“Modern trends of Kazakhstan’s internal state audit: the US and UK experience”

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MODERN TRENDS OF KAZAKHSTAN'S INTERNAL STATE AUDIT: THE US AND UK EXPERIENCE

Abstract

The quality improvement of state audit system is vital and relevant for all post-Soviet republics and Kazakhstan particularly. On the whole, it is grounded on the old notions, and is not suitable for the contemporary economic situation and numerous private enterprises' growth. The article aims to highlight the advantages of the audit systems in the USA and the UK for the contemporary state of the audit system in the Republic of Kazakhstan. In order to achieve the stated purpose theoretical bases, statistical data, legislative and regulatory official documents were analyzed. The analysis shows that the most perspective approaches to the internal audit system development are risk management and budget planning. The main problematic areas are the legal support, staff of auditing departments and services, the quality of revisions and competence of state auditors. It is substantiated that training and education for the auditors are highly demanded. The internal annual audit reports can be used as the effective instrument of the governmental control as well as the marker of the most undeveloped spheres.

Keywords internal state audit, state audit types, budget, financial control, external public audit, Kazakhstan, USA, UK

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INTRODUCTION

The development of the audit is closely related to the peculiarities of the financial and industrial history of particular country and determined primarily by the nature of the capital market development. The audit function exists in many countries to take a more comprehensive view of the economic and social implications of government operations (Diamond, 2002).

The internal audit has got increasing attention as an important component of government financial management and a vital tool for improving the performance of the government sector. There are many different internal audit models, and it may be necessary to consider different audit traditions, country capacities while introducing the measures to improve internal audit, especially in the transition economies and the developing countries (Oussii, Klibi, & Ouertani, 2018).

The budget funds and state assets effective management is impossible without having complete information about their usage. Knowing this information enables us to find optimal management decisions on regulating budget and inter-budget relations, creation and usage of the budget funds, budget system principles compliance, the functioning mechanisms improvement, and the state assets effective management. The source of such information for government is the system of state audit and financial control.

To find out the better audit system or a part of such system in order to apply it to the current Kazakhstan`s state audit system, it is better to compare the existing one with the audit systems of the UK and the USA. Moreover, the audit system standards developed and accepted in the European Union should be taken into account.

In 2013, the 21st Congress of the International Organization of Supreme Audit Institutions (INTOSAI) adopted new standard ISSAI 100 "Fundamental Principles of Public Sector Auditing", which describes the audit nature, including the principles that are needed to achieve audit high standards (Ahmed, 2015; Böhm, Bollen, & Hassink, 2013). In accordance with ISSAI 100 standard, the state audit environment is an environment where the government and other state bodies are responsible for using the budget funds. These authorities and bodies are accountable for the governance, their work and the resource usage.

Internal state audit aims at improving and increasing the efficiency of the central state and local executive bodies' activities. It has a precautionary nature in contrast to the state financial control system that aims at identifying the violations and taking response measures. The internal state audit should not just ascertain any discrepancies, but find out the reserves and potential use of public financial resources with greater return and efficiency and have the precautionary nature. Such systems are already used in the USA and UK, where the internal state audit system provides budget programming, monitoring and evaluation of the government programs.

1. LITERATURE REVIEW

The UK is considered modern audit motherland because the development of the audit in its current notion and function started in the UK. Since 1844, a range of laws about the companies in England were adopted, due to which the private joint-stock companies should invite the auditor not less than once a year and provide him all the financial documents, as well as make the report to the shareholders. It meant "the birth" of the obligatory audit. In 1854, in Edinburgh, the "Accountant Society" was established (nowadays it contains 12 thousand members), which united the accountants and auditors. In 1862, in the UK, the law "About the Obligatory Audit" was adopted. Later, in 1880, the Institute of Public Accountants in England and Wales was created (Matthews, 2006).

The English specialists largely contributed to the audit system development. Lawrence Dixie invented the balanced equations to find out the forgeries, random errors, and lack of accounting. The 70's of the 20th century were a new start of the audit in its current form. It was a start for audit harmonization at the regional, international, and global levels. The audit system development was connected with the development and peculiarities of some countries' financial and industrial history and the new capital market nature (Basioudis & Francis, 2007).

