



**SIGMA**

**Support for Improvement in Governance and Management**

A joint initiative of the OECD and the European Union, principally financed by the EU

**SIGMA Peer Assistance Review  
of the  
Riigikontroll of Estonia**

**The Detailed Report of the Peers**

**September 2005**



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## SECTION 1: BACKGROUND AND INTRODUCTION

### 1.1 Background

In early 2005 the Auditor General of the State Audit Office (the Riigikontroll) in Estonia requested SIGMA to work again with them and carry out a second peer assistance review of the Supreme Audit Institution. The first Peer Review was carried out by SIGMA in 1999, with SIGMA peers from the Netherlands, Denmark, Germany and the UK. The results of this Peer Review were well received and led to a comprehensive development programme based on the preparation of a well defined Strategic Development Plan (SDP). The Netherlands Rekenkamer was then engaged as the main technical assistance partner during 2000-2003 through a Netherlands funded programme. This programme covered four main areas: audits, organisation and management, information, and communication. The outcome of this programme was appreciated by the two partners as it is readily apparent that the Riigikontroll is now a modern and well functioning SAI.

During the dialogue with SIGMA, when preparing for this Peer Review, it became quite clear that whilst the Riigikontroll has now reached a reasonable level of professional development and operates to EU benchmarks it required motivation and suggestions to move beyond this level and towards the very best practices and standards for its work. SIGMA specialist advice and recommendations were therefore needed to focus on further improvements to financial and performance audit quality and standards, and on the operational and functional effectiveness of the Riigikontroll and the public accountability system of Estonia. The importance of the role of the Riigikontroll in providing assurance advice to the public and parliament on whether the Governments has provided good and honest stewardship and effective management of state resources; and value for money in the delivery of its programmes is very important indeed.

The Auditor General therefore asked that SIGMA should, together with Riigikontroll peers (see **Annex 1**), review and address issues for further developments in time for them to be considered and, if accepted, included in the next Strategic Plan of the Riigikontroll for the years 2006-2009. The Auditor General also asked for a short review of the legal framework to be undertaken (see **Annex 2**) so that any issues of financial and operational independence and the audit of local government could be discussed and considered.

This review therefore began with a short review of progress in relation to the recommendations made in the 1999 review (**Annex 3**) and a brief review of the statutory arrangements for public sector external audit in Estonia. The peers then focused on the major challenges for the Riigikontroll the immediate years to come. This Detailed Report discusses and presents recommendations for some of the challenges and opportunities the Riigikontroll will need to consider in order to find their own particular solutions to the situation in Estonia at the present.

SIGMA engaged very senior and experienced auditors from Germany, the Netherlands, Sweden and the UK<sup>1</sup>. They performed their assignment under the guidance of Nick Treen, Senior Advisor, SIGMA. Two one week field missions for the review were carried out in April 2005, and meetings held at OECD in Paris before and after the field missions for planning and reporting coordination. The outcomes of this review are presented in this paper - the Detailed Report of the Peers. It gives many comments and recommendations based on the peers' experiences, analysis and knowledge, and the detailed discussions held with the Estonian peers, for the Riigikontroll to consider.

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1 . Detlev Sparberg, Germany and NATO; Harry Kramer, the Netherlands; Bo Sandberg, Sweden; Richard O'Connor, European Court of Auditors and the UK, Nick Treen, the SIGMA SAI expert Peer Assistance Review Team Leader; and Lalitha (Annes) McGoogan, SIGMA Project Assistant.

## 1.2 Criteria and methods

The criteria used by the team for assessing the Riigikontroll present state of performance derive from the INTOSAI Auditing Standards and, especially for the Financial Audit, the standards and guidance issued by the International Federation of Accountants (IFAC<sup>2</sup>). However, due to the present level of development in the Riigikontroll other forms of so called 'best and good practice' for the public sector have also been applied – especially those that relate to the EU. The review was based on a combination of document review and interviews with the audit staff at all levels as well as detailed and intensive dialogue with the Riigikontroll management. A sample of both Financial Audit and Performance Audit planning documents, internal approval processes and reports were analysed in order to obtain a better understanding of the quality of recent audit work. We also held discussions with representatives of the major stakeholders such as the Select Committee of the Parliament which deals with the Riigikontroll's reports, as well as senior officials at the Ministry of Finance and a number of Ministries to obtain an auditee and “customer” perspective. We also spoke to representatives of government Internal Audit units, and found particularly helpful and useful discussions held with the Ministry of Finance Financial Control Department. Auditing and accounting professional bodies in Estonia were also a good source of advice and information for the SIGMA peers.

It is evident that the Riigikontroll has made significant progress in moving towards becoming a modern and effective Supreme Audit Institution in a relatively short time. The peers are aware that the Estonian Public Sector in general is still in a period of significant change, some of which will impact on the Riigikontroll. Therefore it is perhaps more opportune than ever to pursue those developments in the way audits are planned and carried out which will pay dividends for all interested parties in later years. Achieving this will undoubtedly require some fundamental re-thinking of priorities, audit approach, appropriate resource levels and allocations, and a period of stability as well as the commitment of Parliament to support and help in developing the Riigikontroll to the very best European and international standards and practice. The peers consider this to be a realistic aim.

Exit conferences as well as a 'contradictory' procedure with the Estonian peers (see **Annex 1**) have been applied to this Report. Where there may remain factual imperfections and unrealistic recommendations in the report this is the responsibility of the SIGMA peers.

## 1.3 Topics covered by the Peers

In line with these underlying considerations the Detailed Report addresses:

- Riigikontroll development
- Audit legislation
- Implementation of the recommendations made following the SIGMA Peer Review 1999
- Corporate, Strategic and Operational Planning
- Financial Audits
- Performance Audits
- Relations with Parliament
- Organisational Structure, Staffing and Management
- Quality Management

## 1.4 The Development of the Riigikontroll

The Riigikontroll was established in 1990 and is headed by an Auditor General. In 2000 the core audit work was vertically organised in three functional Audit Departments covering Financial Audit, Operational Risk Audit and

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2. <http://www.ifac.org>

Performance Audit respectively. Each of them was headed by a Chief Auditor. The three Departments were responsible for their specific audit function across all Government Ministries. In December 2004 this structure was replaced by a horizontal client oriented structure. Four Audit Departments were created with each responsible for covering all types of audit activity in a group of Central Government ministries. Each headed by a Chief Auditor.

The current Riigikontroll Act was approved in 2002 with more precise audit objectives and content as well as the scope of the audits. Another new requirement of the law is that the Riigikontroll should include in their reports the responses of the auditees. In 2005 the audit law was also amended to include a requirement to perform financial audits of the Local Government, but not performance audits.

As a result of the Estonian accession to the EU in May 2004 the Riigikontroll contacts with other Member States Supreme Audit Institutions, the Court of Auditors (ECA) and other EU institutions have become more frequent and normal. It has a highly developed and well functioning international co-ordination and relations unit. Membership of the EU has brought with it the receipts of various funds and 'own resources' and the need to provide assurance to the EU concerning disbursement of funds etc. Recent years have also involved collaboration and networking with other former candidate countries to mutually improve their basic audit structures and procedures. The Riigikontroll is today an outward looking and well motivated organisation.

During the period up to 2005 the state financial system has also developed rapidly and Estonia has most recently introduced a modern public financial accounting and management process including e.g. accruals accounting, performance reporting, and a reinforced and empowered internal audit covering all major state bodies. There is now a requirement for a Formal Audit Opinion for each state accounting entity's (all ministries and county governments, the State Chancellery within the scope of its area of government and administration, and the constitutional institutions – the Riigikogu, the President of the Republic, the SAO, the Legal Chancellor and the Supreme Court) annual report and the Consolidated Annual Report of the State. This represents a major step in public accountability but also a major challenge for the Riigikontroll.

Hand in hand with the new developments in the state financial management goes increased expectation that the Riigikontroll should add value with its audit and also be capable giving qualified advice to all stakeholders in the state accountability system. A major step in enhancing the accountability structure for the public sector audit was taken in 2004 when a Committee on the Control of State Budget - a select committee of the Parliament was established to deal with the activities and reports of the Riigikontroll.

## **1.5 Acknowledgements**

SIGMA and the peers want to express our gratitude to the peers of the Riigikontroll who so actively and professionally contributed to the Review - Auditor General Mihkel Oviir, his Chief Auditors, other senior auditors and staff. This is especially relevant to our main speaking partners and the organisers of the review Riigikontroll Director Tonis Saar and Head of International Relations Rein Söörd who have the admiration of the SIGMA peers for their knowledge and understanding of the Riigikontroll and their commitment and effort to making the peer assistance review a useful and helpful process. All the staff at the Riigikontroll gave the SIGMA peers much time and provided much interesting and stimulating discussions during the Peer Review. Without their knowledge and open attitude to discussing possibilities as well as problems this Peer Review would not have been possible to carry out so well. The Estonian peers are set out at **Annex 1**.

Many thanks also go to our expert team of interpreters and translators led by Vaike Seppel (see also **Annex 1**).

## SECTION 2: AUDIT LEGISLATION

### 2.1 Background

As part of the work of the peers we have reviewed the current Estonian law on the Riigikontroll – the State Audit Office Act (the SAO act) of 2002 (see **Annex 2** for the detailed review). Here the review is briefly summarised.

The SAO act is a modern audit law because it contains most of the important elements modern audit laws should incorporate. The law also corresponds to a large extent to the INTOSAI recommendations. It gives the Riigikontroll a considerable independence and also a wide mandate. The Act is a notable achievement when compared with the previous SAO act that was in force for many years and on which the previous peers of 1999 had several observations.

### 2.2 Main Issues arising from the review of the legislation

#### *Independence of Chief Auditors versus Comprehensive Responsibility of Auditor General*

According to the SAO act the Riigikontroll is an audit office following the widely spread auditor general model. In all Supreme Audit Offices established under this model the Auditor General has complete personal responsibility for the work of the audit office and the resulting reports. This differs considerably from the court or collegiate model where a college or a council has overall responsibility and authority and the nominal head of the organisation, normally called President, is of 'primus inter pares' and is restricted to more general tasks, mainly representing the audit office before the Parliament and public and responsibility for administration and human resources.

The Act gives the Auditor General of Estonia all those general tasks and responsibilities, but involvement in the audit process is more limited than other Auditors General. Some key responsibilities given to the Chief Auditors of the four Audit Departments who are regarded as independent.

In practice the Chief Auditors ensure the performance of audits and sign audit reports (unless decided differently in the annual work plan). According to the law, chief auditors are only responsible for supervising the audits which would conform to practice in other audit offices where Auditors General usually delegate senior officers to manage the planning and execution of the audits as well as the drafting of reports but retain personal responsibility for approving plans and reports and presenting them to Parliament. If an audit is actually carried out by a chief auditor the law requires the Auditor General to exercise supervision of the work. Otherwise little is specified in the law under the "status and duties of the Auditor General".

#### *Recommendation*

- The Auditor General should be responsible for all aspects of the auditing and reporting carried out by the Riigikontroll and also for signing the main audit reports for external publication. He is appointed by Parliament, whereas the chief auditors are appointed by the Auditor General. Accordingly he should be the one with the ultimate responsibility which does not of course prevent him delegating such tasks as he sees fit to his senior staff as is normal business practice.

A related issue, the benefit of concentrating reporting to Parliament on material errors in accounts requiring qualification important matters of performance and informing the auditees separately about other less important matters arising from financial audit are dealt with later in Section Reporting to Parliament below and in the later section on "Relations with Parliament".

### ***Audit of a Consolidated Annual Report of the State not covered in the SAO act***

According to the State Budget Act the Riigikontroll has to audit the annual report of the state and the annual reports of constitutional institutions. The Riigikontroll shall prepare an audit report concerning a consolidated annual report of the state not later than by 31 August of the year following the accounting year, and as regards the constitutional institutions not later than by 31 May, and the audit reports shall contain an assessment of the accuracy of the consolidated report and the legality of the transactions.

These important tasks are mentioned only in the State Budget Act but not in the SAO Act. Here only two reports to the Parliament are mentioned, an overview on the use and preservation of state assets and annual activities report.

#### ***Recommendation***

- It is important that all tasks and responsibilities of the Riigikontroll are specifically included in the SAO Act and not only in another law.

### ***Budget of the Riigikontroll***

Another main issue is the question whether the Riigikontroll should be entitled to present its budget requests directly to the Parliament or if the present procedure of involving the Ministry of Finance is sufficient. In this respect the peers have different views depending on the experience in their own audit office.

Currently the Riigikontroll drafts its own budget and presents it to and negotiates it with the Ministry of Finance. The Ministry of Finance may make amendments to the draft budget only if this has been approved in the negotiations. When reviewing the draft state budget, the Government has the right to amend amounts entered therein or to omit amounts therefrom. Upon amendment or omission of amounts designated for a constitutional institution the Government is obliged to present amendments together with justification therefore to the Parliament.

Therefore it can be argued that the Parliament learns about the rejected Riigikontroll budget requests and the reasons for it, and they have the possibility to decide about it. The Riigikontroll has also the right to address the Parliament in its annual activity report and explain why the allocated budget is not sufficient. On the other hand it can be argued that a direct access right to the Parliament brings the Riigikontroll into a much stronger position. The Ministry of Finance or even the Government cannot just reduce the Riigikontroll draft budget but have to address the Parliament themselves.

The situation in most Supreme Audit Institutions is similar to the actual one in Estonia. There is a general sentiment that a direct access right to Parliament is stronger and better for the independence than the need to go through the Ministry of Finance. In addition even this does not guarantee that the draft budget is always fully granted because if the general state budget is restricted the audit office will have to carry their share of the burden as well.

However, very few countries operate such a system in practice. It is done, for example, in the UK, where the NAO is accountable to a Public Accounts Commission (not the Parliamentary Accounts Committee, but an all – party committee of Members of Parliament with special responsibility just for this task) which examines the NAO Budget and appoints the external auditors of the NAO's Accounts.

#### ***Recommendation***

- Financial independence is very important for the Riigikontroll. It is significant if the Auditor General does not have the financial and human resources he considers he needs to carry out his audit tasks properly and fully. The Riigikontroll may consider making a case to the Parliament but should discuss the issues and concerns fully with the various stakeholders, especially the Ministry of Finance, before taking this step.

## *Audit of Local Government*

In its last Peer Review the peers recommended to put in place arrangements for an effective external audit of local government. These arrangements should consider carefully constitutional difficulties and resourcing restraints. The Parliament has decided to extend the Riigikontroll mandate to carry out financial audits of the local governments. This corresponds to the recommendation made by the peers in their 1999 report. The Riigikontroll seems also aware of the personnel and other resource problems linked to such an extended task and prepared to cope with it.

### *Further issues*

Generally the SAO act can be regarded as a good example of a modern audit law with the Riigikontroll fitting well into the European INTOSAI family. The present audit law review concentrates on pointing out matters that should be re-considered. It does not evaluate and comment those many rules that are positive. The following comments are supposed to be helpful in further enhancing the present law in order to be totally in line with the INTOSAI Auditing Standards and the audit practise of the best Supreme Audit Institutions within INTOSAI.

### *Recommendations*

- Further changes of the SAO act seem not to be realistic right now or in the near future. The issues discussed above, however, should be considered for the next review of the Riigikontroll Act.
- In other new EU Member States the issue of the period of office of an Auditor General has been causing some concerns. SIGMA would suggest that for an “Auditor General a period of office of not less than two times the length of the national parliament, non renewable, is a good practice. This will help avoid the possibility of unwelcome political pressures being placed on Auditors General who may seek renewal after a shorter period of office.

## **2.2 Reporting to Parliament**

For the time being the Riigikontroll sends all its audit report to Parliament. Often these reports are rather large and contain many details. Parliamentarians, however, all over the world don't want to read large documents. Therefore even very important reports are not dealt with properly only because they are too long and contain too many details and less important issues.

Many Supreme Audit Institutions have realised this problem and, as a solution, restrict their reports sent to Parliament to the really important issues that the members of the Parliamentary committee concerned should be and wish to be informed about. They inform Parliament especially about those important findings and recommendations where the auditee refused to follow the audit office advice and where the help and support of Parliament is required. Other issues of minor importance that can and should be dealt with by management are only sent to the auditee via a so-called “management letter” – see also Section 7 below.

The introduction of such a management letter procedure would have the advantage that Parliament had to deal only with important issues. Accordingly the chance that they will actually deal with these important observations is much bigger. This again would increase the chances of the audit office to get the help and support they need. Right now the Riigikontroll is not always happy with the support they receive from the Parliament. It would also further enhance the reputation of the Riigikontroll as audit office are often worldwide criticised for bringing up too many unimportant matters.

