

In The name of God

**Country Paper
of
the Supreme Audit Court
Islamic Republic of Iran**

Issues arising in the financial auditing of countrywide financial statements

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**Research and Planning Center
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1. Introduction:

Legal system and legal structure in every country has direct and inevitable effects on the economic environment at macro-level as well as financial atmosphere of economic entities at micro level and consequently affects the management of both public and private sector considerably. This happens especially in countries like Iran, where most part of economic activities is controlled by government. Iran's economy is a centralized economy dependent on and controlled by government. The government intervenes in the economic activities of the country and most of Iranian companies either belong to government or to some how are dependent on government. Although, according to Article 44 of the Iranian Constitution, the majority of state-owned enterprises, state banks and insurance companies are being privatized and their shares are offered to the public through the stock exchange market, Iran has begun privatization just a few years ago and Iran is at the primary steps of privatization.

Due to this reason, state-oriented economy is common in Iran and this makes the legislature ratify laws and regulations with special focus on government and public sector. In such circumstances, the government laws and regulations dominate all laws and regulations and this by itself affects all aspects of the economy in Iran. Due to the fact that this issue is very extensive, we have decided to explain one of the challenging issues in the audit of financial statement in Iran with special focus on the audit of public companies.

In this paper every effort is made to address the supervision and audit of financial accounts and financial statements and address the financial accounts and financial statements in Iran by the qualified authorities. In other parts of the paper we explain about various governmental observers from the three branches (the Executive, the Legislature and the Judiciary) which supervise public operations and report about the financial activities of government organizations. The main point of debate is about auditing, inspection, supervision and criteria used by each of the competent authorities in the investigation and supervision activities, explanation about the objective of each authority and finally preparing audit reports by the same supervisory authorities.

2. Supervisory and controlling authorities responsible for the examination of companies and government organizations

There are three supervisory and controlling authorities in Iran which are responsible for supervision of the public and government performance. Such supervisions could be

done systematically or case by case depending on the auditing organization and the objectives they pursue based on rules and regulation and the scope of their legal powers. The above mentioned supervisory institutions include: *General Inspector's Office, Supreme Audit Court and Audit Organization*. These three organizations maintain a supervisory relationship with the Iranian government and public sector entities. Each of the same organizations has been given specific capacities and powers based on the current rules and regulations in Iran. But at times, the same supervisory organizations might conduct parallel investigations/examinations in performing their duties. One of the important issues about these supervisory organizations is the level of power and the legal authority framework they possess. The supervisory authorities, depending on their audience, possess different levels of power and report differently. And this by itself will considerably affect their relationship with government companies and public sector.

3. General Inspection Organization (GIO)

General Inspection Organization is a supervisory organization operating under the Judiciary established based on article 174 of the Iranian Constitution. Activities of GIO are supervised by the Head of the Judiciary.

Inspection by GIO could be done in three different forms:

1. Regular inspection
2. Extraordinary Inspection
3. Case by case Inspection

The law of GIO has defined inspection as follows:

Inspection includes: "regular and objective activities based on legal mission of GIO about the organizations under inspection through:

- A) Investigation of what was done and what should have been done
- B) Analysis of the past and present performance
- C) Determining the differences and deviations between the current situation and the desirable situation and the evaluation of their importance
- d) Presenting necessary suggestions for improvement, for removal of shortcomings, improvement of the behavior of personnel and the operations of organizations and finally performing encouragement and punishment policies.

Some of the duties of GIO are as follows:

Regular controlling and supervising all the administrations, military and disciplinary forces, state run institutions and companies, municipalities and the offices associating with them, public notary offices, foundations of public utility, institutions whose financial resources totally or partially belong to the government or in one way or another presides them or financially supports them and reporting about the irregularities and administrative and financial misuse to the related organizations. .

Reports prepared by GIO about irregularities and administrative and financial misuse in ministries, revolutionary institutions and foundations, government institutes and companies and units affiliated with them are sent to the following people:

A) Irregularities related to the ministries and institutions of the Islamic Revolution and the foundation are submitted to the President

B) Irregularities related to corporations, public companies and related institutes are submitted to the minister concerned.