From their side, the auditors started to widen the sphere of their activities since the middle of the 20th century. The scientific and technological revolution made the audit companies use modern techniques and equipment in managing the companies, accounting optimization and automation, implementation of quality control systems, and other operation.

In the USA, the audit appeared due to the UK audit practice and was brought to the country by the British accountants in the 19th century.

In 1886, the first law about public accountants was adopted, and it was a start for audit companies' creation. A year later, the auditors' association was organized. In 1896, in the state of New York, the auditors' activities were legislatively regulated. In 1912, R. Montgomery wrote a book "Audit: Theory and Practice" that is more known nowadays as "Montgomery's Auditing". In the USA, the audit became obligatory for the companies registered in the Securities and Exchange Commission. The Commission was created in 1934 after the Wall Street crash in 1929. "Truth in Securities" law (1933) (Blum, 1938) and the Securities Exchange Act (1934) (Tracy & MacChesney, 1934) demanded that the companies had to provide the appropriate forms of financial reporting.

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Nowadays, there are around 45,000 audit companies in the USA, which can be grouped into four categories:

- "Big Six" denotes the biggest audit company in the USA (before 1980, it was Big Eight) and includes Arthur Andersen & Co., Coopers & Lybrand, Deloitte & Touche, Ernst & Young, KPMG Peat Marwick and Price Waterhouse (Al Shaer & Zaman, 2018; Medhat, Zhuoan, Meiting, & Yaowen, 2018; Francis, Maydew, & Sparks, 1999);
- other national companies that have the offices in big US cities and international potential;
- big regional companies with the staff of more than 50 people;
- small local companies (Carcello & Neal, 2003).

The auditors are certificated with three specializations:

- public accountant;
- public internal auditor;
- public informational system auditor.

To get a license, one should pass the exam on the theory and practice of accounting, audit, and legislation. The exams are held twice a year in May and October by the special commission on education and experience level. Only 10% of people can pass this exam (Chang, Dasgupta, & Hilary, 2009; Chang, Gygax, Oon, & Zhang, 2008; Hribar, Kravet, & Wilson, 2010).

With the significant changes in the political and economic life of the country in the 90's of the 20th century, several laws regulating the audit and financial control activities were adopted. In May 2006, the laws were edited and changed. Compared with the older laws, the new one fully disclosed the fundamental concepts, principles, types, subjects, and competencies of authorized bodies, rules for auditors' certification, licensing, and audit activities. The law "About Audit Activities" contributed to consolidation of the actual independence of auditors and audit companies in the Republic. In accordance with the law, the auditors' territorial chambers and the republican audit chamber, the audit commission elections, and the qualification commission for auditors' certification were created.

The accounting and auditing legal basis is developed considering the requirements of the Constitution, Civil Code, Code of Administrative Offenses, Tax Code, Laws "On Bankruptcy", "On Joint-Stock Companies", "On Foreign Investments", and other Republic of Kazakhstan's regulatory acts that govern the activities of companies, firms, and other commercial organizations.

During the 5th Republic of Kazakhstan Audit Conference that took place in Almaty on March 16, 2000, "International Audit Standards in Kazakhstan" were viewed and adopted. International Auditing Practices Committee (IAPC) published the regulatory documents on International Standards on Auditing (ISA) and Standards on the related services (Boolaky & Soobaroyen, 2017).

Thus, firstly, the audit in Kazakhstan was based on Kazakhstan's audit standards developed based on international standards. During the 5th Conference of the Chambers of Auditors of the Republic of Kazakhstan, it was decided to switch the audit to international standards and adopt them as the national ones. It was legislatively reinforced in the Republic of Kazakhstan's Law "On Auditing".

In 2007, the Chamber of Auditors of the Republic of Kazakhstan also published the Compilation of International Standards on Auditing, Expressions of Confidence, and Ethics. The Chamber of Auditors of the Republic of Kazakhstan is a full member of the International Federation of Accountants (IFAC) and has an official right to publish the audit standards. The Chamber of Auditors of the Republic of Kazakhstan played an important role in enhancing the prestige of Kazakhstan throughout the world in the context of the implementing the international reporting results and testing the foreign experience.