In this context it does not seem important whether the expression “management letter” is applied or the reports covering those issues not to be reported to the Parliament are called differently, for example “report to the auditee”. Important is only the message that reports to the Parliament should contain only important issues.

### *Recommendations*

- The introduction of such a management letter would be a good practical and more modern solution for the Riigikontroll. This is not prevented by the current Law.
- Those significant reports sent to Parliament containing only important issues should then always be signed by the Auditor General whereas the task to sign the management letters or other reports could be delegated to the chief auditors or audit managers (again depending on the significance of the audit findings, and the recipient of the letter). This would also demonstrate very visibly the different importance of audit findings and enhance the effectiveness and reputation of the Riigikontroll.

## SECTION 3: IMPLEMENTATION OF THE 1999 SIGMA PEER REVIEW RECOMMENDATIONS

### 3.1 General

The peers made a follow-up on the outcomes to date on the Peer Review 1999 Recommendations. It was a joint exercise with the Riigikontroll responsible and two of the peers<sup>3</sup> engaged in the Peer Review 1999. In short the results were impressive and development has been sustained over a period of great activity. The following (in italics are the SIGMA Recommendations of 1999) are a summary of the progress made (and see also **Annex 3** for more details of the activities carried out by the Riigikontroll to implement the peers 1999 Recommendations.

### 3.2 Legal framework

*The right/obligation to carry out the full audit scope (financial/regularity and performance audit) as defined in the INTOSAI Auditing Standards.* This is covered in the SAO Act of 2002.

*Require the Riigikontroll to perform a full Annual Attestation Audit on Financial Statements.* The Riigikontroll gives an opinion in line with the INTOSAI Auditing Standards on the Consolidated Annual Report of the State. With the introduction of the new Attestation Audit/Audit Opinion of the whole Government's annual accounts an opportunity now exists to move fully to a financial audit based on national and internationally recognized audit standards. See also Section 5 below for further analysis and comments.

*Provide the Riigikontroll with a greater degree of financial independence.* The situation is largely the same. The budget still goes through the Government. Especially there remain issues of financial independence, concern for adequate salaries, and resources for new audit assignments. See also Section 2 above for some further discussions.

*Arrange for an effective external audit of Local Government.* An amendment to the SAO act in 2005 entitles the Riigikontroll to carry out Financial Audit of the Local Governments, but not any Performance Audit of the individual Local Governments. This is also discussed further below in this report.

*Institute a formal arrangement for a government response to the recommendations made by the Riigikontroll in its main reports.* The formal arrangement is laid out in the SAO act. Attention is, however, needed to ensure that the new system works.

*Provide for a sensible and useful intervention on the budget proposals of the Government.* The Select Committee on the Control of State Budget uses information provided by the Riigikontroll in reviewing the draft State Budget<sup>4</sup>. The Auditor General participates in the Government sessions with the right to speak. But this does mean there is a need for careful management of possible future conflicts of interest. It would also be good if participation was more clearly explained publicly as observation only.

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3 . Nick Treen and Detlev Sparberg.

4 . Some interesting work is done by the UKNAO on verifying Government Budget assumptions and this may provide some good practices for the Riigikontroll to follow – see Audit of Assumptions for Budget 2005 - REPORT BY THE UK COMPTROLLER AND AUDITOR GENERAL | HC 452 Session 2004-2005 | 16 March 2005.

### Conclusion

Most of the issues have largely been taken care of. The financial and operational independence of the SAI still needs to be carefully guarded.

### 3.3 Audit Methodology and Standards

*Manuals need to be developed or reviewed.* All responsible Chief Auditors have developed their own manuals/ Guidelines since 2000. The latest are Guideline for Preparing the Work Plan and Conducting the Audits - applicable to all departments (2005), and a Guideline on Audit Opinion of the Riigikontroll on the Consolidated Annual Report of the State (April 2005), approved by the management of the Riigikontroll.

*Make maximum use of the practical experience of auditors.* This has been strived for and broad staff participation has been secured. However, recent levels of staff turnover has made this difficult and great attention does need to be maintained on maintaining institutional memory”.

*Manuals based on current best practice in the EU.* Primary sources for adaptation in the Riigikontroll have been the a) 15 EU Guidelines b) the Netherlands through three and a half years of assistance (PSO programme) c) the UK and d) the adoption of the Swedish NAO's procedures for Performance Audit.

*Introduction of Manuals is important.* It has been the guiding principle.

### Conclusion

The issues have been taken care of. However, this is an area where developments are always necessary.

### 3.4 New Types and Areas for Audit

*Broaden the scope and type of audits.* Done: Financial Audit, Attestation Audit, Operational Risk Audit, and Performance Audit.

*Starting up Performance Audit by focusing Financial Management.* Done and today the audit of Financial Management is an important part of Financial Audit. The Riigikontroll has played a role in stressing the importance of Financial Control and Internal Audit, both now introduced in an amendment to the Government of the Republic Act in 2000. It is worth noting that Internal Audit and Financial Control are of a good standard now at the state level in Estonia, and that a similar focus in the new audit area of Local Government may also be a good tactic for the Riigikontroll.

*Review its anti-corruption activities to ensure that they are effective and useful.* The responsibility to check the declarations of economic interest of Local Government officials transferred to the Ministry of Interior. The Riigikontroll has focused more on legality issues audit (using a risk based approach).

### Conclusion

These issues have been taken care of. There seems, however, to be space for even further improvements.

### 3.5 Planning and Quality Assurance

*A whole range of planning mechanisms needs to be considered.* Corporate Strategic Plans 2000-2003 respectively 2003-2005; Audit Strategies for 2002-2004, Annual Work Plan; the recently adopted Guideline gives detailed advice based on risk evaluation and materiality considerations. We found, however, too many Audit Managers and Auditors who were not aware of the strategic issues or at least did not consider them to give sufficient guidance.

*Appropriate information systems for a modern Supreme Audit Institution.* A new document register system and a Time Reporting System (TRS) have been introduced. . Every audit can be followed in the TRS but improvements are planned to this system.

*Modern Key Management training incl. direction, supervision and review of audit.* Management Training was carried out within the PSO programme 2000-2003. However, so many of the trained people have left and this issue still must be topical. Modern Job Descriptions are in place.

*Mission and Vision documents should be developed as well as Strategic Plans.* Done.

*Develop a comprehensive Strategy for ensuring High Quality in Audit.* A comprehensive approach and work have been the results, e.g. embraced in the following documents: Guidelines for Preparing the Work Plan and Conducting the Audits; Personnel Policy, Staff Regulations; Policy for communication with Media; Communication Policy. The peers think, however, that a modern Quality Assurance System would be an effective platform for further developments.

*Management and Quality Control Systems need to be developed to cope with the expanded Financial Audit and Performance Audit beyond the legality area.* The Chief Auditor is responsible for quality control. Internal discussions serve as an important means of quality control. The Audit Managers and the Methodology, Planning and Reporting Service are also involved in the quality control. The pros and cons with this design would be analyzed in other parts. Basically the peers think this is not yet fully in line with a modern Quality Assurance thinking and needs to be developed.

#### *Conclusion*

Many of the recommendations been addressed there are still some issues to elaborate further.

### **3.6 Making use of Audit Findings**

*Without any specific references to the Peer Review 1999 this is a most topical issue.* In February 2004 the Riigikogu Select Committee on the Control of State Budget (SCCSB) was established and within the PSO 2003 programme a visit by the representatives of the committee and the Riigikontroll to the Rekenkamer /Parliament in the Netherlands gave valuable stimulus and ideas. SIGMA Paper No 33 is translated and distributed in the Parliament. The SCCSB makes inquiries to the Government with a deadline of one month to respond. We learned, however, that there is a substantial potential for a more efficient dialogue between the three concerned parties and the follow-up on Riigikontroll audit reports.

*Care its relations to its clients and auditees -- especially the Minister of Finance.* Guidelines dealing with these are: Communication Policy; Guidelines for Preparing the Work Plan and Conducting the Audits; cross training and secondment with the Ministry of Finance in the first years; audit plans are co-ordinated with the Department of Financial Control of the Ministry of Finance.

*Be aware of the risks with a High Media Profile.* Public Relations staff visited Denmark and Sweden; Communication Policy developed; the Dutch trained in communications skills. We found that the Public Relation Service seems to be expert and well ahead. It is good to see they are proactively integrated in the core audit processes.

*Modernise its reporting systems to ensure fairer and more effective reporting. Layout and format to be standardised. A stronger contradictory procedure.* The contradictory procedure has been strengthened substantially and is a requirement (§50) in the SAO act. Improvements in other aspects can also be noted.

#### *Conclusion*

Most of the issues have been taken care of. However, this is a never ending concern and an important area to perform well in.

### 3.7 Management and Organisation

*Mission and Vision statements should be communicated to staff. The Auditor General should be more involved at an early stage of significant reports and should delegate more administrative functions to his senior staff.* Mission and Vision statements have been developed and also available on their homepage, but the peers have got the impression that there are too many of the staff not being aware of them and the Strategic Thinking.

*Staff assessment process should be simplified... less threatening and linked to personal development and training issues, performance pay system to highly effective and well performing staff.* The assessment has been simplified. Annual performance is assessed by the direct manager who makes a proposal to the performance pay.

*IT-facilities to be further developed and enhanced as well as a capacity to undertake audits of computer systems.* CAATs as IDEA have been procured and some basic training as well. We got the impression that many of those who used them have left and that there are too many not using them now.

#### Conclusion

Thus the issues have been taken care of. We got the impression, however, that some of these capabilities seem to have been lost and will need to be replaced due to high staff turnover in 2004.

### 3.8 Training

*Develop a graduate training programme to help attract highly qualified people.* An introductory programme for newcomers was developed and introduced, a test period under supervision and a mentor for six months.

*Conduct a training needs assessment, a gap analysis.* As a result of the SIGMA Peer Review in 1999 and the PSO programme a training needs assessment was made and it has been updated annually. Internal training has been arranged as the resources so permitted. No special scheme for accountancy training has been developed. The peers acknowledge this but emphasize the need of comprehensive training programme.

*Institute an organised Policy of Job Rotation.* Personnel policy includes relevant part to encourage job rotation between different audit departments. We note that this is probably not the most urgent need today bearing in mind the reorganisation of the Riigikontroll. At the same time this could be an opportunity and bonus for the young people to stay longer.

*Establish links with possible training partners and collaborators.* Established training with the Ministry of Finance, the Tartu University and some Private Auditing Firms.

*Participate in the Certification of Auditors training course organised by the Estonian Accounting Board.* A few auditors have on their own initiative got the certificate. This is very good and needs to be further and officially encouraged. Later in this Report the peers suggest closer coordination and greater participation and use made of professional Certification through the Estonian Board of Auditors for all financial audit staff.

#### Conclusion

Many of these issues have been taken care of already in the beginning of the period. We got the impression, however, that the Riigikontroll might have lost momentum and now needs to revitalise its training.

### 3.9 Summing-up

We note that most of the issues addressed by the previous peers have been taken care of, especially those of a structural character through the Strategic Development Planning process and a methodical and systematic approach to change management. This is very good indeed, and in this the Riigikontroll has been a model for other SAIs to follow. The more 'soft' recommendations seem to be lagging behind a bit and not dealt with quite so effectively and will need further future attention. Many of the big initial investments in training need now to be readdressed due to the staff turnover and the natural course of time. It is good that after the high staff turnover in 2004 (31 leavers, which

is some 45%), only 7 staff members have left the Riigikontroll in 2005. This still means much recruitment action will be necessary to achieve full complements following the additional local government tasks given to the Riigikontroll.

It should also be said that the Riigikontroll have laid a good platform, and are now consolidating it further, at the same time as they go ahead for the next stage of development. The backlash, from high levels of staff turnover, is something that many Supreme Audit Institutions have struggled with and especially in transition countries. Bringing stability to the staff complement, raising salary levels, and managing turnover and recruitment sensibly is thus one of the most urgent challenges for the Riigikontroll today.

## SECTION 4: CORPORATE, STRATEGIC AND OPERATIONAL PLANNING

### 4.1 Audit Strategies and Plans

#### *Planning is important*

The Peer Review of 1999 SIGMA recognised that there was a need for more effective planning at the Riigikontroll. It recommended the preparation of corporate and strategic plans as well as more detailed operational and audit planning. These were necessary to specify, on a continuing basis, the tasks confronting the Riigikontroll, the outputs required in terms of the duties laid on the Riigikontroll by Statute and the standards to be applied. It also recognised that this needed to be accompanied by reviews of the resources and skills required by the Riigikontroll to deliver these outputs to the required quality and those actually available. This would be essential in helping the Riigikontroll determine its priorities and present to Parliament a defensible programme of work and plans for the future development of State Audit in Estonia.

A SAI's ability to do this effectively is to some extent determined by the legislation under which it operates and the relationship it enjoys with the State Parliament and other stakeholders. Despite the significant progress which has been made in these areas since the last review, there are still matters which require further attention in order to make the whole of the external audit process more effective.

Most State Audit Institutions have the responsibilities for carrying out two distinct types of audit. The first and some would say the foremost of these is independent external Financial Audit. By this process the SAI usually provides to Parliament a formal, professionally and internationally recognised audit opinion or certificate on the reliability of the Financial Statements produced by Ministries and Agencies to whom resources are allocated for carrying out their programmes of activity. This is sometimes called attestation audit. This is usually an annual requirement and needs to address all of the accounts concerned each year. The international standards that apply to this audit are developed by IFAC, and INTOSAI now have a project to issue themselves Guidelines on the adoption and use of these standards by SAIs.

The second is Performance Audit by which the SAI examines whether the same public sector bodies have managed their resources and programmes in order to ensure optimum economy, efficiency and effectiveness (sometimes called value for money). Such work is not necessarily related to any particular financial year and is focussed normally on providing reports for Parliament Audit Committees to consider and discuss.

Different criteria need to be applied to the planning for each type of audit. In financial audit work the emphasis needs to be on doing appropriate examination of the whole of all the account(s) for which one is required to give an audit opinion/certificate. The objective should be to ensure that the financial statements are free from material misstatement and that transactions have the appropriate legal and Parliamentary authority. Because this is usually a permanent and annual requirement, appropriate resources have to be devoted to ensuring that this work is done to the required standard. The level of resources required should not normally vary much between years as long as the numbers of individual accounts to audit do not change significantly or there is a radical change in audit approach - although the peers note that in Estonia recently there have been many significant changes. From 2005 there is a requirement to give an opinion on Consolidated Annual Report of the State and this is one single audit task. Before the audit was performed and reported on the single entity level. Annually there were performed 30-40 financial audits. The amount of audit resource needed will need to reflect requirements to fully follow audit standards. Not having the resources to meet these standards is not acceptable and will be regarded as unprofessional and negligent.

Performance audit is also important and is frequently given more attention by Parliamentary authorities than the more mundane, but vital, task of certifying the Government's accounts. But the extent of such work needs to take

account of the resources that must be devoted to the first priority of financial audit. Thereafter, the choice of those aspects of ministerial activities that justify being addressed should be driven primarily by the perceived or known risks to economy, efficiency and effectiveness which have been identified through monitoring of ministerial activities and procedures. This requires a comprehensive knowledge of the way in which ministries work and formal analysis of the risks which may be present in order to select those audits which will be most useful and add most value. The extent of possible performance audits in most jurisdictions is nearly infinite. Picking winners is therefore very important.

Until such time as the accounting and internal control problems in the ministries which have hitherto prevented the Riigikontroll from giving 'clear' opinions on the Budget Implementation Report (a Consolidated Annual Report of the State from 2005) have been resolved, the resources devoted to Financial Audit and advice on how internal controls and accountability can be improved should still be given priority. This will, quite naturally, impose some limitations on the amount of performance audit work which can be done in any one year. The arguments for this should be discussed and agreed within the Riigikontroll and discussed with the SCCSB while at the same time maintaining the independence of the Riigikontroll. It is important for the SCCSB to be aware if there are any special resource issues affecting planning for performance audit outputs.

Getting the house in order on financial audit will pay immediate dividends on persuading ministries and the Government to address the present financial control and accounting weaknesses. Dividends will also be paid in later years through increased efficiency of Financial Audit in a more coherent and well defined system. A more effective Financial Audit will also assist in planning Performance Audit.

There may also be scope for reliance (IFAC ISA 610 will be the guide for this, and see also the Annex below) on the work of Internal Audit following the publication and implementation of the guidance for Internal Audit issued in December 2004. But the Riigikontroll will need to be sure that the Internal Audit units are capable of doing work to the standards required by the Riigikontroll, and if this is the case be able to prove by examining in detail the actual work on which reliance will be placed, including reperformance of some tests for example). The introduction of a Consolidated Annual Report of the State for 2004, as well as creating problems for the Riigikontroll initially, of both a resource and technical nature, will provide an opportunity to plan to do this if not this year perhaps the next. Further suggestions concerning Financial Audit are set out below in Section 5.