It is noteworthy to mention that in all cases a copy of the same reports are sent to the Head of the Judiciary for follow up.

Meanwhile, in case the government audit organization, security/supervisory/inspection authorities of ministries and other institutions responsible for inspections come across irregularities and administrative and financial misuse in executive organizations, and government companies, they are required to inform the GIO about the irregularities so that GIO takes necessary actions regarding inspection. In practice, GIO inspects state-owned enterprises and ministries randomly and in case an irregularity is detected in a government organization, it dispatches its inspectors to the same organization for further investigation. With regard to what was said before, inspection of an organization is different from auditing. It is not as professional as auditing and only the supervisory role of GIO is similar to Supreme Audit Court in public companies and public sector.

4. Audit Organization (AO)

Audit Organization is another supervisory organization involved in the auditing of government companies and public sector. The AO operates under the Ministry of Economic Affairs and Finance and its activities are performed based on its charter

and needs of government regarding auditing and providing technical and financial services to government sector.

Some of the duties and authorities of the AO includes:

A – Conducting audit of all public institutions/organizations and acting as the legal inspector of the same institutions as well as auditing companies that 100% of their capital belongs to the government, ministries, institutions and state-owned enterprises.

B - The legal responsibilities of inspection and auditing of other companies which more than 50% of their capital is directly or indirectly belongs to ministries, agencies or state-owned enterprises.

C - The legal inspection and audit of institutions of the Islamic Revolution, if approved by the General Assembly or by the highest authority, and other organizations that are managed through the representatives of government.

D) Legal inspection and audit of sub-companies of banks, non-governmental public institutions and institutions of the Islamic Revolution and organizations that are managed through the representatives of government.

E – Audit of ownership of fixed assets projects and other contracts to create fixed assets which are carried out by the government organizations.

F - Compilation and dissemination of accounting and auditing principles that include accounting standards, auditing standards, professional codes and related guidelines in the country as the official and technical authority.

It is noteworthy to mention if the audit reports and financial statements do not comply with the principles and criteria set by AO, no government authorities, banks, state and non-state credit institutions, stock exchange and non-governmental public institutions will approve the above mentioned documents.

Considering the fact that AO operates under the Ministry of Finance and Economic Affairs (one of the government ministries) the activities of AO primarily meets the major needs of government regarding auditing and in fact AO acts as internal auditor of

government for examination of financial statement of companies and government institutions.

Furthermore the duties and the scope of powers of AO in relation with development of accounting and auditing standards shows that the application of the same principles and standards in preparing and presenting financial statements as well as the use of these standards in the process of financial auditing of the financial statements is necessary and inevitable. As the result, the auditors of AO use the approved accounting principles developed by AO in the audit of financial statements of state-owned enterprises and companies affiliated with government. In addition, the auditors express their opinion on the desirability of presenting financial statements in public companies. This type of auditing related to the financial statements and conducted by AO is quite technical. This kind of audit is known as financial auditing and its output is the final report which contains four types of opinion on the financial statement of government and public sector. These opinions include: unqualified opinion, qualified opinion, adverse opinion and disclaimer and the same audit report prepared by auditors will be presented to the General Assembly.

Auditors of AO are invited by the general assembly of state-owned companies to perform audit and legal inspection and their audit fee is paid by the companies which needed audit service. In addition to independent audit, inspectors also actively monitor the compliance of rules and regulations by the audited company. It is the duty of legal inspectors of public companies to monitor the compliance of rules and regulations and reporting irregularities in this regard. In Iran both duties are performed by the audit team.

5. Supreme Audit Court (SAC)

Supreme Audit Court is another supervisory organization monitoring financial performance of government and public sectors. The SAC operates under the direct supervision of Parliament according to Article 54 of the Constitution. Article 55 of the Constitution specifies the duties and powers of the Supreme Audit Court as in the following:

"Supreme Audit Court shall examine all the accounts of ministries, institutions, government companies and other organizations which in any manner whatsoever benefit from the state budget. This is to prevent any approved budget is exceeded and all funds are utilized in their right place. The SAC shall collect the accounts and the related

documentations according to law and prepares and submit its report together with its professional opinion to the Parliament. The same report must be made public."