In the Message of the President of the Republic of Kazakhstan N. Nazarbayev to the people of Kazakhstan, "Kazakhstan-2050 Strategy: a new

political course for the established state", it was noted that the country needs to create an integrated system of state audit based on the most advanced world experience (Nazarbaev, 2012). In accordance with this Message, the Government Decree No. 609 dated June 18, 2013 "Concept for the implementation of state audit in the Republic of Kazakhstan" was developed and approved. In this concept, the main approaches to the gradual state financial control reformation and state audit implementation with widening its functional approaches were clarified.

On November 12, 2015, the Law "About State Audit and Financial Control" was adopted. This law clearly distinguishes between the concepts of state audit and financial control, and defines the authority and activity organization of the state audit and financial control bodies (Ministry of Justice of the Republic of Kazakhstan, 2015).

The Republic of Kazakhstan's Ministry of Finance Decree No. 392 signed on March 19, 2018 sets the internal state audit and financial control rules. The Decree declares the rules of audit, defines the state audit stages, finds out the procedure of the state objects audit list, and combines the audit planning and programming, etc. (Ministry of Justice of the Republic of Kazakhstan, 2018).

2. GENERALIZATION OF MAIN STATEMENTS

2.1. The UK internal state audit system

The authorities and functions of the supreme financial control body are established by the British Parliament. However, the main document that regulates the issues and implementation of state financial control is the National Audit Act, adopted in 1983 (Elizabeth II, 1983). In this Act, the authorities of National Audit Office (NAO), function, status, and appointment of the Comptroller and Auditor General are identified.

The Comptroller and Auditor General have the wide authorities in giving access to the audited entities' information and obtaining all the necessary information in the legislative way. The National Audit Office has a peculiar status in the system of governmental organizations. NAO has the authority to conduct the audit of the accounts of all government ministries, service departments, as well as several other public legal entities. However, its powers are defined by the powers and access possibilities of the Comptroller and Auditor General subordinate to Parliament. It means that NAO acts and operates on the Parliament's behalf. NAO gives the Comptroller and Auditor General discretionary authority to audit the government's financial performance (Böhm, Bollen, & Hassink, 2016; Beekes, Pope, & Young, 2004). The Comptroller and Auditor General have the exclusive right to prepare the audit report to the UK Parliament about the effective and economical state financial resources usage by the government and its services. NAO provides two types of audit:

- financial audit;
- money audit.

In general, NAO activities are very effective, as, for example, the Comptroller and Auditor General activity in 2015 allowed saving 1.21 billion pounds. In 2018, the activity of NAO led to the financial impact of 539 million pounds (National Audit Office, 2019).

The state internal audit is provided by the Government Internal Audit Agency (GIAA) (Government Internal Audit Agency, n.d.). The functions of GIAA are as follows:

- effective management of the public money;
- risk management;
- internal control.

GIAA was established in April 2015 for the internal audit quality improvement for the central government. The Government Internal Audit Agency is the executive agency of Her Majesty's Treasury (HM Treasury).

The report is done once a year and is presented in the UK Parliament (Beattie, Fearnley, & Hines, 2014).

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Still, the developed countries' audit system may face a crisis. The concerns about the audit industry appeared during the collapse of Carillion, BHS, and Patisserie Valerie in 2018–2019. The Carillion's (the big construction and building company) collapse created a big debt, job losses, incredible pension deficit, and million pounds of unconcluded contracts (Bhaskar & Flower, 2019). The audit failures at BHS, Carillion, and Patisserie Valerie indicate a wider crisis of trust in the audit industry. In October 2018, the Financial Reporting Council (FRC) reported that 27 percent of the auditors did not meet the quality standards (in 2017, this number was 19 percent) (FRC, 2018). In the UK, the audit industry is regulated by FRC that is responsible for auditors, accountants, and actuaries, and setting the UK's Corporate Governance and Stewardship Codes. The EU audit reforms require the auditors' rotation (at least every 20 years), prohibit certain non-audit services, and limit some other non-audit services (House of Commons, 2019). Still, the scandals of 2018 show that the current reforms do not work and demand new approaches to problem solving. For example, FRC consulted when strengthening the going concern standard for auditors that lasted for three months (FRC, 2019). After this, in November 2019, FRC did another research, which showed that only 75 percent of the auditors satisfied the requirements (FRC, 2019). Soon there will be represented the new body – the Audit, Reporting, and Governance Authority (ARGA) – that will have new mandate, wider powers, and accountability to the Parliament.