#### *Recommendation*

- Strategic planning and overall audit planning will now focus on the two main types of audit – financial and performance. For financial audit the key is the calculation of the resources needs for a minimum defensible audit and the numbers of separate financial statements to audit. For performance audit selection of studies and the management of the studies themselves and the use of advanced performance audit techniques are key. The need to have a steady supply of performance audits through the period Parliament will deal with these audits is also a key planning and timetabling issue.

## **4.2 The balance of Financial and Performance Audit at the Riigikontroll**

### *Planned*

Examination of the Strategic Plan of the Riigikontroll for 2000 – 2003 (main directions of activity) and the associated documents "Audit strategies" for 2002 – 2004 and 2003 – 2005 have provided some insight into how the apportionment of work between the three main areas of audit activity previously carried out (financial, risk and performance) was planned. But, for Financial Audit, the documents do not provide convincing arguments for the division of resources between strategic areas (actually, the 11 ministries to be covered) and the number of audit projects planned (ranging from 34 in 2002 to 58 in 2004 as shown in the strategy planned for 2002 – 2004) as it is not clear what are formal legal requirements for annual financial statements to be prepared, audited, and then laid in Parliament. Historically there appears also to have been little analysis of the numbers of separate accounts and the account areas involved for financial audit and the opportunity of examining such common systems, such as pay.

A similar lack of overall analysis and needs assessment applied to the audits planned for Operational Risks (34 – 41) and Performance Audits (20 – 24).

It was noted that the selection criteria, which appear to be applicable to all forms of audit project, are set out in the Section entitled 'Obligations and choices of the Riigikontroll' were as follows:

- Incidence of problems or probability of such incidence
- Volume of State finances and assets connected with the topic
- Number of citizens directly impacted by the topic
- The possibilities of the Riigikontroll to add value
- Relevance to the obligations and priorities of the Riigikontroll
- Parliamentary interest
- Significance for the partners of the Riigikontroll
- The feasibility of the project.

These criteria would certainly be of relevance to the selection of Performance Audit projects but they are of questionable value in the context of Financial Audit. What is missing in both cases is the assessment of risk – for Financial Audit (it was also noted in the strategy that for Financial Audit the goal was to increase the number of audits year-by-year and cover finally all public sector).-- that the Financial Statements as a whole or the areas of expenditure concerned are at risk of being materially misstated – and then for Performance Audit - the extent of known or perceived risks to economy, efficiency and effectiveness. Risk assessment was actually used and linked to audit tests , but that requirement wasn't well documented. As there were no real consolidated accounts it was considered that there was no need for “consolidated risk analysis”.

The overall number of projects planned for the period 2002 – 2004 (317) seemed very, if not over ambitious. This is not necessarily a bad thing, but unrealistic planning can cause many problems

***Delivered Audits***

Analysis of the audit reports actually produced by the Riigikontroll since 2002 shows that 202 reports were eventually produced in the period broken down by year as follows:

2002	64
2003	76
2004	62

Up until 2004 the Riigikontroll was organised on a functional basis with three specialist Departments responsible for Financial Audit, the Audit of Operational Risks and Performance Audit respectively. It is interesting to note that the types and number of audits varied significantly between categories as follows:

	Financial	Operational Risk	Performance	Total
2002	35	21	8	64
2003	40	29	7	76
2004	28	20	14	62
Total	103	70	29	202

This represents a significant shortfall in what was originally planned. The audit strategy document for the period 2003 - 2005 shows that the scale of output was reduced but the reasoning/justification for this was not provided in the document.

#### *Recommendation*

- We would suggest that for the future the Riigikontroll could be a little less ambitious in terms of total output, and concentrate for financial audit on delivering its obligatory (now very clearly only the Consolidated Annual report of the State in order to have an appropriate high standard for this work as its first priority. And to do perhaps fewer but larger performance projects based on the risks to the three 'Es'. The peers discuss the strategy for Performance Audit more fully in Section 6 below

### **4.3 Audit remit and focus**

The Riigikontroll asked the peers for a second opinion regarding the present and future balance of the audit portfolio - how to address the following topical issues

- The Audit of the Consolidated Annual Report of the State
- The Audit of State Revenues
- The Audit of the Local Governments
- Measures against Fraud, Irregularities and Corruption
- IT Audit

#### *Audit of the Consolidated Annual Report of the State*

The Budget Execution Audit is one of the main pillars in the overall accountability perspective, giving the Parliament feedback for its decision - direct or indirect - to discharge the Executive, the Government, from its responsibility. An SAI could form its role in that accountability system in different shapes. To illustrate how such a coherent design could look like you could study a case study from Sweden: 'Accountability and Control' (OECD Public Management Committee, October 2003)<sup>5</sup>.

The new Consolidated Annual Report of the State implies a more coherent and complete form of presenting the totality of assets and liabilities of the State. They should have a high priority even in the future. The possibility to rely upon the Internal Auditors at the ministries (equivalent) opens up for more coordinated and efficient use of the total resources for the public sector audit. In the Annual Report 2002 the Riigikontroll elaborates quite skilfully their argumentation for the possibility of applying the Dutch model in Estonia. Careful considerations are, however, recommended before the Riigikontroll definitely settles on a design for the future. There is also a serious 'caveat' here, however, according to the new IFAC standards (ISA 610 which is *applicable to the audit of Financial Statements in the Public Sector*) the external auditors are required to carefully evaluate the work of the Internal Audit before rely upon it. *'The external auditor should consider the activities of internal auditing and their effect, if any, on external audit procedures.'* (§2) *They should, however, always consider that 'the external auditor has sole responsibility for the audit opinion expressed, and that responsibility is not reduced by any use made of internal auditing.'* (§8) The Swedish NAO has also taken a decision to basically rely on their own work for their Attestation Audit or make a thorough evaluation of the status of the Internal Audit concerned. These more strict attitudes and rules are due to the well known accounting and auditing problems in both the private and public sectors in the US in the 1990s and again in the early years of 2000. In Section 5 below a more in depth examination is made. Here we are just referring to a more comprehensive assessment.

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5 . OECD Public Management Committee Expert Meeting on Accountability and Control. Case Study of Sweden by A Hjalmarsson and G Jonsson 2003.

### *Recommendations*

- The Riigikontroll audit of the Consolidated Annual Report of the State, as today, should have an important weight but that the possibilities for an even more efficient use of audit resources should be carefully scrutinized. What do you mean?
- Relying on the work of Internal Auditors is a good Financial Audit practice. The possibility and the degree to rely upon the Internal Auditors should however be re-examined from an International Auditing Standards point of view - the ISA 610 in particular. As an interim measure in the early years of preparing the new Consolidated Annual Report of the State any supplementary audit work from whatever source is to be welcomed as an effort to make the new accounts eventually fully auditable by the Riigikontroll.
- The Riigikontroll should further develop its auditing standards on the methods and practices used to rely on internal audit work, and a system for the quality assurance of the internal auditors work.

### *Audit of State Revenues*

The audit of state revenues is from a professional point of view one of the more difficult areas. We think, however, that there is an important unexploited potential for adding value with a more sophisticated and comprehensive audit approach. That would at least from time to time motivate a coordinated approach of both Financial Audits and Performance Audits. In Section 5 below a more in depth examination is made.

### *Recommendations*

- This type of audit should get a higher weight in the Riigikontroll audit portfolio. SIGMA has provided some examples of an overall approach to Revenues audit and much valuable advice is now available from the Bonn EUROSAI 2005 congress.
- A good first step is to ensure the proper and full reporting of revenues in the Consolidated Annual Report of the State and review whether this area would be good for a major performance audit study.

### *Audit of the Local Governments*

The audit of Local Government is an issue where many different approaches can be observed already in the EU context. There are many factors influencing the design as e.g. the degree of fiscal sovereignty, how restrictive the laws on local government are, and the 'history' of financial scandals in the country concerned. We restrict ourselves to note that the Riigikontroll has now got an assignment to audit the Local Government and that there are many different options how to fulfil this assignment available to the Riigikontroll. In Section 5 below a more in depth examination is made.

### *Recommendations*

- The Riigikontroll should study different options before the final design is decided upon. Whatever the final solution there remains a need for an effective external audit of local Government with out duplications of audit effort.
- In other New Member States SIGMA has seen that preparing a Local Government "PIFC policy paper" is a good approach. The Riigikontroll should advise the Ministry of Finance to do this and be active in the support of its development.

### *Measures against Fraud, Irregularities and Corruption*

There is an increasing concern about how a Supreme Audit Institution should counter-act Fraud, Irregularities and Corruption. In the EU context the issue on 'Protecting EU Financial Interests' has the highest priority. Many

member states, and Estonia is one of them, develop certain National Strategies to counter-act Fraud and Corruption. The Riigikontroll has some experience when the office started with their special programme on Operational Risk Audits, since 2005 these aspects are incorporated mainly as an important assignment for the Financial Audit. This is a huge area to cover and they actually represent different types of problems with different measures to counteract. The INTOSAI Auditing Standards and IFAC have relatively well defined advice. Basically a Supreme Audit Institution should be 'a watch dog' not a 'blood hound' going on every possible indication. The main contribution should be to strengthen the regular Financial Controls and increase the likelihood that the normal Internal Audit and External Audit approaches would prevent and detect these types of problems.

However, there is a growing concern that a Supreme Audit Institution should be more 'proactive' in these areas than the traditional approach. For example, in the US GAO (the GAO have added "fraud risk" to their audit risk model<sup>6</sup>) has sharpened its approach in all these areas. The same can be said about the EU/EC approach and strengthening OLAF and the Internal Audit. A Supreme Audit Institution should also feel a certain responsibility to push the Executive's responsibility for designing, managing and follow-up on the systems needed for these areas. Performance Audit is one way of assessing them from the 3Es point of view. The peers would like to refer the Riigikontroll to one guideline from the UK HM Treasury 'Managing the risk of fraud'<sup>7</sup>.

### ***Responding to Evidence of Violations of Law***

The individual auditor must be trained to understand the importance of test and evaluation results that indicate violations of the law. Reference to supervisors will be called for before responses can be made to the organization unit being audited. The seriousness of the finding will dictate the response. The response could call for more evidence to be gathered, or confirmatory tests and reviews, before calling attention to the evidence. Serious violations may call for the Audit Supervisor/Manager to recommend to his/her superior that further work is required to confirm evidence of culpability and to prepare for handing the evidence collected over to the police or prosecution services where warranted. This action will require the decision of senior audit management.

### ***Some bench marks on Accountability and Corruption relevant to Estonia***

A recent study on Corruption in Post-Communist Societies<sup>8</sup> found that Estonia was relatively (compared to the other nine post communist countries of the region) well off on a number of more objective numerical indicators on Accountability (TI-Corruption Score 2003; Election Upset; Annual Average of Bribery Convictions; Bribery Convictions per One Million Inhabitants; Special Anti-Corruption Unit). This is encouraging. However, there still is a lot to do in this area.

### ***Recommendations***

- The Riigikontroll should review its present strategy and approach in these areas with the aim of being more proactive and vigilant. This is an important area in all countries and for the EU in particular, and the strategy adopted should show that the Riigikontroll is active and adding value.
- There should be some assessment on whether a performance audit in this area is a priority and would be useful and helpful. This could be linked to work in the Revenues area on "black economy" issues and concerns.

### ***IT Audit***

IT audit can be interpreted in many ways. We can see at least the following three aspects:

- Audit of the IT-area Management and Development - normally from the 3Es perspective,

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6. <http://www.gao.gov/special.pubs/gaopcie/>

7. [http://www.hm-treasury.gov.uk/media/42E/E2/Managing\\_the\\_risk\\_fraud.pdf](http://www.hm-treasury.gov.uk/media/42E/E2/Managing_the_risk_fraud.pdf).

8. The System Made Me Do It – Corruption in Post-Communist Societies, Rasma Karklins, 2005, p 130, cfr, Appendix 6.

- Audit of IT-security in different management systems with the focus on the risks arising from the special IT environment,
- The use of CAATs (Computer Assisted Audit Techniques like IDEA).

The first aspect, Management and Development, is in principle the same as other big investments and could also be a follow-up and/or an evaluation of state programmes. We have studied one recent report of that type: 'Performance of the state-owned IT-area Management and Development Projects. This is a meaningful type of project that well defends to be included in the Riigikontroll portfolio. There are some special features about IT-investments that make it more important than many other investments, e.g. the problems financing investments in IT-infrastructure out of the regular ministerial budgets; and the possibility to have common solutions and defined interface with other parts of the IT-structure.

#### *Recommendations*

- The Riigikontroll audit should continue its present policy on this area with careful value added requirements when deciding upon to carry out this type of audits.
- The use of CAATs (eg Win IDEA) is essential for the effective and efficient conduct of the audit of the new Consolidated Annual Report of the State. The expected increased use of statistical sampling for financial audit will need the use of such techniques.

The second aspect, the *IT-security*, has successively been incorporated as a normal but high risk area that should be dealt with in the first instance by the normal Financial Audit. IT is today the media for all information processing regardless its application. Previously major special IT-security audits were performed. Such ones can even today be motivated e.g. for a major system like the Treasury account once every third year or when circumstances so motivate. This should be dealt with in the Strategic risk analysis for the whole sector by the Riigikontroll. For more normal users of IT there are today shorter more common-sensed based Questionnaires that the ordinary Financial Auditor can use as a Basic Screening together with the IT-responsible at an auditee. If this simplified but very basic and essential scrutiny so motivates further in depth studies could be made or recommend by the Riigikontroll to the client. We have attached one such guideline from the Swedish NAO (as appendix 11). After some initial training and back up support from an IT-specialist an Audit Manager or a Senior Auditor should be able to handle this instrument.

#### *Recommendations*

- The Riigikontroll audit should include a screening approach of IT-security in its arsenal of tools for the Financial Audit.
- All qualified financial auditors need to have a basic level of competence in IT audit and the use of WinIdea.
- The audit of the new Consolidated Annual Report of the State will require a more coordinated and thorough audit approach to the main IT systems used in that area. In particular regular detailed reviews and annual updates will be needed for the Treasury and accounting systems and the State revenues systems for example.
- It will be good to make use of "Team Mate" type audit software.

The third aspect, CAATs, is mentioned above and is not an audit area – but it is an important and necessary audit tool that can be used for both financial and performance audits. The peers have observed, however, that there will be a need of reinforced training in this area for nearly all financial auditors.

## SECTION 5: FINANCIAL AUDIT

### 5.1 General

The peers have addressed the following aspects of the Financial Audit at the Riigikontroll:

- the Audit of the Consolidated Annual Report of the State
- the Audit of the State Revenues
- the Audit of the Local Governments
- Relation to Internal Audit
- Other Methodological Issues

### 5.2 The Audit of the Government's Budget Execution

The Riigikontroll, was required to annually deliver a Formal Audit Opinion (and an adjacent Audit Report) on the Government's Budget Implementation/Execution Report. This report is one of the most important feedbacks to Parliament on how the Government has performed in line with the objectives and roles given by Parliament, the relevant legislation and the resources allotted to them. It is one of the pillars of the accountability cycle in a modern democracy. The latest developments in the public/state sector financial management - performance reporting, full accrual accounting, substantially strengthened internal control and audit, make it more important than ever with a well functioning feedback from an independent Supreme Audit Institution.

*The Riigikontroll approach in 2003* (for the FY 2002) had the accountability focus on the individual ministries (and equivalents) - altogether 31 separate opinions (although it is not clear to the peers that these separate opinions were required by law). This is a set up similar to the one in UK where by law every Accounting Officer is responsible and accountable for producing accounts for audit by the UK NAO. The outcome for the FY 2002 in Estonia was that 3 were totally 'clean', 'true and fair in *all* material respects and corresponding to the regulation of the Minister of Finance'; 26 were 'qualified' in some aspects but basically reliable, 'true and fair in all material respects and corresponding to the regulation of the Minister of Finance, excluding the possible influence of circumstances recorded in the qualifications'; one (1) was an 'adverse' (?) opinion 'not corresponding to the regulation of the Minister of Finance; and finally one (1) was a 'disclaimer' - the Riigikontroll refrained from expressing a Formal Audit Opinion - due to 'material uncertainty'.