The objective of the Supreme Audit Court as stated in the articles of the Constitution of the Islamic Republic of Iran is the exertion of continuous financial control and supervision in order to safeguard the public treasury through the following ways:

A - To control financial operations and activities of all Ministries, institutions, government companies and other organizations which in any manner whatsoever benefit from the state budget.

B - To examine and audit funds spent and the revenues and other sources of obtaining revenues in relation to the financial policies stipulated in the approved budget with consideration of the operational and auditing report received from the related auditees.

C - Preparation and drawing up of the budget liquidation report together with its own comments and its presentation to the Parliament

According to the Constitution and the Supreme Audit Court Act, the responsibility to supervise the budget and mentoring the compliance with budget laws has been given to SAC Law. The topic of audits conducted by SAC is the budget of the whole country and mentoring the compliance with the budget laws and other obligatory regulations. The auditors refer to the same laws and regulations for auditing. All government organizations in public sector fall within the examinations of SAC and the auditors refer to the laws and regulations ratified by the Legislature for their audits. Considering the fact that SAC is the supervisory arm of the Parliament to safeguard public treasuries and properties, SAC is entitled to audit any organization, even if they get a small budget from government. Mostly, in its examinations, SAC stresses on compliance audit. In this regard, all the activities of companies and auditees are examined to prove their compliance with laws and regulations. SAC owns audit guideline for examining the accounts of and financial operation of auditees. The same guideline has specified the audit framework and the scope of audits of SAC in the general process of auditing public companies and the related institutions.

The final output of audits conducted by SAC in every audited organization will be the audit report. These annual reports contain the opinions and suggestions of the SAC regarding the accounts and financial performance of government companies, institutes

and organizations. The annual reports are submitted to Parliament and must be disclosed to public as well.

With regard to what was said before and considering the authorities specified in the rules and regulations, the type of audit conducted by SAC is compliance audit but in recent years SAC has initiated performance audits through the amendments of the current rules and regulations. It must be mentioned that there are mandates for conducting performance audit in the current Act of SAC but the same mandates are not that clear and prevalent and that's why SAC does not do performance audits extensively. However, some laws and regulations have been ratified by the Parliament as the result of the follow up of SAC in this regard and the same laws have opened windows for implementation of performance audit. In fact the ratification of such laws will be the primary step for conducting performance auditing in SAC. One of these laws is the "law on improper decision". This law makes the executive managers accountable for the decisions they make in relation to expenditures in their respective organizations. The same law increases the accountability of managers in compliance with rules and regulations and also pays attention to the effectiveness, the appropriateness and decision of them. In addition to what was said, this law stresses on the importance of performance auditing and why it can be considered as an step towards conducting this kind of audit. At the moment, the SAC has started the performance audit of selected projects using its current mandates and INTOSAI standards. The full execution of performance audit requires ratification of new laws and regulations by the Parliament. According to the current laws, the SAC is the only supervisory organization that that is allowed to conduct performance audits in government and public sector.

Table 1: Comparison of the activities of the three supervisory organizations in Iran: General Inspection Organization (GIO), Audit Organization (AO) and Supreme Audit Court (SAC)

Description	General Inspection Organization	Audit Organization	Supreme Audit Court
Type of activity	Inspection of financial and administrative performance	Audit and legal Inspection	auditing
Type of supervision and examination	inspection	Financial audit of financial statements	Auditing compliance with rules and regulations and performance audit
Criteria used in the activity	All the national rules and regulations	Generally accepted accounting	Financial regulations and other obligatory rules

		principles	
Type of report	inspection report	Audit report	Audit report
Type of professional opinion	Report about irregularity or appropriateness	Unqualified report, qualified report, adverse or disclaimer	Unqualified report, qualified report, adverse or disclaimer
Audience of reports	Depending on the case, they are sent to the judiciary, the President, the minister concerned	General Assembly	The Legislature (Parliament)
Operating under	The Judiciary	The Executive	The Legislature
Report of irregularities/wrongdoing	Depending on the case, they are sent to the judiciary, the President, the minister concerned	To the General Assembly by legal inspectors	Public Prosecutor's Office in SAC
Technical dimensions of activities	judicial	auditing	Audit and legal

6. Comparison of Activities of General Inspection Organization and Supreme Audit Court

The activities of GIO will focus on inspection and investigation regarding crimes and reported wrongdoings (both financial and non-financial) in government organizations but GIO does not conduct auditing. But the activities of SAC will focus on regular and annual examination of financial accounts and financial performance of government organizations which is conducted professionally.

