidated financial statements of the public sector for the period of 2021, which should be published.

TCA's ASSESSMENT METHODOLOGY OF STRATEGIC MANAGEMENT, INTERNAL CONTROL AND ENTERPRISE RISK MANAGEMENT

It is of great importance that administrations have established and operate internal control systems, enterprise risk management and strategic management mechanisms in order to meet the requirements of an effectively functioning public financial management.

The internal control system is a set of processes and methods that ensure that organizations can achieve their strategic aims and objectives, carry out their activities effectively- in accordance with legislation and ethical rules-, ensure that resources are protected and used on the basis of efficiency, and that financial and management information are reported accurately and on time. Enterprise risk management and strategic management, on the other hand, aim to establish a holistic structure that will enable organizations to determine their missions, visions, strategic aims, objectives and the risks that may affect them, and to carry out their strategic and daily activities in this direction. All these three systems- internal control, enterprise risk management and strategic management- are essentials of modern governance approaches.

The Turkish Court of Accounts (TCA), external audit institution of Turkey, in line with its mission and vision, monitors the compliance efforts of public institutions with this modern governance approach through its audits. In this context the TCA has been carrying out regularity audits covering financial audits, compliance audits, and assessments of financial management and internal control systems of auditees for more than a decade. In this way, the TCA aims at contributing to a better financial management system by guiding the organizations through its audits and trainings offered to public institutions.

As mentioned above, the TCA has been assessing financial management and internal control systems of auditees for more than a decade. However, recent changes in information technology and international frameworks for internal control and risk management have prompted a renewed focus on internal control assessment. Consequently, the TCA management has decided to develop a new approach to its assessment of internal control systems of audited entities by adopting an integrated method. As globally known, the Committee of Sponsoring Organizations of the Tread way Commission (COSO) issued its updated "Internal Control-Integrated Framework,"



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and “Enterprise Risk Management-Integrating with Strategy and Performance” in 2013 and 2017, respectively. After the renewal of the COSO’s risk management framework, the TCA has decided to develop a new methodology, the main idea of which is to evaluate all three systems together: Strategic management, enterprise risk management, and internal control systems (the three systems).

In this context, an evaluation tool has been developed and integrated with the audit management program (SAYCAP) to enable audit teams to follow audit procedures in their regularity audit assignments. COSO’s assessment method for evaluation of effectiveness of the auditee’s internal control system has mainly been adopted to develop the evaluation tool. According to the method, there are two requirements for effective systems as follows:

- Each component of the systems and relevant principles are present and functioning
- The components are operating together in an integrated manner

The evaluation tool includes audit procedures with 4 different focuses to assure that the systems are present and operate efficiently. These focuses are;

- Overall assessment of the three systems
- Component evaluation of internal control
- Principle evaluation of internal control
- Audit findings regarding the three system deficiencies

While designing these procedures, primarily the Public Financial Management and Control Law No. 5018 and the regulations made with the relevant sub-legislation of this Law were taken into consideration. In addition, an evaluation method in accordance with the standards generally accepted all over the world in the field of internal control system and enterprise risk management has been adopted. These adopted standards are as follows:

- COSO Internal Control- Integrated Framework
- COSO Enterprise Risk Management Framework
- COSO Internal Control- Integrated Framework –Illustrative Tools for Assessing Effectiveness of a System of Internal Control
- COSO Internal Control- Integrated Framework – Internal Control Over External Financial reporting: A Compendium of Approaches and Examples

Every year, audit teams are conducting assessment procedures in their audits as suggested. For each procedure, an evaluation is made between 0 (zero) and 4 (four) points. Three different “Institution Scores” - internal control, risk management, strategic management- are reached by summing the scores obtained from each procedure. Consequently, based on the audits and assessment results, the TCA publishes its reports consisting of evaluation of the three systems to assure that the systems are well designed and operated, and appropriately updated. In addition to the audit reports, enforced by law, the TCA also issues a statistical analysis of maturity levels of the three systems. The main purpose of the analysis is to raise awareness for the adoption of these three systems by revealing the general situation of the auditees and by monitoring the progress/improvement of audited entities regarding strategic management, ERM, and IC system over the years.



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