*The Riigikontroll approach in 2004* (for the FY 2003) had the focus on the whole State Budget and expressed one Formal Audit Opinion consequently the Government as such as the accountable. The underlying and verifying work was, however, built on the same type of approach as for 2003. All ministries were audited with separate reports to the Government. The basic audit approach is a *Systems Based* Audit with a *materiality threshold* of 1%. The Formal Audit Opinion was more freely formulated covering different aspects: the *state costs* - a *clean Formal Audit Opinion*; the *state revenue* - a *clean Formal Audit Opinion* but on a very low level of assurance - 'state revenues as shown in the Government Annual Report have been received in the State Budget.' *The Government Annual Report was 'not in line with Internationally Recognized Accounting Principles.* The Parliament has practically no possibility to get a sufficient overview of the financial situation in the state and assess the effectiveness of the Government activity in the budget year, i.e. *an adverse Formal Audit Opinion.* The *Performance Reporting* (i.e. Action Plan Implementation Reports, which for the first time are included in the State Budget Execution Report), was definitely not up to required standards and 'not suitable for use in next year's draft budgeting bill' - an *'adverse' Formal Audit Opinion.* These Formal Audit Opinions were followed by some severe objections on irregularities mainly in relation

to: the Procurement Act and the State Assets Act; the insufficient supervision of earmarked subsidies; improvements but still significant deficiencies in the Government internal control systems; and the reporting within ministries has improved but there are still significant shortcomings in the agencies in the area of their government.

*The Riigikontroll approach in 2005* (for the FY 2004) was still under discussion. There will be one Consolidated Financial Statements and Accounts on the State Budget. Full accrual accounting both expenses (since 4 years) and revenues (new) is applied. The Internal Auditor in each ministry is required to express a Formal Audit Opinion on the annual report of the Ministry covering both 'true and fair' and 'legality'. The Riigikontroll *may* rely partly or totally on the Internal Auditor 's Formal Audit Opinion if the quality so permits according to the State Budget Law. The consolidation is done by the Ministry of Finance for about 1300 state budget units in 2004. The consolidation of the actual data as such seems not to be a major technical problem.

There is now, since November/December 2004, a Guideline for the Internal Auditors on how to audit the Financial Statements and accounts for a ministry. Some training has been delivered to the Internal Auditors as a collective in early 2005 during 2 days, 100 out of 160 auditors attended. Most of the Internal Auditors still seem to feel insecure on how to address this assignment. Some of them, e.g. Ministry of Defence and Ministry of Education and Research have already taken the decision to contract out the assignment to a Chartered Accountant firm. The Internal Auditor of the Ministry of Finance has a similar situation to the Riigikontroll as they have subordinate units that should produce their own Formal Audit Opinion on their agencies (equiv.) and it is up to the Internal Auditor at the Ministry of Finance to decide whether they can rely upon their outcome or not. The Internal Auditor at the Ministry of Finance has already taken the decision not to rely upon other Internal Auditors' Formal Audit Opinion this year and designed an audit based on that all assurance would be given by themselves, the Internal Auditor at the Ministry of Finance. An audit programme is designed and audit samples defined and they have been sent to the subordinate Internal Audit units to work with under their supervision and deliver the results to the Internal Auditor at the Ministry of Finance. This Internal Audit unit does not see any major problems with the approach and feels confident doing this exercise without any assistance of a Chartered Accountant Firm. The deadlines are also expected to be kept.

The Riigikontroll should deliver one Formal Audit Opinion on the Consolidated Annual Report of the State on 'true and fair' basis together with a further statement concerning legality and conformity with legal provisions and intentions. The peers have provided the Riigikontroll with examples of such opinions from the UK NAO and suggest the format of the 'opinion' follow closely those of IFAC standards<sup>9</sup>. How much and if the Riigikontroll should rely on the Internal Auditors Formal Audit Opinion is still being discussed at the time of this review, but, as mentioned above the peers advise the use of IFAC ISA 610 to guide its work relations with internal audit..

*In conclusion the peers note that:*

- The Annual Report by the Riigikontroll on the State Budget Execution is a very comprehensive document with much useful information.
- It contains many interesting summing-up assessments of the present developments in the financial management of the state sector. Adding value to the independent feedback on the ongoing development to the Parliament and the Government.
- The terminology and structures used for the Formal Audit Opinion is not fully in line with the IFAC International Auditing Standards.
- It is difficult to get a proper understanding, at least for a non professional, of the Formal Audit Opinion - its different dimensions and level of assurance. This is a problem when not using internationally accepted standards.
- The low level of assurance on State Revenues seems motivated and it is correct to decline to express more assurance than that which can be substantiated. It is encouraging that the Riigikontroll takes this seriously.

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9. It is noted by the Peers that the UK term *true and fair* is equivalent to the IFAC terminology *fair presentation*. This has recently been agreed by the UK Financial Reporting Council: <http://www.frc.org.uk/press/pub0854.html>.

However, it might be a bit difficult to understand for a non professional and it also raises the question if not a higher level of assurance is expected from stakeholders and would add more value for the stakeholders,.

- The elaborations of the 'objections' are material and easier to understand.
- The 'coverage' of the State Budget as such seems sufficient for this type of financial audit – but will not be acceptable if IFAC standards for financial auditing are applied.
- The peers are not totally convinced that the conclusions for a 1% materiality threshold are solidly substantiated with substantive evidence.
- The advice given (below) for the Attestation Audit in 2005 would solve nearly all of the problems described.

#### *Recommendations*

- A major review of the format and wording of the Formal Audit Opinion should be done in line with the IFAC International Auditing Standards terminology and structure. This would also bring Riigikontroll work in line and up to the standards set for private sector audit in Estonia. A statement regarding regularity and compliance with legislation and regulations will be necessary.
- The collection of more substantive evidence is likely to be needed to verify that the materiality threshold (currently at 1% but see further discussions below) is established and well documented on all levels underpinning the opinion. This is needed in addition to other audit evidence from other types of audit tests eg compliance tests of the proper operation of systems.

*The peers have studied draft guidelines for the audit approach for the Annual Report for the FY 2004 and note that:*

- The intended 'global' design with a) one overall audit plan with one strategy for planning materiality (see further below; b) one Riigikontroll Formal Audit Opinion on the Consolidated Annual Report of the State ('true and fair' and covering 'legality and compliance') seems to be the most suitable; and c) the Internal Auditors Formal Audit Opinion for each first level budget holder ('true and fair' and 'legality'), together will give some feedback on accountability on different levels of the public sector. In its Annual Report the Riigikontroll would beneficially present the outcome of the Internal Auditors' Formal Audit Opinion work as well with its own findings and comments in the same areas. This should be supported by a review of internal audit which will form the base for any decisions to rely on their audit work.
- With legality and compliance with authorities as part of the audit opinion work the financial audit will need to have an audit assertion for regularity (examples from the UK NAO of this have been provided to the Estonian peers) and this audit assertion can be placed into the design of all audit programmes and be subject to the materiality concept. This does not mean ignoring regularity errors below materiality – any irregularity is important to follow up and report to the auditee, but will not necessitate the design of audit work to detect all errors of that type i.e. the same approach for errors of disclosure, measurement, completeness etc. Peers note that this has been applied since 2004.
- The whole current design for formal use and reliance on IA is quite similar to the set up in the Netherlands, where it is regarded to function smoothly and with strong and well qualified Internal Audit units established since many years. There are, however, differences especially in the set up phase that needs to be considered carefully by the Riigikontroll – not least that the Netherlands approach is not generally considered in full compliance with ISA 610 or the IIA standards. The present level of competence and experience of the Estonian Internal Auditors needs also to be developed substantially for the approach to be workable.
- The Riigikontroll may rely upon the Internal Auditors work carried out to support their own “Audit Opinions. However, this is such a big change in the design and roles that it needs to be carefully addressed, and subject to firm and documented agreements with internal audit. It should be well understood that the

review of IA, the determination that IA plans are acceptable, and then the re-performance of adequate samples of all internal work will be a necessary part of this reliance.

- This possibility to may rely does not mean the Riigikontroll does not take the full responsibility for its own Formal Audit Opinion on the Consolidated Annual Report of the State. The Riigikontroll will probably need also to take a proactive role together with the responsible Minister of Finance to develop the Internal Auditors to the level of performance required to be able to use as a basis for Riigikontroll. This would in practice, even in the best of scenarios, take some years to achieve.
- The one account approach will mean that many account areas may be suitable for a statistical (monetary Unit) sampling based substantive testing audit approach using WinIdea to sample transactions held in the Treasury system (and the monetary sample traced back to the end authoriser), e.g. pay and non pay in particular. This will save audit resource and give better and more quantitative audit evidence. It will also be a good test of “audit trail” integrity.
- The practical work will, of course, need to be spread to the different Chief Auditors and Audit Managers in the Riigikontroll under the coordination and supervision by one Chief Auditor responsible for pulling all audit work together -- today Audit Department 1 seems to be the very logical solution for the overall supervision and coordination of the audit.

*This new and revised approach, using a more transaction based audit approach requiring appropriate levels of audit evidence to be obtained for all account areas and material account figure, would probably mean:*

- Permit a more helpful and useful application of the planning materiality threshold and a better basis for assurance on a certain well defined level. Use of a flexible approach and strategy to setting a single plan for materiality will be needed at planning because the Consolidated Annual Report of the State is so large that materiality may need to reflect different levels of assurance needed for assets and liabilities from payments and receipts.
- Be a less resource demanding audit approach and provide much better audit evidence. When the approach is fully functioning it will allow, for the first time, all the necessary audit work for a proper audit opinion on the government accounts to be made with adequate audit evidence for all the material account areas and figures.
- In due course more sensible and practical systems for relying on IA will developed be built up on a proper “ISA 610” basis, and this cooperation will be very valuable and useful in ensuring full and proper government financial reporting.
- With an initial analytical review of the audit areas (global and specific risk assessments and linked testing of high risks identified) assessing its basic characteristics would increase its targeting capacity and maybe also reducing the needs of sampling size.
- The outcome of the other ministerial approach based on the System Based Audit would give more detailed information and inform about the efficiency of the Internal Control structures (see below).

The other part of the strategy would as now be a System Based Audit of the ministries (equivalent) rendering a Formal Audit Opinion by the Internal Auditors. That as well as other Financial Audits would give additional and supplementary assurance. Besides there is a well motivated interest to hold each Minister accountable for his area of responsibility. Riigikontroll would have a multifaceted role here:

- Coordinating their work with the work of the Internal Auditors to avoid a duplication of work.
- Support the Internal Auditors in their work and strengthening the audit work as such in the Public Sector
- Strengthening and adding value to the Internal Control system of the state sector.

- Riigikontroll would not issue their own Formal Audit Opinion on the same individual ministries - just writing audit reports...both Financial Audit and Performance Audit are possible. The Performance Audit reports would normally not form a basis for the Riigikontroll Formal Audit Opinion on the Consolidated Annual Report of the State. This is the normal solution in most countries with a more developed Performance Audit. The main arguments against are: a) that the Performance Audit is not an annual event and that it therefore would be hitting randomly b) that the Performance Audit is of another character than compliance and Attestation Audit.

### *Recommendations*

- The Riigikontroll should consider introducing a One Account Audit Approach for their Audit Report on the Consolidated Annual Report of the State – with the significant outcome of one audit plan and a flexible use of planning and reporting materiality for the whole account.
- The concept of an audit assertion for “regularity” and that this comes under the materiality concept needs further understanding and application for the audit evidence and assurance necessary for the audit of the Annual Accounts.
- The audit will be by account areas, with detailed testing coordinated by a single Chief Auditor and carried out by the Chief Auditor responsible for the client where the audit testing is performed. Audit work will be carried out in accordance with Riigikontroll standard methodologies and quality levels. This will need to be explicitly certified by each Chief Auditor.
- The supporting audit work on each ministry will be performed as is decided is necessary to support the audit opinion and also set out in the one audit plan. That will be as now a more System Based Audit Approach well integrated with the audit performed by the Internal Auditors and their own style of Audit Opinions.
- Methods for the proper reliance and cooperation with IA need to be continued to be developed as quickly as possible using “ISA 610” as a basis.

### **5.3 Audit of the State Revenues**

The audit of State revenues is important and difficult involving as it does large amounts of money, large complex systems – often heavily computerised, and large amounts of law and regulation. It is also high risk to fraud, corruption, avoidance and abuse. The Riigikontroll itself have in their Report to Parliament on the Report on the Implementation of the State Budget for the FY 2003 given a limited assurance on the true and fair view of the revenue side of the State Budget: '... The revenues recorded have been paid to the Treasury Account (... The state revenues as shown in the Report have been received in the State Budget'). This is an assurance on a low level and does not cover the most interesting and problematic aspect of the audit of government revenue – completeness. The Riigikontroll should be credited for being honest and professionally correct in clearly stating the extent of this audit. This is a weak spot for many Supreme Audit Institutions - many of them without clearly indicating what is being done or not done.

This means in practice that the Riigikontroll:

- has audited cash based revenues of the audited agencies representing 91% of the state revenues in 2003 – but the peers note that the 9% of revenues is a material amount.
- has many good and relevant audit observations regarding revenues e.g. regarding insufficiency of supervision; lack of audit trail on individual transactions; not collecting all potential revenues from their assets; the budgeting and accounting for revenues from the state economic activities.

- 'has compared the State Budget Revenue Income Reports of the Tax and Customs Board with transfers to banks and the State Budget. Their findings were that in total amount they are correct and transferred to the state budget at the right time.' This is at least to the credit of the Government and worth while saying.
- has, however, criticism on the structure of reporting, problems assessing single entries of revenue, and more basic problems with conciliating due to 'net' value accounting and reporting.

*The peers concluded that:*

- The 'gross' coverage of 100% is desirable.,
- The audit findings and observations made to date are material and relevant. There are interesting audit findings as well as recommendations,
- The total conciliation of the tax and customs account against the State Budget is necessary as well as the 'right time' aspect. The physical transfer is made, however, in most cases by an automatic data routine that is designed to guarantee that. Therefore it gives little assurance of a value added type to just say that it works. It is on this level at the whole State Budget that the Riigikontroll assure the true and fair/properly represents of the whole State Budget revenues. The further observations are therefore above this level. Thus it is a bit problematic to understand the gravity and the frequency of these observations as they are done besides the assurance.
- The Riigikontroll should review their work on the State Budget Revenue as well as how they phrase the Formal Audit Opinion. The revenues are probably one of the most risky areas if you include the revenues that should actually have been due to the state (completeness).

We regard this as a most important obligation for a Supreme Audit Institution to address.

There are the following levels to consider:

- 'It is a unique task for the public sector and the scale and the complexity of tax operations are huge and difficult to make completely proof against evasion. The adequacy of compliance has to be judged in terms of the cost-effectiveness of better enforcement and political and social acceptability. There are therefore problems both in defining the scope of the auditor's responsibilities and in devising appropriate techniques for discharging them.'
- Three problems are particularly acute in the assessment of completeness and correctness: a) a systems based audit approach would be the most appropriate; b) to have a high level of assurance would require the auditor to have the same right and duplicate the assessment procedures undertaken by revenue officers supported by access to citizens records and premises, and c) materiality and audit risk are particularly difficult and need to be seen in a political context as well - recommended materiality levels: 1) 2% on main stream, 2) for branches downwards 10%.

Due to that the main problem is that it is very difficult to assess what the 'real' revenues should have been as a consequence of the taxes and customs legislation one needs to supplement the Financial Audits with Performance Audits. The latter should try to assess via different more or less sophisticated methods the 'black or shadow' economy or other types e.g. contraband. This is a predominant example where Financial Audit supplemented by Performance Audit would add value by synergy. The peers have supplied some basic methodological advice on how to approach this problem, and there are now some helpful EUROSAI advice available.

*The peers concluded that:*

- This is a somewhat neglected area that needs to be better addressed in the future.

- Further considerations should be given to the Structure of the Audit Approach. A fully fledged approach would identify four distinct phases:
  1. Completeness/occurrence: persons and entities liable to tax, taxable events and transactions are identified,
  2. Regularity/measurement: resulting tax is properly, correctly and timely determined in accordance with statutory regulations,
  3. Completeness/occurrence/disclosure: all taxes so determined are fully and promptly collected and allocated,
  4. Disclosure: the tax collected is correctly accounted for.
- The materiality and risk assessments and materiality thresholds are especially complex and demanding to apply for revenues.
- The level of assurance actually used by the Riigikontroll for FY 2003 is low.
- A fully fledged approach is a major commitment and will take a considerable time to establish in the Riigikontroll context. Of the complete sequence the Riigikontroll could also require that the Tax Authorities would make their own assessments on the 'black economy'.
- An approach that would permit a somewhat higher degree of assurance would, however, be desirable, is difficult to understand the implication of this low assurance and then reading about the objections.
- The Riigikontroll should have the same rights as the auditee to verify individual declarations on a sample basis.

#### *Recommendation*

- The Riigikontroll should give this area a higher priority than up to day and be included in the audit portfolio as one of the more important engagements. Whilst the Financial Audit approach needs to be developed further this is an area where a performance audit looks well worth while.