2.2. The US internal state audit system

The USA has its own government internal audit system. Apart from the control and audit of the budget funds, it also has achieved a big progress in the budget program, monitoring, and evaluation of the government programs (Figure 1).

In most countries, the current monitoring and control is done by the executive branch (Mark & Pfeiffer, 2011). The Congress also takes part in providing financial control through the Government Accountability Office (GAO) that has substantial resources and a broad mandate for the activity. GAO was established in 1921 to control the executive branch by the legislative one and perform the audit on the Congress' initiative. Nowadays, GAO realizes the classic financial budget expenditure audit, the performance audit, and government program strategic evaluation. Annually, the office makes around 1,000 audits, and its staff is 3.3 thousand people. The financial benefits of the GAO activity in 2018 are USD 75.1 billion, and it has made almost 700 reports and suggestions on the government programs and policies (Government Accountability Office, 2019).

Any Congress member can send a request on government program evaluation. The functions of GAO are as follows:

Source: Authors.

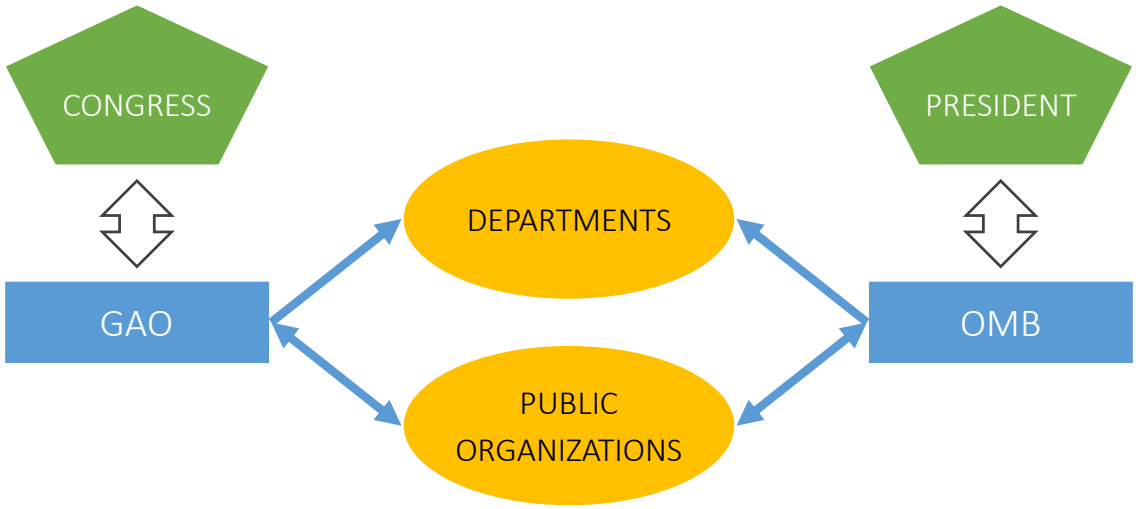


Figure 1. The system of the government audit in the USA

- evaluation of federal program, policy, operation, and activity;
- financial audit;
- government financial performance control;
- evaluation of necessary actions and meaning of proposed measures.

In the federal executive branch's agencies, internal control is provided by the Office of Management and Budget (OMB), which is one of the most powerful departments at the federal level. The OMB Head is a member of the Cabinet of Ministries of the USA. The current control is provided by the departments themselves. Also, the special structures were created within departments that are responsible for the operational control, wherein GAO and OMB can evaluate the program independently of each other and potentially compete with each other.

One of the main peculiarities of the government internal audit in the USA is the extremely active role of the private sector organizations that also evaluate the government program. Such organizations include non-profit organizations and research institutes, private foundations, professional associations, associations of citizens, etc. As the US federal departments publish a big information volume about their activity results, the private organizations have access to it and can make their own assessment of government programs.

2.3. The Kazakhstan's internal state audit system

Nowadays, the government audit and financial control system is presented by the Counting Committee, local audit commissions, and the authorized body for internal state audit. The government audit system gives the President, the legislative and executive branches, and the society the objective and truthful information about the budget funds and the state assets usage in accordance with the legality, effectiveness, and cost-effectiveness principles. The Counting Committee performs the external state audit of the national and budget funds. Besides, the Committee performs control over the completeness and timeliness of revenues to the republican budget and strengthening financial discipline. There were compensated 125.6 million tenge due to the work of the Counting Committee in 2018 (according to the statistical data of the Counting Committee in 2018) (Counting Committee of Kazakhstan, 2019).