The results of investigation of SAC will be reflected in audit reports prepared for individual auditees. These reports are combined together based on a regular framework and form the annual report. The same report will be the basis of the judgment of Parliament in connection with the execution of the budget by the government during the budget year and also will be the basis for approval of the budget for next year. Consequently, it could be said that audits conducted by SAC regarding the financial performance of government and compliance with rules and regulations are systematic and professional. But the inspection conducted by GIO is random inspection based on the received reports indicating that violations and crime has taken place in the financial, non financial and administrative sectors of government. The results of inspection will be reflected in the form of inspection reports explaining the occurrence of crime and violations. The same reports are sent to officials of the Judiciary, the Executive and the Ministers concerned. These reports will be followed up by the Judiciary so that intended objectives are met. As the result, this inspection and the subsequent processes are completely judicial.

In the organizational structure of SAC, there is a Public Prosecutor's Office which has a Public Prosecutor and a sufficient number of judges. Having conducted audits, auditors will report about the violation of rules and regulation to the Public Prosecutor's Office. The SAC having this type of organizational structure conducts its examinations both from legal and audit point of view. The supervision process starts since the arrival of auditors in the auditees until they complete audits and presents the audit reports.

According to the law if the auditors, during the audit process, face violations of laws and regulations, they negotiate with the top managers of auditees to solve the problem. If they can not agree with the auditees, they report the same financial violation/irregularities to the Public Prosecutor's Office in SAC. The challenge here is that, at this stage, the report of violation being examined by the judges become legal and unfortunately the judges have little knowledge of audit issues and that's why the reported case become less important. This is of course a major supervisory problem in SAC while examining the sound implementation of the national budget. To solve this problem, two different views have been expressed. A group of experts believe that the Public Prosecutor's Office should be separated from the organizational structure of SAC and be affiliated to the Judiciary. In this case, the SAC will apply its full capacity to auditing and will deal with public audit more professionally. Some other experts believe that removing the Public Prosecutor's Office from the organizational structure of SAC will reduce the powers of SAC in protecting and safeguarding public treasury and consequently will decrease the status and dignity of SAC.

7. Comparison of Activities of Supreme Audit Court and Auditing Organization

Supreme Audit Court as the agent of the Iranian Parliament is responsible to safeguard public treasury according to Articles 54 and 55 of the Constitution. The responsibilities of SAC include the supervision on the implementation of budget and compliance audit. Through its audit, the SAC operates as the external auditor of government and will increase reliability and validation of annual performance statement as well as the budget. The status and dignity of the Supreme Audit Court accredited by the Constitution , the highest legal reference and the top of national laws. Independence and impartiality of SAC in examining financial statements and performance statement of government has been guaranteed by the fact that SAC operates under Parliament according to the Constitution. Independence and impartiality of SAC, as external auditor of government organizations, is a significant element in SAC's supervisory activities. On the other hand, according to its charter, Audit Organization primarily meets the major needs of

government regarding auditing and presenting financial and technical services to government entities, and is responsible for conducting independent audit and inspection of state-owned companies and enterprises that more than 50% of their shares belong to government. Considering the fact that Audit Organization operates under the Ministry of Economic Affairs and Finance and this ministry works under the Executive, the AO shall be considered as the internal auditor of government. The purpose of this organization is to audit the financial statements of companies which will lead to the enhancement of credibility and reliability of the same statements for third parties that use the results of the same audits for decision making and judgments.

Therefore, the financial audit of the financial statements of state-owned companies falls within the responsibilities of AO. The generally accepted accounting principles and standards in Iran is the main criterion for auditing financial statements and auditors of AO apply the same standards for the examination of financial statements.