#### **5.4 Audit of Local Governments**

Due to some financial irregularities and mismanagement the political pressure has been strong and resulted in the latest amendment to the SAO act (ref.) to cover the external audit of Local Government. The Riigikontroll has now the audit right and liability to audit the Local Governments each year from a Financial Audit point of view but not a Performance Audit. The latter means that it is not meant for Riigikontroll to go in and audit individual Local Governments in line with the 3Es criteria. The Riigikontroll argues that this new assignment will be a major engagement and that they need substantially more resources to do it in line with INTOSAI Auditing Standards. They have not yet decided how to fulfil their obligations.

#### *The peers concluded on this issue:*

- There are many options available on how to fulfil this obligation. It is important the Riigikontroll make it clear to themselves which ones are the most efficient and still realistic. The Riigikontroll should advise the Government to adopt a PIFC type "policy paper" approach (similar to that used during Accession for state level PIFC), and the Riigikontroll should be active in support of this.
- It is important to respect that the Local Governments are autonomous bodies with the full legal and political accountability to their constituencies. At present the Local Governments choose their own

auditors, normally Chartered Accountant firms, reporting back to the Local Government Councils. These auditors should be the only ones having the right/obligation to issue Formal Audit Opinions on the Local Government annual reports.

- It is important to design the Riigikontroll engagement in a way to avoid future set backs in form of a substantial 'expectation gap'. Regardless of the alternative finally chosen it must be an awareness of the Parliament what they can expect or not due to the resources the Riigikontroll can dispose for this assignment.
- It is also equally important to make clear that even if the Riigikontroll does not have the right to do Performance Audits of individual Local Governments, it still has the right to do Performance Audits on issues that is natural for the Riigikontroll to do e.g. how a certain ministry, or some agencies belonging to that group, perform supervision of Local Governments activities and responsibilities and report these findings, as today, in their Performance Audit reports. The same goes for the Riigikontroll rights to follow the economic and financial situation in the group of Local Governments to report back to the Parliament and the Government if facts so motivate. This obligation might need a further clarification in the audit law to avoid unnecessary frictions. This means in practice that they analyse public material and also can request further information by the Local Governments.
- That the Riigikontroll's rights to examine the underlying files to the Chartered Accountants' Annual Report should be clarified as soon as possible and which rights/obligations the Riigikontroll have if they find severe cases of violations of appropriate auditing standards incl. ethical violations. We have the opinion that it is desirable that the Riigikontroll has such rights/obligations to supervise and report to appropriate instances, this might need to be legally addressed.
- That the Riigikontroll annually reports back in their Annual Report to the Parliament and the Government on the financial situation in the Local Governments based on their more general monitoring on the Local Governments economic 'health' and sound financial management based on their actual audits.

#### *Recommendation*

- A comprehensive strategic approach for the Riigikontroll's audit of Local Governments in line with these considerations should be developed. A PIFC type "policy paper" approach is advisable and this should be supported by the Riigikontroll.

#### **5.5 Relation to Internal Audit**

The new State Budget Act explicitly mentions that the Riigikontroll 'may' rely upon the "Audit Opinion" of the Internal Auditors for its own Attestation Audit of the Consolidated Annual Report of the State. These arrangements appear in practice to be quite similar in some ways to that applied in the Netherlands. We leave aside the formal aspects of this as it has been addressed above already. However, it is clearly good for SAIs, wherever possible, economic and practical to do so, rely on IA work.

We concentrate here on the consequences for the Riigikontroll audits and the Internal Auditors work if such a model should be applied. Thus we are in this chapter accepting the 'audit pyramid' concept as interpreted by the Riigikontroll and referenced to the Dutch design. The Riigikontroll itself indicates in the Annual Report 2002 that 'a system-based angle only when workable internal control systems are in place'. The Internal Audit units and their staff need to be substantially up-graded and better co-ordinated and supervised by the new 'harmonising unit' - the Financial Control Department at the Ministry of Finance.

We concur with these assessments and estimate that even in the best of scenarios it will require a broad approach improving the general conditions for the Internal Auditors, e.g. better salaries and a comprehensive training are required.

We would also like to emphasize the need of a constructive and supportive working relation between the External Auditors and the Internal Auditors, which is also stated in the appropriate international auditing standards. Both types of auditors should try to coordinate their planning and informing each other on audit results and recommendations. It is the optimizing of the total audit resources that should be a guiding principle. Many good examples of such co-operations have been seen during the last few years but not all over the field.

We also see a need of a clear and transparent standard for the Riigikontroll assessment of the requirement on the Internal Auditor units to be able to fulfil the external auditors' acceptance of the Formal Audit Opinion of the Internal Auditors for their own Attestation Audit . Sigma have attached an **Annex** on SAI and IA relations for support in this area.

#### *Recommendations*

- The Riigikontroll should review its present interface with the Internal Auditors in line with these views.
- The Riigikontroll should further develop its auditing standards on and a system for their quality assurance of the internal auditors work (based on ISA 610).
- The Riigikontroll should also develop an interim strategy how to deal with initial problems expected for this new audit set-up.

#### **5.6 Methodological Issues**

We have examined some financial audit files, both audits for the Attestation Audit and Risk Management Audit, to get an impression of how the auditing standards and the internal regulations are actually designed and implemented. We have in particular looked at:

- The general conditions of the audit documentation (in binders mainly)
- The chapter on Knowing the Business
- The Risk Assessments
- The Flow from Risk Assessments to Audit Programmes/Audit Steps
- The Audit Trail
- The descriptions of Population and Samples and the extrapolation from samples to the population
- The use of materiality thresholds
- The cross referencing of the information in the files.

The overall impression is good. The binders are in good order and followed the standards and internal regulations. We had, however, some problems to:

- Understand how the materiality threshold on 1% has actually been applied. It seems to be more of a general common sense based assessment ('not so many irregularities' - this is also substantiated by the Annual Report 2002: 'In short, the materiality threshold is the maximum permissible numbers of errors which is still acceptable.' p. 9).
- Understand how 'materiality thresholds' have been used further up the 'tree' to consolidate a Formal Audit Opinion for the whole State Budget. This includes a documented compilation of the different ministries and major agencies to the highest level, i.e. the whole State Budget,.
- To get a reasonable overview of the progress and supervision of the audit work and documentation gathered.

- Much more use should be made of *CAATs* like *WinIDEA* and *STATA*.

#### *Recommendations*

- The Riigikontroll should make an internal analysis of the materiality threshold concept as designed and applied.
- The 1% level, being a very strict requirement on compliance, should be reconsidered bearing in mind how the concept is applied. It might be misleading for the stakeholders. Instead a more general verbal phrasing should be considered.

The use of CAATs should be reinforced in all phases of the audit. A first step might be to assess how many of the auditors who actually are using the IDEA and in which situations. If the results would be discouraging it is pivotal to train the staff using such instruments in many of the audit phases: planning, risk analysis, sampling - extrapolations to the whole population's analytical reviews as well as substance testing.

- A commonly used technique with a special more elaborated form to monitor and document audit progress and documentation should be used (cf. e.g. at the private audit side).
- There should be a financial audit manual. The policy for performance audit could be adopted and an existing manual from a well developed SAI used as a base for a Riigikontroll manual. Of those available the peers would look closely at the manuals of the USA GAO and the Canadian OAG – both are fully available from their respective web sites.

## SECTION 6: PERFORMANCE AUDIT

### 6.1 General

In addition to the comments made above concerning planning and staffing at the strategic level more detailed examination of some recent work provided further insight into performance audit areas which could benefit from development. The peers work has started from the rather self evident starting point that whilst the Riigikontroll is a small SAI the rapid recent development, output and quality of its performance audit has been remarkably good. The standards the peers have applied to this part of the report reflect this starting point, and the desire of the Riigikontroll to have even better performance audit outputs and outcomes. This is particularly relevant in the context that the Riigikontroll has now an active and serious partner in the Parliament making use of its audit reports – this is considered in more detail in Section 7 below.

### 6.2 The planning of recent Performance Audits

Analysis by the peers of the Performance audits carried out in 2004 showed, as in the past, an uneven spread of output between the four Audit Departments. Analysis of the coverage by individual ministry showed that six received no coverage at all in the period, whereas three ministries (Education and Research, Environment and Economic Affairs and Communications) accounted for 50% of the reports produced. For example there appears to have been no coverage of Defence expenditure. However, the peers do note that strategy and focus were decided some 4 years ago (and the Parliament and Government were clearly informed of this) and if defence area had been selected other topics would have been left out because of resource restrictions.

The Audit Strategy document for 2002 – 2004 set out the strategic goals of Performance Audit for the period. The document stated that the selection of specific projects would follow the selection criteria set out above under the paragraph headed “what was planned”. The goals of the Performance Audit were set out under the broader topics as follows:

- Independent coping of individuals - to provide assistance towards effective use of resources for the improvement of the ability of individuals to cope with life
- Development of the business environment – improving effectiveness in the development of entrepreneurship
- Physical security of individuals and property – improving management of the justice chain
- Education and vocation (ability to cope independently) – improving opportunities for individuals to find employment based on their education and to cope with life
- Preservation of living and natural environment – support of Estonia’s sustainable development and balanced use of natural resources
- Health Care – effective use of health insurance resources in solving the nation’s most urgent health problems
- National defence capability – facilitate rational (economical and efficient ) use of defence resources paying particular attention to large investment projects
- Preservation of the cultural environment - facilitating the effective use of public funds for the preservation and development of indigenous culture

These goals do not seem to have been based on any formal process of analysis which would set out the reasons and justification of their selection. Peers noted that if there was any risk analysis, it was not very well documented. In particular there seems to have been no well documented assessment of the risks to economy, efficiency and effectiveness in any of these areas. There was however an explicit strategy to focus attention on public service delivery.

In some cases they seem, at least when compared to UK and Holland practice, to be very close to the policy boundary and indicate Riigikontroll criticism of policy. Overall they seemed to the peers to be loosely defined and perhaps overambitious in their scope and evaluative possibilities. The peers noted that in some cases issues would probably need to be addressed with considerable expert input from external sources for them to reach valid and strongly defensible findings and conclusions. But using experts where needed is natural in many SAIs for performance audit projects – and the peers would encourage to continue that use by the Riigikontroll.

The aim of all Performance Audit should be to help promote beneficial change within the audited bodies. This is usually achieved by examining whether:

- Improvements in the quality of service can be achieved.
- Objectives could be achieved in more cost efficient ways.
- Opportunities exist for making financial savings and avoiding waste.
- There are better ways of working to achieve the policy objectives.

In most circumstances it is necessary to carefully and methodically collect information and analyse the following aspects of an auditee's projects, programmes and activities and to understand the relationship between them and the risks associated with each element before a case can be made for pursuing any particular aspect in a performance audit:

- Aims and objectives
- Resources
- Inputs
- Processes
- Outputs
- Outcomes – both actual and intended

There is little evidence that these processes have always been methodically followed in the Riigikontroll, at least in the recent past. Often audits seem to be decided upon only on the first and the last bullet. The main lines of the Strategy for 2003 – 2005 revise the objectives of Performance Audit in the period changed to the following:

- Business environment – to contribute to the efficiency of government measures for development of business activities, including help in the long term, by means of state aid and restrictions, to concentrate capital and technology for the purpose of increasing net foreign trade. Also to ensure the advantageous nature of the business environment created by the government in general including infrastructure development measures.
- Environmental protection – to reduce health and environmental hazards caused by hazardous waste generated by human activities. To avoid the production of such waste as well as examining its handling, collection, transportation, recovery and disposal.
- Healthcare – to focus on bottlenecks in the availability and use of medical services for a person covered by health insurance on three levels: family physician, medical specialist and hospital. Also to cover in part emergency medical care and medicinal products and benefits for temporary incapacity

- Subsistence – to focus on whether the government has created sufficient prerequisites for ensuring the needs of children and supporting the development of their potential until they enter the labour market. This would cover pre – school and basic education, the availability of development activities in leisure time, conditions necessary for career choice, vocational education. Special attention would be paid to risk groups.
- Legal protection – government measure directly aimed at controlling crime, pre-trial and judicial proceedings and execution of criminal punishment.

Although in some cases these goals seem a bit more specific there is little documented argument as to why they should have been selected apart from general interest. It is noteworthy that some major areas of almost endemic risk for the UK and Holland, such as defence procurement, seem to have disappeared from the agenda. It may well be that there are aspects of all these central government activities that do/do not merit investigation (eg few large military equipment contracts) but they cannot be identified in the documents we have seen.

The planning of a performance audit delivered in 2005 was reviewed and it was evident at least in this case, that the audit had emerged from a process of monitoring, initial proposals from the monitor, and management input and some form of preliminary study. Although the subject fitted into the broad areas identified as the focus for performance work the material seen was still lacking in analysis of the risks.

#### *Recommendations*

- Procedures for identifying and selecting performance audits need to become more methodical. Selection of audits needs to be well justified in order to support senior management decision making on needs and priorities. This will increase the chances of “picking winners” and reduce risks of not choosing effectively the best audits to do within the limited resources available. Performance audit strategy needs to be reviewed more regularly.
- There is now a big need to ensure a steady flow of significant and interesting reports to the new Parliament Audit Committee. This will need careful planning and monitoring.

### **6.3 The internal negotiation process**

Audit proposals /plans are submitted to a process called Internal Negotiation at the Riigikontroll. This is a form of peer/management review them by the management, representatives of the Audit Departments, Methodology, Planning and Reporting Service and Public Relations Service. The meetings are chaired by the Auditor General. The papers are distributed before the meeting for written comments and are subject to further reviews and comment at the meetings. The Auditor General makes his decision to approve/not approve the plan on the basis of the discussion. It was noted however that, if the meeting made suggestions for modification of a proposal it did not get resubmitted or circulated thereafter to ensure that appropriate action had been taken.

The same process applies to draft reports with one exception. Although it is the Auditor General who approves the project he does not in the end sign the reports personally to indicate his accountability for the performance audit (which is the practice for UK and Holland) which seems somewhat anomalous.. This responsibility falls to the Chief Auditor of the Audit Department concerned. However, in Sweden and the USA practices are more flexible and choosing the level for who will sign off a report is meant to indicate to the stakeholders its importance and level of quality assurance i.e., the most important outputs for parliament will be signed at the highest level.

Although some form of internal management review process is common in other Supreme Audit Institutions it usually occurs at the working level. Thereafter it is for the auditors of the projects to convince all elements of the management chain of the quality of their work with each level taking formal 'ownership' once they have approved it and being responsible with the team for convincing the next level of management and processing their comments/ recommendations. This process usually concludes with the Auditor General who personally takes the decision to approve proposals and reports and presents the latter personally to Parliament. This theme is also covered in Section 8 below in the paras concerning audit quality.

The present process at the Riigikontroll does not encourage individual levels of management to take formal responsibility in processing (monitoring, supervision and review) the work. And it does not conclude with the Auditor General taking the final formal responsibility and delivering 'his' product to Parliament.

In other Supreme Audit Institutions it is common that, as each stage of the project fieldwork, report drafting, clearance with the auditee etc, that auditors, their managers and more senior staff confirm formally to each other that:

- work has proceeded according to plan and if not why not
- the evidence supports the conclusions
  - the ministry have agreed that the quoted facts are correct and whether or not they agree with the conclusions
  - what the important points are
  - what issues might inhibit the report achieving its desired impact

This encourages all parties to take formal ownership of the report and acknowledge that their responsibilities have been met. This is very important information for the Auditor General to have assurances.

#### *Recommendation*

- The internal negotiation process needs strengthening and aligning with good priorities and international standards.

## **6.4 Delivery**

The shortfall in deliveries of performance audits in recent years and the imbalance between the various audit products has already been discussed above. The peers examined in more detail six of the performance audit reports in 2004, two of them in greater detail in order to follow the process from conception to delivery. Our comments on the two reports examined are attached in an **Appendix**.

#### *Recommendation*

- Consistent delivery of planned audits to high quality standards is important. This is especially relevant now the Parliament has an active SCCSB who will be demanding, but hopefully helpful, users of the Riigikontroll's audit reports and will not easily understand delays or reductions in promised outputs.