According to Article 143 of the Republic of Kazakhstan's Budget Code, the internal control body authorized by the Republic of Kazakhstan's Government is the Financial Control Committee of the Ministry of Finance of the Republic of Kazakhstan and its territorial units that provides the control over the compliance of the republican and local budgets funds usage.

The internal state audit is an integrated part of the state management and an activity-independent evaluation. In accordance with this, the implementation of state audit is one of the approaches in the budget funds control. The general standards of state audit and financial control, procedural standards for individual audit activities, and types of state audit and others were developed and implemented by the Counting Committee. Still, there is a need for some more work on developing the normative legal acts that will regulate state audit and financial control (Kydyrova, Satymbekova, Kerimbek, Imanbayeva, … & Kanafina, 2016; Orazalin & Akhmetzhanov, 2019).

2.4. The Kazakhstan's internal audit system as a tool for managing the country's development

At first, audit was created with an accounting function, but later it was transformed into management-oriented competency. At present, performance audit is an independent area that plays an important role in managing the policies of organizations and countries. INTOSAI audit standards state the following: "Performance audit is related to the audit of cost-effectiveness, efficiency, and effectiveness and covers:

a) audit of the economic and administrative activities under administrative principles and management practices and policies;

b) checking the effectiveness of using human, financial, and other resources, including the

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Source: Asian Development Bank (2011), authors.

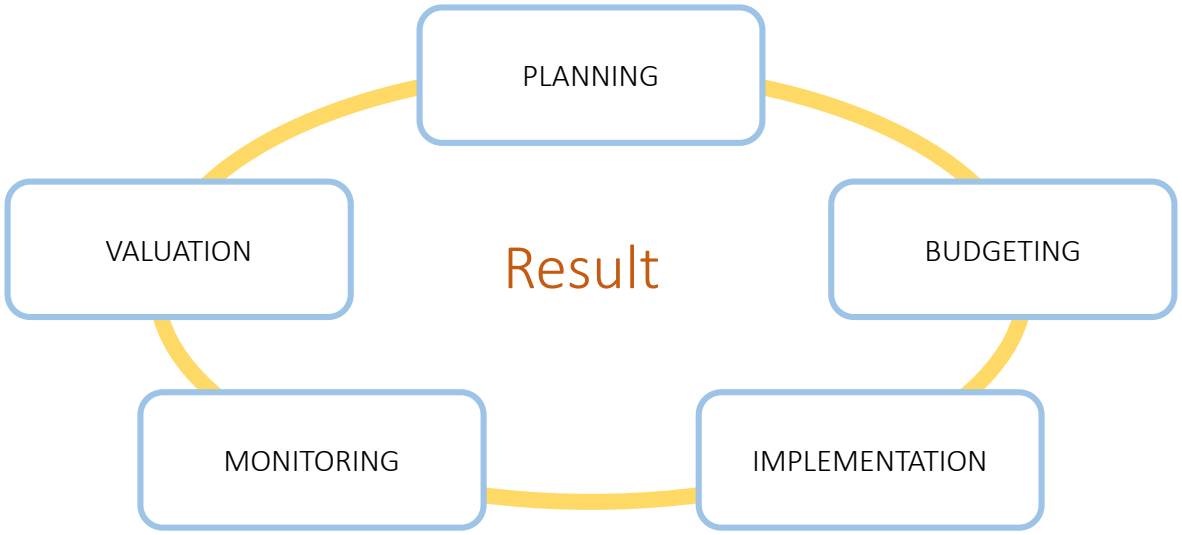


Figure 2. Components of a result-oriented budget process management

study of information systems, measures to improve the performance and monitoring mechanisms, as well as procedures used by audited entities to eliminate the identified shortcomings; and

c) performance audit achieving the objectivity of the audited entity and audit of the actual impact of the activity compared with the intended impact" (INTOSAI, 1995).