8. Interaction between Audit Organization and Supreme Audit Court in conducting the financial audit of government companies

Interaction, coordination and cooperation between the two organizations in examination of the financial accounts of government companies have facilitated supervision in Iran. Supreme Audit Court, in terms of its governance and supervisory role accredited by the Constitution, has more power in comparison with Audit Organization. Thus, the Audit Organization provides the SAC with a copy of the audit reports regarding financial auditing of financial statements of state-owned companies. Therefore the SAC is considered as the users of reports, audit services and legal inspection of AO. The Audit guidelines of Supreme Audit Court clearly stresses on this fact.

Since the report of the independent audit and legal inspection regarding the financial statements of government companies will give credit to the same statements and with regard to the fact that the legal inspector is responsible for announcing the violations/irregularities, therefore the content of independent audit report and legal inspectors is of significant importance to the SAC.

Having received a copy of the independent auditor and legal inspector's report issued by AO, the Auditors of SAC study all the items in the same report and ask the auditees about the reasons mentioned in the items of the same report. The SAC will examine the implementation of audit reports issued by the independent auditor and legal inspector while conducting their audit. They also keep the same information in the audit files.

Therefore, the audits conducted by AO auditors regarding the financial statements of government companies will considerably decrease the task load of SAC's auditors. As the result of this interaction, many parallel tasks are eliminated. For example, having studied the reports prepared by AO, the auditors of SAC will notice an item which is related to a legal claim that has had important financial effects on the financial statements and this claim has not appropriately been disclosed in the financial statement and has not been identified as potential liability. In such cases, the SAC's auditors do not need to examine the case again. By referring to the same item, they can report about the incompliance of rules and regulations without doing parallel audits. Similarly, there are many examples where the auditors of SAC reduce their workload by relying on the reports of AO auditors.

According to the audit guidelines of SAC related to the audit of government companies, the SAC conducts comprehensive audit including financial audits, compliance and performance audits. Compliance audits are completely conducted by SAC. In the auditor's guideline, the responsibilities of auditors are to examine and audit information, documents and their compliance with rules and regulations. The phrase "binding standards" refers to accepted accounting principles and standards issued by the Committee on the Development of Accounting Standards of AO and communicated to the government companies and its affiliated units. The application of these standards is necessary for preparation of financial statements. Government companies which do not observe the same standards, their financial statements are invalid all around the country. AO also acts as the independent auditor of government companies and reports about the fairness of presenting their financial statements and compliance of such statements with the generally accepted accounting principles.

Therefore, the audited financial statements by the independent auditors of AO is highly important to the SAC. As the result, both of these statements as well as independent audit reports are used by SAC while auditing the financial accounts and the annual performance statement and accordingly SAC's auditors rely on such reports/information. It could therefore be said the audit of financial statements is one kind of audits conducted by SAC in government companies. The examinations conducted by AO help auditors of SAC in this regard. One of the paragraphs in the audit reports of SAC is the "paragraphs related to the financial statements". Based on the audit guideline of state-owned companies, the audit findings obtained out of the examination of financial statements will be presented in this part of the report. According to article 2 of Supreme Audit Court ACT, auditors are required to examine the financial statements of the

auditees so that such statements are prepared based on the accepted accounting standards. On the other hand, for the implementation of article 4 of the Supreme Audit Court Act, auditors are required to examine the accounts of balance sheet and other accounts related to it. The accounting principles and standards are considered as the common literature and the communicative language between the government (accountable entity) and the Parliament (requesting accountability). The accounting standards are means through which government responds to the Parliament about the amount of budget received and the funding sources of such budgets(monetary and non-monetary). The auditors examine the purposes for which the budget has been used and if the related rules and regulations as well as other indispensable by-laws have been complied with or not. Whatever affects accountability is significant in the examinations conducted by SAC. Therefore, the subject of materiality in the implementation of the duties of SAC is very broad and to some extent contains the whole operations. Thus, the auditors of SAC must examine the financial statement and its related items very precisely and report major errors and deviations from accounting standards (based on Rial calculations) and their effects on financial statements.