## SECTION 7: RELATIONS WITH PARLIAMENT

### 7.1 General

The relationship between an SAI and the national Parliament is central to the cycle of accountability. It is the duty of the SAI to carry out its tasks in a professional manner and to recognised standards. It should present the results of its work in public reports which are understandable to a reasonably well educated member of the public. They should be concise but well argued and balanced and provide the evidence to support the conclusions. The Reports should make realistic recommendations which are also SMART:

- Specific
- Measurable
- Aceptable
- Realistic
- Time bound

For its part the customer – Parliament – needs to have a supportive attitude towards the work of the SAI and to respond effectively to its reports. This helps to ensure that the Government is held accountable for the use of the budget allocated to it to meet the costs of implementing its policies. Relations with Parliament are often entrusted to a senior Committee which studies the Reports produced by the SAI, considers its own response and then reports to Parliament its own conclusions along with recommendations for action. Obviously, successful management of this process can also be complemented by the SAI having good relations, not just with the Committee but also with other stakeholders. These will be the ministries responsible for managing their individual budgets, the Ministry of Finance in its role as promoter of sound financial management practices and others such as the media and academia. It should also have a responsive attitude to matters relating to public spending which are raised by individual Members of Parliament and the public at large. Outlines of the way in which the role is managed in other countries, some identified good practices and experiences in the Netherlands and the United Kingdom are attached in an **Appendix**<sup>10</sup>.

### 7.2 The role of the Riigikontroll

One of the key recommendations of the previous Peer Review was to establish a Public Accounts Committee to consider the work and reports of the Riigikontroll. This was seen as an important step in enhancing public accountability and financial control. Prior to the committee being established, Riigikontroll forwarded its audits to the Finance Committee, which regarded them as only an ancillary task. A SCCSB was eventually established in February 2004. The Riigikontroll hoped that the Select Committee would give a clear and direct input to the work of the Riigikontroll and via its status within the Parliament help to implement recommendations for improving financial accountability and the management of resources. The stated aim of the SCCSB is to guarantee, in co-operation with the Riigikontroll, control over the government as to the implementation of the state budget and economic, efficient, effective and legal use of the state assets. The founding decision says that the Committee's tasks are to:

- review the consolidated annual reports of the state and its audit report;

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10 . Perhaps the best source of advice for EU SAIs is SIGMA Paper No 33: Relations between SAIs and Parliamentary Committees – [www.oecd.org/gov/sigma](http://www.oecd.org/gov/sigma). This is referenced in the Annex together with conclusions from a World Bank Study for further information and explanations.

- review auditing issues in the public sector;
- discuss the Riigikontroll's audit reports and overviews and any other significant issues brought forward by the Auditor General;
- inform the Riigikontroll of the problems that the committee members have learned about when communicating with officials and private persons;
- Form, on the basis of Riigikontroll's information, a position on the cases of obstructing Riigikontroll's work.

The committee reports to the Parliament at least once a year.

The committee has a right to:

1. organize joint sessions with the Parliament's standing committees, if necessary;
2. submit to the Parliament and its standing committees opinions about the annual draft State Budget Act and the Consolidated Annual Report of the State;
3. submit to the Parliament's relevant standing committees proposals for developing, altering or complementing legislation;
4. submit inquiries to the government;
5. submit opinions and proposals to relevant persons and institutions;
6. Consolidate the proposals of the parliamentary committees and submit these to Riigikontroll for complementing its work schedule.

The committee sessions are usually held in public although it can decide to hold a session in camera, in order to protect personal data, a banking, business or state secret. This would seem to have provided a suitable basis for achieving the desired improvements but, in practice, the process does not work as well as it could. These matters are discussed below followed by a number of recommendations.

### **7.3 The status and working methods of the SCCSB**

#### *Status of the SCCSB*

At present the PAC, being a Selected Committee instead of a Standing Committee, holds a lower position in the hierarchy of the parliamentary committees.

#### *Recommendations*

- For the SCCSB to have the weight and credibility it needs to bring about improvements in public accountability and management, its status needs to be elevated within the Parliamentary Committee system.
- The SCCSB should benchmark their working methods against the good practices contained in the SIGMA Paper No 33 and the World Bank study in Annex 18. Study visits to other nations parliaments (together with the Riigikontroll and the Ministry of Finance) to observe their practices is very much to be encouraged as is sharing experiences with other Baltic Parliaments.

#### *Working methods*

The extent of reporting by the Riigikontroll to the SCCSB:

To date the usual practice has been that all audit reports produced by the Riigikontroll are sent to the committee whether they covered financial audit, operational risk or matters relating to performance. Although report production

has not been high this has meant that the Committee has had to process everything produced by the Riigikontroll irrespective of its importance.

It is debatable whether it is necessary to send all reports dealing with financial/risk audit to the SCCSB. If the matters raised in them are sufficiently serious they would presumably need to be covered in the context of the annual opinion given on the annual report of the ministry concerned ( ? This is not the task of the SAO). If not they could perhaps be better dealt with by means of a Management Letter (ML) to the Ministry concerned which is common practice in other Member States. The ML procedure can be used to comment on matters which, although important do not affect materially the Accounts concerned such as:

- a) Significant accounting and internal control weakness;
- b) Significant weakness in general or administrative controls, or any system inadequacies; and
- c) Failure to implement previous management recommendations.

Less significant issues may be reported orally to the auditee although they may prefer all points to be included in the letter. In such circumstances, the letter should separate the major issues from the minor points.

The overall aim of a management letter is to:

- a) Provide the management of the auditee with advice of direct benefit for them, thereby improving the performance and accountability;
- b) Protect the Riigikontroll against possible future criticism by providing evidence of matters drawn to management's attention; and
- c) Secure improvements in internal control, thus reducing both the probability of similar problems in subsequent years.

The introduction of such a management letter procedure can also be helpful in demonstrating the varying nature and importance of audit findings and enhance the effectiveness and reputation of the Riigikontroll. It would also enable its main Reports, those it should send to the SCCSB, to focus on the important issues affecting the economy, efficiency and effectiveness of the management of programmes and activities by Ministries concerned in implementing the policies laid down by the Government. To ensure that the SCCSB remains informed of the scope of other audit activity which has not led to formal reports being presented the Riigikontroll could produce as part of its Audit Report on the Consolidated Annual Report of the State, a summary of the ML activity, the nature of the matters raised and whether they have been responded to in an acceptable way by the Ministries concerned.

#### ***The presentation and handling of Audit Reports:***

Hitherto, audit reports have been transmitted to the SCCSB under cover of a formal letter by the Auditor General. The Reports are signed by the Chief Auditor responsible for the work in the Riigikontroll and accompanied by a note outlining the main problems raised in the audit report. On receipt, the report is allocated to a Committee member designated as rapporteur. This choice has generally been made according to the fields that member knows best and in which they are most competent.

The committee usually meets three times a month to discuss audit reports and other matters. Sessions are relatively short lasting for 20-40 minutes and usually about half the members are in attendance. The Chairperson of the committee announces the audit reports on the agenda and the rapporteur makes a brief verbal presentation to the committee and answers questions from other members. If necessary, additional information can be asked of the representatives of Riigikontroll who are present - usually the Chief Auditor with or without other members of the team responsible for the audit and the Head of the Riigikontroll's Public Relations Service'. Following their discussions the committee usually decides just to 'take note 'of the information but sometimes may decide to send the audit report to some Standing Committee of the Parliament or to send a note to the Minister concerned asking him/her to pay attention to the problems outlined in the report.

The Committee does not produce a formal public report and recommendations. The hearings of the Committee are public and no verbatim record of discussions is kept. It produces minutes of its meetings but they are very limited in scope, often referring just to those present and the reports discussed. The substance of the reports is described in a

couple of sentences if at all. Following discussions with the Chairman of the SCCSB it was clear that there is no real problem at the working level between the committee and the Riigikontroll in that the reports of the Riigikontroll are welcomed. He was however interested in how working methods might be improved.

#### *Recommendations*

- The SCCSB and the Riigikontroll should discuss the 'lifecycle' of a report from the strategic planning, through subject selection, the audit approach, the style of the product and the way in which the key messages need to be brought out and recommendations made. They should also consider and agree on the following:
  - Whether it is necessary to present all types of report to the SCCSB or just those concerning major performance audits.
  - The number of reports is it reasonable to aim to produce and for the SCCSB to handle.
  - the extent of suggestions from the Committee of subjects for examination which will enable them to have some input but ,at the same time, permit the Riigikontroll retaining their independence and ownership of the audit work that they do.
  - What they consider constitutes a good report.
  - Timing of publication. There should be an agreed timetable to assist the planning of SCCSB meetings.
  - Whether it would enhance the reputation of the Riigikontroll and give weight to their products if the Auditor General should personally sign all the reports and also appear personally before the Committee when reports are discussed accompanied by whomsoever he requires as support.
- The SCCSB should require the senior officials of the Ministries concerned (in all cases this will mean an official representing the Ministry of Finance in order to ensure consistent approach to financial management issues and explain general government financial management practices relevant to the specific audits being considered) to be present at the meetings at which reports concerning them are discussed and be able to question them. They should also keep verbatim records of proceedings. They should take a position on the matters raised in the Riigikontroll reports, come to their own conclusions and recommendations and publish reports in which this is recorded. Most importantly, if they are to ensure added value from their work and complete the chain of accountability they should formally require the Government to respond to the recommendations they make.
- If the SCCSB consider they do not in future wish to receive detailed reports from the Riigikontroll on non – material issues arising from financial audits and examinations of operational risk which do not materially affect accountability they should endorse the use of Management Letters by the Riigikontroll for raising such matters with the Ministries concerned. If required they should consider asking the Riigikontroll to prepare a separate Annual Summary of such financial work or to include coverage of this in the Audit Report on the Consolidated Annual Report of the State.

## SECTION 8: ORGANISATIONAL STRUCTURE AND MANAGEMENT ISSUES

### 8.1 General

With effect from 2005, the Riigikontroll has been reorganised from a 3 way vertical functional split of responsibility to a horizontal arrangement of four Audit Departments each under the control of a Chief Auditor. They are now responsible for two main types of audit (Operational Risk Audit as an audit type per se is now incorporated into the approach for Financial Audit) in relation to the ministries for which they have been allocated responsibility.

This was intended to improve the knowledge of individual ministries and to provide better opportunities for staff to gain expertise in all types of audit and exploit the potential benefits of cross fertilisation. This would apply particularly to the input to performance risk assessment work from the identification of areas of known weakness as a result of financial/risk audits. While this was done for the best possible motives we understand that there was a significant loss of staff, especially amongst experienced performance auditors.

There is no ideal way to organise audit activity though it is interesting to note that some Supreme Audit Institutions have in fact moved somewhat in the other direction in order to strengthen individual competences expertise into specific fields of audit (e.g. the UK NAO). However, the organisational structure of the UK NAO remains firmly focused towards and oriented to clients and auditees – it is only within the main organisational Units that we see audit staff specialism, and this is below senior management levels. A key feature of the UK NAO system is that staff has clear specialism leadership with one of the Assistant Auditors General responsible for professional staff issues related to a specialism i.e. financial audit and performance audit.

#### *Recommendations*

- The new client organisation and orientation of the Riigikontroll is good. More attention now needs to be made to support individual specialisations through, perhaps, a specific senior manager taking horizontal responsibility for a specialism ie one for financial auditors and another for performance auditors.
- Chief Auditors need to recognise that they are the key to closer and better client relations and management. They need to get out and about more and visit key auditees as a major part of their senior management roles.

### 8.2 Staff complements and numbers in post

The staffing situation at the Riigikontroll in April 2005 was the following:

Subject	Audit Departments				Admin Total	
	1	2	3	4		
<b>Total posts</b>	15	16	21	18	29	99
<b>Manned</b>						
All staff	9	10	17	13	28	28

Auditors	8	10	16	12		46
-- whereof FA	5	7	7	3		22
-- whereof CertFA	0	0	2	0	1	3
-- whereof PA	3	3	9	9		24
Audit Managers	1	2	3	0		6
<b>Years at Riigikontroll</b>						
< 1 year	5	2	2	5	7	21
2-4 years	4	3	7	5	4	23
> 4 years	0	5	8	8	18	39

Including the Auditor General there are 99 posts. The staffing at April 2005 showed that only 78 posts were manned creating a shortfall of some 20%. Three of the vacancies arose from staff on maternity leave but the balance represents a 17% shortfall which would be significant for any Supreme Audit Institution. The distribution of posts between the 4 Audit Departments ranges from 15 to 21 with 29 posts in the administration. The percentage of posts manned ranges from 60 to 80% in the Audit Departments but is 100% in the Administration.

Of the total 46 audit staff in place, 66% of 70 total posts, 22 were engaged on Financial Audit and 24 on Performance Audit. The number of audit staff in post for less than one year was 14 (26%). These figures are significant in that they indicate the extent to which the staff is lacking in experience. There is also an imbalance between the resources applied to Financial and Performance Audit if assessed in the context of what the peers consider should be the current main priority – Financial Audit. This is simply because the extent and quality of the Financial Audit required by the law and audit standards is not negotiable. Failure to carry out a sufficient and defensible level of Financial Audit is unprofessional and negligent. In view of the impending requirement to audit a Consolidated Annual Report of the State and the likelihood that the Riigikontroll will not for the moment be able to rely on Internal Audit some reassessment of priorities and distribution of resources would seem to be needed. In fact it would seem that the new Consolidated Annual Report will help rationalise and organise the Financial Audit more efficiently and effectively. The extent of effort devoted to Performance Audit was discussed in the Section devoted to Performance Audit.

#### *Recommendations*

- To strengthen recruitment and professional training for Financial Auditors e.g. Certification training from the Board of Auditors.
- Be proactive in making proposals for better financial statements (following international accounting standards) and better financial management and internal control.

### **8.3 Human resource management**

#### *Motivation and remuneration of staff*

A Staff Survey carried out in 2003 indicated that the major areas of concern of staff were, low salaries compared to other public and private sector employees, uncertain career paths. Other factors were also cited the most common being lack of appreciation for their efforts and lack of involvement in the decision making process. The system of payment based on competence was also not so popular. The question of remuneration is always a sensitive one but it would appear that the salaries at the Riigikontroll are not pitched at a level which will enable them to attract and

retain suitable staff in competition with other employers in the public and private sector. The peers were told that some 17 staff had left for other better paid jobs within the public sector recently. The Chairman of the SCCSB raised this recently with the Ministry of Finance who acknowledged that extending the Riigikontroll's competence has cost implications but had not been taken into account in recent budgets.

In view of the new assignment that the Riigikontroll will take on the audit of Local Government organisations attracting staff of the right calibre will become an increasingly important issue to resolve with the appropriate authorities. The setting of salaries at a good market rate and enhancing basic remuneration for achieving challenging but attainable levels of quantifiable performance could also impact positively on the morale and motivation of existing staff and improve retention levels.

The Riigikontroll's Methodology, Planning and Reporting Service is responsible for advising on audit developments. The service is staffed by two people who cover all aspects between them. There would be some advantage in creating two areas of specialism to address the particular problems of development of Financial and Performance Audit.

#### *Recommendations*

- The Riigikontroll needs to improve staff levels rapidly and be able to pay what is needed to recruit the staff it needs.
- Development and updating of audit methods for financial and performance audits is essential and needs adequate staff and other resources

#### **8.4 Basic training and continuing professional education (CPE)**

At the moment the organisation has a modest training budget. Investment in basic training in audit skills is essential for all staff that join the Riigikontroll without relevant qualifications and experience. Also the approach required to audit in the public sector is different to that of the private and this needs to be clearly communicated to and understood by all staff and the auditees with whom they work. There is great enthusiasm for learning within the Riigikontroll and it would be opportune to build upon this provided appropriate resources can be obtained. Whilst the peers consider that the present cadre of staff are relatively young and some are inexperienced there is great potential for further development and this should be given every encouragement.. There will be a need to plan for continuing professional education and personal and professional development for those who make a career within the Riigikontroll. Increases and improvements in training would help to enhance the personal prestige of staff and job satisfaction while at the same time helping improve skills and performance.

It has been discussed in the office to establish a Certification Programme for Financial Auditors. Such a programme could certainly be designed in many ways and with due regard to the local requirements on competence and skills and available resources. In most circumstances, however, it is a reasonable strategy to draw upon the resources and competence that are available in the country, i.e. on private side as well. Another argument for this is that the private and the public sector tend to apply the same auditing standards in line with the new organisation for auditing standards established by the INTOSAI and IFAC. It would also increase the status of both the public and the private auditors if there would be just one certification with two branches, instead of splitting the resources. Discussions with the Board of Auditors do not indicate any insurmountable problems with training professional auditors with this body in the Riigikontroll. The Riigikontroll should also note that the EUROSAI Training Committee are addressing the issue of professional training and this would be a good forum for Riigikontroll collaboration and participation.

For example, in Sweden at the Swedish National Audit Office they have since some years a certification programme for Financial Auditors with good experience so far. It embraces 5 years studies and on the job training with 400 hours of lectures, designed to start from an academic degree in accounting. An external examination is performed by the association that certify Chartered Accountants on the private side. There are one test after 3 years and a final test after 5 years. The tests are the same (to 75%) as for the auditors on the private side and they are given at the same day. Today 90% of the staff have started up with this programme. A financial salary incentive on +10% after being 'certified' is applied. (A more in depth description is attached as Annex 14.)