The use of performance audit methods allows tracing the following pattern: implementation of results-based budgeting principles caused a reorientation of state audit systems operation to a new product in the form of an independent external assessment of the budget process to improve the quality of information about the work of mechanisms for making the managerial decisions. Schematically, the result-oriented budget process management cycle is presented in Figure 2.

The process of development of public management of Kazakhstan can be divided into four stages (see Table 1).

The signs of established practice suggest that today Kazakhstan is at the third stage of the presented classification. The existing methods for evaluating the targeted programs require improvement in the Republic of Kazakhstan at various levels. In the public management system, as a rule, the only

Table 1. Stages of development of public management in Kazakhstan

Stages	Characteristics
Minimum requirements for public policy	Basically, verification of the implementation of laws is carried out. An audit of the use of financial resources is done. In Kazakhstan, it is provided by Counting Committee for Monitoring the Implementation of the Republican Budget. This stage continued until the implementation of state audit.
The first stage or interventionist government policy	The first stage is the interventionist policy that provides the monitoring of the implementation of targeted programs and national projects and preparation of conclusions on the developed regulatory acts. The ministries create the units responsible for auditing performance - the Internal Audit Service.
The second stage or interaction with business	The second stage is interaction with business when the regulatory impact assessment is mandatory but has a formal nature. Public consultations are held with the participation of business associations represented by the National Chamber of Entrepreneurs and self-regulatory associations. There are business orders from consulting firms and university centers to evaluate their corporate social programs.
The highest stage. It is when assessment is integrated into state and public institutions	This stage is not reached yet.

way to measure performance is the self-development of measurement standards. In other words, the performance of the state apparatus is evaluated based on the measuring scale and assessment methods developed by it.

Today, improving the effectiveness of public management is a change in the fundamental approaches to the quality of planning in Kazakhstan. The most important step was the signing of the Presidential Decree on the appearance of the function of preliminary assessment of the draft republican budget in the Counting Committee in 2017. At present, one of the primary tasks of state audit bodies is the assessment of planned indicators, the identification of planning deficiencies through expert analysis, and the publication of these facts. It should lead to improving the quality of program documents and the degree of responsibility for planning. This fact expresses the preventive nature of the state audit that allows adjusting the programs at the earliest possible stages. The transition to the most developed stage, when assessment will be integrated into state, corporate governance, and public institutions, requires the coordinated work of all bodies and non-governmental associations.

3. DISCUSSION

3.1. Comparison of the state audit organization effectiveness in the USA, the UK, and the Republic of Kazakhstan

The experience of the post-social countries having entered the European Union from 2004 to 2007 proves that establishing the basis of effective internal control and audit in the public administration sector is not insanely difficult at all, but it requires the political will and can be done in approximately three to four years.

Currently, there are two main state audit system models in the world: decentralized and centralized. In the decentralized model, each Ministry is fully responsible for the budget funds usage control. The Ministry of Finance provides the standard for development and coordinates the ministries' internal audit. The centralized model is characterized by the Ministry of Finance's direct control over each Ministry's income and expenses. Each Ministry creates its internal audit service accountable to the internal auditor of the Ministry. The UK uses the decentralized system, and the audit system of the Republic of Kazakhstan is closer to the centralized system (Financial Reporting Council, 2010).

In 2018, the effectiveness of NAO (National Audit Office: the state audit organization of the UK) was USD 703,16 million, GAO (Government Accountability Office: the state audit organization of the USA) – USD 751 million, and Counting Committee of the Republic of Kazakhstan (the state audit organization) – USD 3,32 million. The data have been taken from the official websites of the organizations (National Audit Office, 2019; Counting Committee of Kazakhstan, 2019; Government Accountability Office, 2019).

3.2. Advantages of using the USA and UK experience in Kazakhstan

The USA and UK experience show that the internal audit has turned into a very significant factor in the development of government departments:

a) the internal control and audit functions have become more complicated. Consultants assisting the operational managers in making the decisions, including the risk management too, appeared;

b) this sphere interaction has got intensified cooperation with the state external audit bodies. The approaches practiced in the corporate sector are actively used in its regulation;

c) the presence of proper public finances internal control and audit, organized based on the international standards, is now considered as a necessary attribute of a civilized community (Knechel, Krishnan, Pevzner, Bhaskar, & Velury, 2013).