Another interaction and cooperation between AO and SAC is the application of the results of inspection and report of legal inspectors of AO. The legal inspectors, elected by the governing board of public companies are responsible to detect irregularities and report it to the general assembly. The conclusion of such regular inspection helps the auditors of SAC in performing their audit responsibilities. Since one of the main responsibilities of SAC is to conduct compliance audit, auditors must detect the non compliance with rules and regulations in conducting their examinations. So, it can be concluded that the reports issued by legal inspectors is a valuable source for SAC. The SAC's auditors are required to study such reports so that in this way they reduce their task load. The issues mentioned in the legal inspector's reports are documented on the work sheets of SAC.

In addition to what was said above, another interaction between SAC and AO is the examination of activities of internal control teams in the auditees. Based on articles 5 and 6 of Supreme Audit Court Act, auditors are required to examine the internal control system and the controlling authority of government companies and express an opinion on its sufficiency or insufficiency. The examinations conducted by the audit team of SAC can be used as an appropriate basis for auditors of SAC in examining the sufficiency or insufficiency of internal control system and the controlling authority. In this case, auditors of SAC will re-examine all the tasks completed by auditors of AO and record and

document them in their work sheets. In addition to this, the auditors of SAC must get the reports about the shortcomings of internal control system prepared by independent auditors. They are also required to examine whether effective measures have been taken by the management of auditees to remove shortcomings or not. In Iran, auditors apply the INTOSAI Internal Control Standards for examining internal control systems in auditees.

9. The objectives of major financial statements and the annual performance statement

What independent auditors of government companies consider in their audits are the major financial statements that government companies prepare based on accounting standards. These statements include: 1. balance sheet (financial position statement) 2 – profit and loss statement 3- cash flows statement 4 – comprehensive profit and loss statement. The integral part of such statements is the explanatory notes that increases the amount of understandability of such statements. It must be noted that the explanatory notes along with financial statements, is the place to provide further information about the presented accounts heading in the financial statements and this will clarify the understanding and interpretation of statements. These statements are prepared and presented primarily for the implementation of financial reporting objectives for decisions making by the users. But the financial statements that companies are required to submit to the Parliament for the process of accountability is the current and investment performance statements specified in Article 98 of Public Audit Act and Article 1 of Annual Report Act ratified after the Islamic Revolution. Such statements are included in the national statements for the purposes of accountability. The reference for the national statements is the same major financial statements prepared based on the accounting standards. For the purpose of accountability, such statements must be prepared in a comparison with the approved budget based on the guidelines of annual report laws and are attached together with other financial statements to the audit report. The auditors of SAC focus on the same performance statements and validation of such statements is done by the SAC as the auditor of government companies.

10. Conclusion

Three supervisory organizations take the responsibility of supervision of the activities and performance of government organizations and public sector in Iran. These include General Inspection Organization (GIO), Audit Organization (AO) and Supreme Audit

Court (SAC). The activities of GIO are conducted in the form of inspection and detection of irregularities/crimes; its activities do not involve auditing. The professional audit task is the responsibilities of the SAC and AO. The SAC mainly conducts compliance audits but in examining the accounts of government companies, SAC also conducts financial auditing. In other words, SAC's auditors conduct both compliance with rules and regulations and financial audit of financial statements. Based on the audit guideline of government companies, if the financial statements are not prepared according to the accepted accounting standards , this is considered as violation of laws and regulations and other indispensable rules.

Regarding the financial audit of financial statements of government companies, there are a lot of interaction and cooperation between SAC and AO. The Supreme Audit Court uses the audit reports conducted by AO in the examination of government companies. The audit guideline prepared by SAC for the examination of government companies specifies clearly how the audit report prepared by AO could be used by the SAC's auditors. Interaction and cooperation of auditors of AO with and auditors of SAC will lead to the increase in the audit quality and accuracy in conducting audits. This initiative will also reduce the audit task load of financial audits conducted by SAC.

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**This country paper was translated from Persian into English by:
Morteza Asadi
Senior International Relations Expert
Supreme Audit Court of Iran**