### *Recommendation*

- Training is a life long learning process and more Riigikontroll resources need to be devoted to it based on a well developed Training Strategy and Plan.
- Using the Estonian Board of Auditors' Certification Programme to professionalise all financial auditors is a priority.

## **8.5 Provision of guidance material**

The Riigikontroll has formally adopted the INTOSAI standards for both Financial and Performance Audit. INTOSAI also make available useful guidelines for Performance Audit, which should also be formally adopted. The INTOSAI guidelines on IFAC financial auditing standards (the International Standards on Auditing) should also be adopted when they are prepared.

The Riigikontroll has also adopted the Manual of Performance Auditing published by the Swedish National Audit Office and has also obtained standards, manuals and other forms of guidance from a number of other national (e.g. UK, Netherlands) and international sources such as IFAC. Consideration should be given to adopting this approach for financial audit – see also above in the Section on financial audit.

Such material is potentially of great help to developing Supreme Audit Institutions but should also be treated with some caution. It is essential that Supreme Audit Institutions view it in the context of their own situations and that they translate the experience and practice of others into something which will be of practical use in their own national environment. The creation of national guidance tailor made to their needs is important as is the provision of basic and other training referred to above.

The role of the Methodology, Planning and Reporting Service of the Riigikontroll will be of importance in developing guidance specific to the Riigikontroll. At the moment it has a staff of only two which may need to be reviewed in light of the current need for developing new methods for the Financial Audit.

### *Recommendation*

- Audit methods are continually being updated and revised and sufficient resources need to be put into this activity.

## **8.6 Quality Management**

In December 2004 the Presidents of the Supreme Audit Institution within the EU endorsed Guidelines on Audit Quality to be considered by the Member State Supreme Audit Institutions. The same Guidelines had already been endorsed by the Presidents of the Candidate Countries SAIs in Riga in April 2004. It was agreed upon that the peers should make a bench mark of the present state of affairs of the Riigikontroll regarding Quality Management against these Guidelines. Some of the latest developments in Quality Management as they are applied in the US, i.e. the Yellow Book, GAGAS 2003 Revision, have also been applied as representing 'best practice'. SIGMA have also recently released a handbook on Achieving Audit Quality in SAIs<sup>11</sup> which complements and supplements the EU Guidelines.

It should be, however, emphasized that the Riigikontroll has demonstrated an interest in Audit Quality for many years. It was also one of the main issues in the Peer Review 1999. Many of the ideas behind the Audit Quality

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11 . SIGMA Paper No 34 – [www.oecd.org/gov/sigma](http://www.oecd.org/gov/sigma) for a PDF copy.

Guidelines are also reflected in the Riigikontroll Quality Assurance systems but it is still mostly a 'traditional' design for achieving quality. The Guidelines on Audit Quality<sup>12</sup> are built upon three pillars:

- Quality Control.
- Quality Assurance.
- Institutional Management.

Together they form a Total Quality Management concept. In the following the peers note where there are different solutions between the Riigikontroll concept and the Guidelines as well as 'best practice'. This model used here for this purpose is labelled as the Bench mark model.

The Riigikontroll model implies that audit quality is more of a common sense concept. Standards do not play a particular important role. A special documentation over its Quality Assurance Management system is not in place<sup>13</sup>.

The Bench mark model means a more standard driven approach. The meaning of Audit Quality should be clearly defined. Objectives for achieving Quality should be defined for each area of operation included in the overall Audit Quality Management system. This system should be documented and up-dated regularly. Quality Controls are the system and procedures to safeguard a high quality. Quality Assurance is the process established by a Supreme Audit Institution to ensure that: Needed controls are in place; Controls are being properly implemented; and potential ways of strengthening or otherwise improving controls are identified.

The "Quality Controls" guidelines say:

*A Supreme Audit Institution should seek to carry out its audit work at a consistently high level of quality in the following dimensions:*

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12 . Some definitions to calibrate this bench mark:

"Quality" is the degree to which a set of inherent characteristics of an audit fulfils requirements. In discussing the work of an Supreme Audit Institution, these characteristics include:

- *Significance* – How important is the matter that was examined in the audit? This, in turn, can be assessed in several dimensions, such as the financial size of the auditee, the magnitude of effects on the public at large or on major national policy issues, and responsiveness to legislative mandates;
- *Reliability* – Are the audit results an accurate reflection of actual conditions with respect to the matter being examined? Are all assertions in the audit report or other product fully supported by the data gathered in the audit?
- *Objectivity* - Was the audit carried out in an objective and fair manner without favour or prejudice? The auditor should base his assessment and opinion purely on fact and on sound analysis;
- *Scope* – Did the audit task plan and its execution cover the full scope of audit and was the audit complete in all material aspects?
- *Timeliness* – Were the audit results delivered at an appropriate time? This may involve meeting a statutory deadline or delivering audit results when they are needed for a policy decision or when they will be most useful in correcting management weaknesses;
- *Clarity* – Was the audit report clear and concise in presenting the results of the audit? This typically involves being sure that the scope, findings and any recommendations can be readily understood by busy executives and parliamentarians who may not be experts in the matters that are addressed but may need to act in response to the report;
- *Efficiency and effectiveness* – Were the resources employed in performing the audit reasonable in relation to the results achieved? And did those results have good and intended impact?

"Quality Controls" is a term that encompasses the systems and procedures that are put in place in a Supreme Audit Institution to assure that its audit work is of a consistently high quality.

13. A general requirement in the GAGAS (para 3.49) is that each audit organisation should have an appropriate Internal Quality Control System in place and should undergo an external Peer Review (every third year). An interesting requirement in the GAGAS (para 3.51) that there should be an appropriate documentation of its system for quality control prepared to demonstrate its compliance with its policies and procedures.

- *Significance and value of matters addressed in its audits;*
- *Objectiveness and fairness in the basis of assessments made and opinions given;*
- *Scope and completeness in the planning and performance of audits carried out;*
- *Reliability and accuracy of the findings, conclusions, recommendations and other matters presented in its audit reports and other products;*
- *Timeliness of the issue of audit reports and other products in relation to statutory deadlines and the needs of anticipated users;*
- *Clarity in the presentation of audit reports and other products;*
- *Efficiency in the performance of audits and audit-related work; and*
- *Effectiveness in terms of results and impacts achieved.*

*In pursuit of this goal, a Supreme Audit Institution should establish policies, systems and procedures that will encourage actions leading to high quality and discourage or prevent actions that might impair quality. These quality controls should be developed and implemented with respect to all phases of the audit process, including:*

- *Selecting matters for audit;*
- *Deciding the timing of the audit;*
- *Planning the audit;*
- *Executing the audit;*
- *Reporting the audit results; and*
- *Follow-up and evaluation of audit findings, conclusions and recommendations.*

The Riigikontroll model relies mainly on the Audit Manager and the Chief Auditor, and for Performance Audits also by asking colleagues to read and make comments; it has a well developed contradictory procedure; and finally before final decision taken by the Chief Auditor a so called Internal Negotiation Procedure. The latter is part of the task for a meeting of the management, representatives of Audit Departments, Methodology, Planning and Reporting Service and Public Relations Service chaired by the Auditor General (This is repetition). The motives for this internal clearance procedure is i.e. that it will benefit upon many others experience and to 'get all parties' on board. The supporting forms and checklists for carrying through the supervision is not so user friendly and efficient.

The Bench mark model would have a Principal Auditor and a Reviewer. The Principal Auditor would probably at Riigikontroll be the Audit Manager or maybe the Chief Auditor and he is the primary responsible for audit quality up to final decision taken by the designated responsible. The Principal Auditor and the other audit team members have user friendly forms and checklists indicating clearly who is responsible for and had done what program step. All the time it is possible to see where in the audit process they are. The Reviewer is normally another Audit Manager or Chief Auditor, who is not involved at all in any of the preceding stages. He should make an independent review that the Supreme Audit Institution auditing standards and all other relevant Audit Guidelines have been met before the formal contradiction and another check after the comments have been given by the auditee whether the Principal Auditor has taken care of the auditees' comments in appropriate way. There is a form to be tick marked and signed off by the Reviewer. This one is kept as a part of the audit file. If anything goes wrong even the Reviewer's role and contribution will be evaluated. This system is a natural part of modern Attestation Audit on the private side as well as the public sector auditing in the US (cfr. the Yellow Book) for both the Financial Audit and the Performance Audit. This is mainly a hierarchical set up. The Principal Auditor is free to consult all expertise needed within the resources available to him to build in quality in the first place..

*“Quality Assurance” guidelines say:*

- *A Supreme Audit Institution should establish procedures for assessing its system of quality controls to:*
- *Determine if needed controls are in place;*
- *Determine if existing controls are being properly implemented;*
- *Confirm the quality of the audit practices and reports; and*
- *Identify potential ways of strengthening or otherwise improving the controls.*

*The quality control assessment procedures should include post-audit reviews of a selected sample of completed audits and the associated working papers, performed by individuals and/or groups who are independent of the audits under review.*

The Riigikontroll model has no specially documented Quality Assurance features.

The Bench mark model has often the following design to fulfil the standard: a special independent function to annually assess the Quality Controls is normally established. This could for a smaller organisation be located at a Methodology unit and being a part time engagement for one senior auditor with a good reputation. A representative sample - in the Riigikontroll case - maybe one forth of all audit engagements are assessed against the standards and checklists. Some Supreme Audit Institutions want to involve many auditors in this checking to develop their competence and active understanding/support for the Quality Assurance work. Others use a few, maybe just one senior reviewer. Both approaches have their pros and cons. We favour the first model of the reasons mentioned above.

The Quality Assurance-function reports individually to the audit teams and their supervisors and decisions makers concerned. Once a year the Quality Assurance-function consolidate the more general lessons learned and present ideas for improvement of the system in a special Annual Quality Report to the Auditor General and the audit staff. Quality thinking is based on a never ending concern for and conviction that Quality can be improved regardless of the actual status.

### ***Institutional Management***

The Riigikontroll design has already much of the Quality thinking in its Management and Supporting Processes. There are Policy papers and Strategies for improving performance and an advanced HRM. What it might be lacks is a clear conceptual relation to the core audit process and their Quality Control and Quality Assurance processes.

The Bench mark model keeps all the most important parts together. It also emphasizes their relation and importance for the overall result. It operates through formulating objectives and identifying Key Performance Indicators for follow-up purposes. It regards the core audit processes and their auditors as their clients and develops a dialogue to find common ground solving the problems. They try actively to find suitable bench marks and partners to match and learn from. The outcome of the Quality work during the year could preferably be assessed by the Quality Assurance function and presented in the Annual Quality Report.

### ***Recommendations***

- The Riigikontroll should consider, after a feasibility study and staff consultation, to establish a Quality Audit Management in line with the EU Quality Guidelines and 'best practice' - similar to the Bench mark model described above. And to establish a formal AQ improvement strategy and plan based on self assessment against the EU Guidelines.

- Special attention should be paid to the Quality Control: the Principal Auditor and the Reviewer (eg two stages of review e.g. the First and Second Partner institute of the GAGAS 2003 – see the Annex); and the Quality Assurance: the independent Quality Assurance function with its annual follow-up and Annual Quality Report to the Auditor General and the audit staff and its link with methodology revision and development (the QA function would rest well in the existing Methodology, Planning and Reporting Service ); the Institutional Management as an umbrella concept to systematically develop and monitor non audit core processes.



# **Annexes**



## ANNEX 1: LIST OF PEOPLE INTERVIEWED

### State Audit Office

Mr Mihkel Oviir, Auditor General  
Mr Jüri Kõrge, Chief Auditor, Head of III Audit Department  
Mr Olav Lüüs, Chief Auditor, Head of IV Audit Department  
Ms Ines Metsalu, Chief Auditor, Head of I Audit Department  
Mr Tõnis Saar, Acting Chief Auditor, Acting Head of II Audit Department; Director  
Ms Krista Uuna, Audit Manager of I Audit Department  
Mr Jüri Kurss, Audit Manager of II Audit Department  
Ms Õie Soovik, Audit Manager of II Audit Department  
Ms Külli Nõmm, Audit Manager of III Audit Department  
Ms Liisi Uder, Audit Manager of III Audit Department  
Ms Sale Ajalik, Audit Manager of III Audit Department  
Ms Tuuli Rasso, Senior Auditor of IV Audit Department  
Ms Inga Häkkinen, Senior Auditor of IV Audit Department  
Ms Laura Maran, Auditor of III Audit Department  
Ms Siiri Suits, Auditor of III Audit Department  
Ms Terje Keerberg, Auditor of IV Audit Department  
Mr Valdo Vaarik, Auditor of IV Audit Department  
Ms Kairi Kübarsepp, Head of Personnel Service  
Mr Toomas Mattson, Head of Public Relations Service  
Mr Kaido Vetevoog, Head of Methodology, Planning and Reporting Service  
Mr Rein Soord, Head of International Relations

### Riigikogu (Parliament of Estonia)

Mr Juhan Parts, Member of Riigikogu, Former Auditor General  
Mr Harri Õunapuu, Chairman of the Select Committee on the Control of State Budget  
Ms Tiina Licht, Head of Secretariat of the Finance Committee  
Ms Helda Puura, Consultant of the Finance Committee

### Ministry of Finance

Mr Kalle Kukk, Deputy Secretary General  
Ms Kaie Karniol, Head of Public Governance Policy Department  
Ms Juta Maar, Deputy Head of State Treasury Department, Chief accountant of the state  
Mr Andres Karotamm, Acting Head of Financial Control Department  
Ms Tiina Vask, Head of Internal Audit Department

### **Ministry of Defence**

Mr Lauri Almann, Secretary General

Mr Agu Tammearu, Head of Internal Audit Department

### **Ministry of Education and Research**

Ms Eve Sild, Acting Head of Planning Department

Ms Anu Angerjas, Head of Budget Division

Ms Katrin Jakobson, Chief accountant

Mr Tarmo Leheste, Head of Internal Audit Department

Ms Külli Aren, Head of Audit

Mr Alar Ilbis, Internal Auditor

Ms Maie Kitsing, Head of General Education Department

### **Ministry of Internal Affairs**

Mr Märt Kraft, Secretary General

Ms Anne Schmidt, Head of Internal Audit Department

### **Agricultural Registers and Information Board**

Mr Ahti Bleive, Deputy Director General

Ms Ly Lobjakas, Head of Financial Department

Ms Sigrid Saluri, Head of Internal Audit Department

### **Tartu University**

Mr Taavi Annus, Docent, Chair of Constitutional and Administrative Law, Institute of Public Law, Faculty of Law

### **Board of Auditors**

Ms Urve Kipper, Executive Director of the Board

Mr Toomas Vapper, Executive Director of the Board

### **Estonian Accounting Board**

Ms Marju Pöldniit, Deputy Chairman of the Board

### **Interpretation and Translation Team**

Vaike Seppel, Head of Team

Mari Kelve, Interpreter

Laura Taul, Interpreter

Piret Viilu, Interpreter

Evi-Mai Vork, Interpreter

## ANNEX 2: REVIEW OF THE ESTONIAN STATE AUDIT OFFICE ACT

### Introduction

The Estonian State Audit Office Act (a law in the European sense) is a modern audit law, not only because it has been adopted by Parliament only in the beginning of 2002, but mainly because it contains most of the important elements modern audit laws should incorporate. The law also corresponds to a large extent to the INTOSAI recommendations. It gives the State Audit Office a considerable independence and also a wide mandate. The result of the Estonian audit law modernisation is even more remarkable when the present law is compared with the previous audit law that was in practise for many years and to which the SIGMAS Peers gave some recommendations in the peer review 1999.

The Estonian State Audit Office Act has especially one peculiarity in comparison to other audit laws of INTOSAI member states. Estonia has adopted the auditor general or office system that many Supreme Audit Institutions also apply. However, they have created a rather unique modification insofar as the Auditor General's responsibilities are reduced in respect of auditing and reporting. This will be elaborated in detail in the following comments.

Another area of concern is the fact that one of the most important tasks of the State Audit Office (SAO), the audit of the consolidated annual report of the state, is not mentioned in the State Audit Office Act but only in the State Budget Act. This again will be elaborated later.

A further topic to be considered is the SAO's budget, specifically the fact that the SAO does not have a direct access to the Riigikogu as regards their own budget, but have to go through the Ministry of Finance. In this respect the peers have different views depending on the experience in their own audit office. Therefore there will be no firm recommendation, only some considerations on this topic.

In addition there are some minor issues concerning the exact and logical formulation and some other smaller areas of concern.