Judging from the international practice, the internal audit allows:

- improving the financial discipline, increasing the state fund and assets resource management transparency and effectiveness in the society's interests;

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- further improving the economic potential of the state through quality control by complying with the international audit standards and the national legislation;
- taking measures to prevent violations and deficiencies, increase efficiency, profitability, and productivity;
- improving the organization management process in accordance with the international practice (this service should be independent, subordinate and accountable directly to the first head of the organization and governing body);
- checking the internal control components function appropriately;
- better budget planning and redirecting the funds into the spheres that demand priority improvement and closer attention (Issatayeva & Adambekova, 2016);
- developing the laws allowing better state bodies interaction and paying attention to the audit and accounting education and the existing staff training. The Treaty of the Functioning of the EU (TFEU), the Articles about the Audit (Foreign and Commonwealth Office London, 2008) must be considered.

3.3. General recommendations for the qualities of the auditor

The Code of Ethics for Internal Auditors in Government states that an auditor should be independent, objective, confident, honest, and competent (World Bank Group, n.d.; Kahyaoglu, B. Balkan, & O. Balkan, 2019).

Being honest is expected during the internal audit process. The basic point of any report is that it should be trustful and fair.

Being independent. As it was stated earlier, the internal audit should be an independent activity. Here the word "independent" belongs more to a meaning of "neutral", as an auditor should not be dependent on someone's words, high ranks, and authority.

Being objective. The professional competency and facts evaluation are defined as the traits of a good internal auditor. A professional auditor should refrain from rash words and including unverified facts without proper evidence in the report (Omolaye & Jacob, 2017).

Being confident. The internal auditor should protect the received information, as it is confidential. The information should not be spread until it is envisaged by law and professional ethics (Holm & Laursen, 2007; Power, 2000).

Being competent. An internal auditor should be competent and have a set of definite skills and knowledge that he needs for doing a proper job. Both audit and reporting require due professional care by persons possessing adequate training, experience, and competence in audit. The highly professional auditors should train their less competent colleagues. Each auditor should be ready to continue his/her education to maintain proficiency. It also means to be aware of modern technologies, audit standards development and procedures, etc. (Cascone, 2010; Allegrini, D'Onza, Melville, Sarens, & Georges, 2011).

Since an internal auditor's job requires special responsibility, there are a few suggested concepts:

- the internal auditors should interact with the government and recommend the management and audit committee the actions that will allow coping with both traditional and emerging risks;
- the organization management should be integrated with the internal audit, and the focus of the internal audit should be the organization and its management;
- the internal audit approaches should be flexible, adaptable, reflect the changing environment, and have in its disposition the modern technologies, technics, and up-to-date standards;
- the internal auditor must be creative to work out and propose a new strategy and effective management (Omolaye & Jacob, 2017).

CONCLUSION

Based on the conducted research, it can be concluded that the external state audit is represented by the Counting Committee for monitoring the republican budget implementation, and the internal state audit is represented by the Ministry of Finance of the Republic of Kazakhstan. The internal audit should allow the organizations to achieve the stated goals using the systematic and consistent approach to assess and increase the processes' effectiveness and management.

For the effective functioning of the state audit system and financial control, the Republic of Kazakhstan needs to adapt to the world positive experience. It will allow creating an effective control instrument to provide the state and society with the independent information that is needed to increase the state management effectiveness and make the decisions at all the state government levels.

The introduction of result-based budgeting principles has influenced the development of auditing. The performance audit is considered as one of the most effective means of improving the quality of management. The performance audit aims to evaluate the performance and management of the audited entity in terms of cost-effectiveness, effectiveness, and efficiency, and provide recommendations about increasing the performance of the specified subject. In world practice, the state audit plays an important role in enhancing the accountability of the executive branch. When evaluating the activities of the public sector, it is necessary to study the issues of linking budget programs with the goals and objectives of strategic plan systematically. Improving the efficiency of public management in Kazakhstan is a change in the fundamental approaches to the quality of planning.

Summarizing the abovementioned, it is necessary to develop and improve the audit system of budget funds usage, taking into consideration the world experience. Since revisions are carried out on programs that last several years, it is necessary to include the chapter about the social-economic program submission into the audit result report and to consider such criteria as profitability and productivity of state funds and material resources usage.

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