Generally the Estonian State Audit Office Law can be regarded as a good example of a modern audit law with the SAO fitting well into the European INTOSAI family. The present audit law review concentrates on pointing out matters that should be re-considered. It does not evaluate and comment those many rules that are positive. The following comments are supposed to be helpful in further enhancing the present law in order to be totally in line with the INTOSAI Auditing Standards and the audit practise of the best Supreme Audit Institutions within INTOSAI.

It is also well understood that for the time being while the request to include the audit of local governments into the SAO mandate is discussed by the Riigikogu, a further change of the audit act right now seems out of question. However, once the present urgent issue of local government auditing is settled, the following recommendations should be considered for the next review of the State Audit Office Act.

### Main Issues

#### *Independence of Chief Auditors versus comprehensive responsibility of Auditor General*

In all Supreme Audit Office established under the auditor general or office model the Auditor General has the comprehensive responsibility for the audit office including auditing and reporting. This differs considerably from the court or collegiate model where a collegiate or a council decides restricting the role of the Auditor General, normally called President, to more general tasks, mainly representing the audit office to the Parliament and public and to as well important administrative and personnel tasks.

According to the wording of the Estonian State Audit Office Act the Auditor General has all those general tasks and responsibilities, and he is also to a certain extent involved in the audit process. Some main responsibilities, however, are excluded and instead given to the chief auditors that are regarded as independent.

According to § 29 sub-section (2) clause 4) the chief auditor ensures the performance of audits and (clause 5)) signs audit report (unless decided differently in the annual work plan - § 50 sub-section (3)). According to § 38 sub-section (3) supervision of audits shall be exercised by the chief auditors. Only if an audit is carried out by a chief auditor the Auditor General shall exercise the supervision. Under § 15 on the status and duties of the Auditor General, nothing is mentioned in respect of auditing and reporting.

In our view the Auditor General should have the comprehensive responsibility for auditing and reporting, and also for signing the audit reports. He is appointed by Parliament, whereas the chief auditors are appointed by the Auditor General. Accordingly he should be the one with the comprehensive responsibility. This does of course not exclude the possibility for him to delegate tasks to the chief auditors.

There is also another important aspect in this context that should be considered. For the time being the SAO sends all its audit report to Parliament. Often these reports are rather large and contain many details. Parliamentarians, however, all over the world don't want to read large documents. Therefore even very important reports are not dealt with properly only because they are too long and contain too many details.

Many Supreme Audit Institutions have realised this problem and, as a solution, restrict their reports sent to Parliament to the really important issues that the members of the Parliament committee should be and wish to be informed about. They inform Parliament especially about those important findings and recommendations where the auditee refused to follow the audit office advice and where the help of Parliament is required. Other issues of minor importance that can and should be dealt with by management are only sent to the auditee via a so-called management letter.

This procedure has the advantage that Parliament has to deal only with important issues. Accordingly the chance that they will actually deal with these important observations is much bigger. This again would increase the chances of the audit office to get the help and support they need.

In our view this would also be a good solution for the SAO. Those reports sent to Parliament should then always be signed by the Auditor General whereas the task to sign the management letter or however this document is to be called could be delegated to the chief auditors. This would also demonstrate very visibly the different importance of audit findings.

#### ***Annual Audit on Consolidated State Budget not in State Audit Office Act***

According to § 45 sub-section (3) of the State Budget Act “an audit of the annual report of the state and an audit of the annual reports of constitutional institutions shall be conducted by the SAO. An audit of the annual reports of ministries and county governments shall be conducted by the person responsible for the internal audit of the corresponding state accounting entity .... The SAO may, in the course of an audit of the annual report of the state, take into consideration the assessment made by the person responsible for the internal audit of the corresponding state accounting entity regarding the accuracy of the annual report and the legality of the transactions of the state accounting entity.”

As stated by § 48 sub-section (5) of the State Budget Act “the SAO shall prepare an audit report concerning a consolidated annual report of the state not later than by 31 August of the year following the accounting year and the audit report shall contain an assessment of the accuracy of the consolidated report and the legality of the transactions.”

As regards the constitutional institutions § 47 sub-section (2) states that “the SAO shall prepare an audit report of a constitutional institution not later than by 31 May of the year following the accounting year and the audit report shall contain an assessment of the accuracy of the annual report and the legality of the transactions.”

These important tasks, the audit of and report about the consolidated annual report of the state and also of the constitutional institutions, are mentioned only in the State Budget Act but not in the State Audit Office Act itself.

Here in § 10 only two reports are mentioned. In sub-section (1) the Auditor General is requested to “present to Riigikogu an overview of the use and preservation of state assets concurrently with the deliberation of the consolidated annual report of the state in the Riigikogu.” According to sub-section (2) “the SAO shall submit an annual report on its activities to the Riigikogu ...”

In our view it is important that all tasks and responsibilities of the SAO are specifically included in the State Audit Office Act. It does not seem sufficient that they are only mentioned in another act. This is even more important as the tasks concerned, mainly the audit of and report about the consolidated state report are of high importance for the SAO, the Riigikogu and the public. Therefore we recommend amending the State Audit Office Act accordingly as soon as possible. As the amendment in a sort of law harmonisation would not change but only clarify the current legal and actual situation such an amendment should be relatively easy to achieve.

### ***Budget of the SAO***

Another main issue is the question whether the SAO should be entitled to present its budget request directly to the Riigikogu or if the present procedure of involving the Ministry of Finance is sufficient. In this respect the peers have different views depending on the experience in their own audit office.

Right now the SAO drafts its own budget and presents it to the Ministry of Finance (§ 10 State Budget Act). Then negotiations are held between the SAO and the Ministry of Finance (§ 12 State Budget Act). If there is no agreement the dispute shall be resolved by the Government; in the case of a constitutional institution like the SAO the Ministry of Finance may make amendments to the draft budget only if this has been approved in the negotiations (§ 14 State Budget Act). When reviewing the draft State Budget, the Government has the right to amend amounts entered therein or to omit amounts therefrom, unless otherwise provided by law. Upon amendment or omission of amounts the Government then is obliged to present amendments for constitutional institutions together with justification to the Riigikogu (§ 15 State Budget Act).

Therefore it can be argued that the Riigikogu learns about the rejected SAO budget requests and the reasons for it, and they have the possibility to decide about it. The SAO has also the right to address the Riigikogu in its annual activity report and explain why the allocated budget is not sufficient.

On the other hand it can be argued that a direct access right to the Riigikogu brings the SAO into a much stronger position. The Ministry of Finance or even the Government cannot just reduce the SAO draft budget but have to address the Riigikogu themselves.

The situation in many Supreme Audit Institutions is similar to the actual one in Estonia. There is a general agreement that a direct access right to Parliament is always stronger and better for the independence than the need to go through the Ministry of Finance. However, only few Supreme Audit Institutions have ever reached this optimum. In addition even this does not guarantee that the draft budget is always fully granted because if the general state budget is restricted the audit office will have to carry their share of the burden as well. There will also be a greater need to prepare the Budget proposal well and make careful preparations to explain and defend the Budget directly to Parliament. Overall the peers consider that the SAO should be able to move easily obtain the budget (and staff) they need as at present restrictions in this area are a threat to their independence.

Therefore the peers cannot give a firm recommendation to change the current situation, which might be very difficult anyhow, but only express some considerations on this topic.

### **Further Recommendations**

The following comments and recommendations are made in the order of the State Audit Office Act and not following their importance. Most of them would only clarify the actual practice and therefore not lead to any changes in the practical application.

## ***§ 2 Status of State Audit Office***

According to this section the SAO is exercising “economic control”. This expression is used repeatedly in the law, e.g. in §§ 3, 6, and 7. In § 6 sub-section (1) the word “audit” is added in brackets. In § 7 sub-section (1) the term economic control is used again without the addition of audit. In § 6 sub-sections (2) and (4) the term audit is used instead.

This was explained by the fact that the term “economic control” is the old expression still used in the constitution. Therefore it might be necessary to mention this term once in the State Audit Office Act. However, it should be avoided to use different terms for the same action. The best solution in such cases would be to mention the old term once and, as done in § 6 sub-section (1) adding the term to be used later in brackets. Then only the new term, in this case audit, should be used consistently throughout the whole audit act.

## **§ 3 Purpose of activities of State Audit Office**

The purpose of the SAO is besides exercising “economic control” to ensure that “the funds of the public sector are used legally and effectively”. Later especially in § 6 the main functions of the SAO are explained in a much wider scope. So § 6 sub-section (2) clause 3) includes the audit of the performance of the auditee.

Therefore it should be avoided to restrict the purpose of the SAO in one of the first sections unnecessarily. In addition this is a repetition that does not add any value to the audit act.

## ***§ 4. Covering expenditure of State Audit Office***

According to this section “the expenditure necessary for the activities of the State Audit Office shall be prescribed in the state budget”. The wording does not say anything about how this is to be achieved. The actual practise, however, is to present the draft budget to the Ministry of Finance and not to Riigikogu directly. As explained above there are different views on the questions whether the SAO should have a direct access right to the Riigikogu or not.

If there is an intention and a possibility to strengthen the SAO’s independence by giving them a direct access right to Riigikogu as regards their own budget it should be included here.

## ***§ 5. Supervision of activities of State Audit Office***

The activities of the State Audit Office shall be audited annually by an auditor appointed by the Riigikogu on the proposal of the Finance Committee. Therefore the term “supervision” used in the title is incorrect. In a law the terms used in the title should anyhow correspond to those used in the text.

## ***§ 6. Economic control (audit)***

Sub-section (2) states that “in the course of an audit the SAO may assess the following: (1) internal control, financial management, financial accounting and financial statements of the audited entity”. This wording excludes the audit of the internal audit. Internal control and internal audit are rather different control mechanisms. Also because the internal audit is specifically mentioned in § 9 it cannot be argued that it would be included in the term “internal control”. Nevertheless it is fully understood and accepted by the SAO that the audit of the internal audit is part of their responsibilities even without being stated in the audit act.

Therefore it should be mentioned in the State Audit Office Act which should be corrected accordingly in order to avoid possible confusions and misunderstandings.

## ***§ 7. Audited entities***

Right now the Riigikogu discusses a proposal to extend the SAO mandate to carry out full financial audits of the local governments. This corresponds to the recommendation made by the peers in their 1999 report.

The proposed changed wording seems rather complicated and difficult to understand. It might be clearer to create a different order listing under the respective full or restricted audit rights the auditees concerned instead of mixing them as partly done presently. So the local government units are mentioned under full audit rights but with a reference to the restrictions, whereas foundations and non-profit associations where a local government unit is the founder or a member are mentioned only under restricted audit rights.

Otherwise it does not seem useful to interfere in an ongoing process as the draft will most probably be changed again anyhow.

#### ***§ 8. Obligation to submit reports***

According to § 8 state authorities and legal persons in public law are required to send a copy of their annual reports to the State Audit Office within two weeks after approval of the report but not later than by 15 March of the year following the accounting year. This is not in full accordance with the new State Budget Act, see § 37 11 sub-section (2) – quarterly report about the Stabilisation Reserve Fund, § 45 sub-section (1) consolidated annual report of the state, and § 47 sub-section (1) deadline 15 February.

In the course of an amendment of the audit act it should be reconciled with the budget act in this respect.

#### ***§ 9. Co-operation in internal control and internal audit***

§ 9 states that the SAO shall co-operate with the Government of the Republic in order to improve the internal control and internal audit of government authorities and state authorities administered by government authorities. As mentioned before here the internal audit is mentioned specifically.

The reason for this section is not fully clear. As the SAO is entitled to audit the internal control as specifically mentioned by the audit act in § 6 sub-section (2) clause 1) and the internal audit by logic, both with the aim of improving them, there is no place for an additional co-operation. Whatever the SAO can and should do in this respect is covered by its audit responsibilities. Co-operation, however, is less than an audit right.

Therefore we suggest dropping this section.

#### ***§ 10. Reports of State Audit Office to Riigikogu***

As mentioned before this section mentions two reports to be presented to the Riigikogu, namely the overview over the state assets and the SAO activities report. As mentioned before the new tasks of the SAO as laid down in the State Budget Act should be included in the State Audit Office Act as well.

It is also not quite clear why according to this section the overview is to be presented by the Auditor General, whereas the annual activity report is to be submitted by the SAO. This should be consistently the duty of the Auditor General; however, this is an internal issue as the Auditor General represents the office. In the audit act itself generally the SAO should be mentioned unless the issue concerns the Auditor General personally like his appointment or his right to attend sessions of the Government.

In sub-section (2) it is laid down in detail that the SAO's annual report shall contain the auditor's opinion and that it has to be submitted not later than within one month after receipt of his opinion. However, in § 5 dealing with the audit of the SAO, neither the task to produce an opinion nor a deadline for it are mentioned. It does not seem logical to set a relatively short deadline (one month) for the SAO to produce its report and not to say anything about the audit opinion itself.

#### ***§ 15. Status and duties of Auditor General***

According to sub-section (2) clause 1) the Auditor General shall determine the number and composition of the audit departments and services of the SAO and establishes permanent positions for persons performing audits outside the location of the SAO. According to sub-section (3) he may employ (and release from service) employees of the SAO.

The audit act does not refer to the budget whereas in another context in § 33 reference is made to the budget when stating that the Auditor General may determine additional payments within the limits of the budget of the SAO.

It is rather clear that the same restriction also applies to sub-section (2) clause 1), because the Auditor General is not fully free in determining the numbers and composition of audit departments and service but has to stay within the SAO budget. It is, however, not accurate to refer to the budget only in one context and not in another one. Either a general clause should be made, for example in § 4 including all actions with financial effects in the audit act, or the reference should be repeated whenever necessary.

According to sub-section 5 the Auditor General shall “ensure the timely preparation and submission of the draft budget and annual report of the State Audit Office pursuant to the procedure provided by law”. This formulation is rather restrictive. It does not include the overview he has to give himself (§ 10 sub-section (1)) nor the report on the consolidated annual state report nor the reports on the annual reports of constitutional institutions (§ 45 and 47 State Budget Act). It also does not mention all the other reports to be sent to Riigikogu for which the Auditor General, in our view, as appointed by Riigikogu, is finally responsible. It would be better instead of enumerating all single responsibilities in detail to generalise his tasks in this respect.

### ***§ 17. Appointment to office of Auditor General***

The Auditor General shall be appointed to office by the Riigikogu for a term of five years on the proposal of the President of the Republic. It is understood by the SAO that the Auditor General although this is not mentioned specifically may be re-appointed because this is not excluded in the audit act. This may be so; in any case it would be safer and clearer to mention this possibility in the audit act specifically in order to avoid possible legal problems.

Another aspect is the relative short term of office, five years, combined with the possibility of a re-election. This may affect the independence of an Auditor General who might not be as critical and consequent as necessary if he has to present himself as a candidate for a second term. The Auditor General’s independence would be considerably stronger if he was elected for a longer term (can often use formula recommended by Sigma is at least twice the period of Parliament) without the possibility of a re-election e.g. 8 or 9 years.

### ***§ 25. Substitution for Auditor General***

If the Auditor General is temporarily unable to perform his or her duties, according to sub-section (1) the duties shall transfer to the chief auditor appointed by the Auditor General as the deputy of the Auditor General. Following sub-section (2) the deputy of the Auditor General shall perform the duties of the Auditor General also upon termination of the authority of the Auditor General until the new Auditor General has assumed office.

It definitively is a good system to have a deputy selected on a permanent basis. However, this deputy who is entitled to act as Auditor General in his temporary or even permanent absence is not appointed by the Riigikogu but only by the Auditor General himself. This does not give the deputy a strong mandate or position. It should be considered to change the present situation and have the deputy also appointed by the Riigikogu. It might not be necessary to have the proposal like in the case of the Auditor General made by the President, he could also be proposed by the Auditor General in order to indicate the different level.

### ***§ 28. Structural units of State Audit Office***

According to sub-section (2) audit departments are structural units engaged in the principal activities of the State Audit Office. This formulation is rather obscure and should be made clearer. The only task of audit departments is auditing and audit related work. This should be clearly expressed in the act.

### ***§ 29. Status and duties of chief auditor***

According to sub-section (1) a chief auditor is appointed to office by the Auditor General for an unspecified term. This is definitively not wrong, and many Supreme Audit Institutions have the same philosophy. However, it should be considered to consider a fixed period renewable for the term of the chief auditor. This would create an incentive for good work performance. It would also enable the Auditor General to replace a chief auditor that did not perform as

expected after his or her term expired. Right now the audit act despite the strong and independent position of the chief auditors does not foresee the possibility to release them from their duties if their work performance is not adequate.

The chief auditor appoints the officials performing the audits prescribed in the annual work schedule of the State Audit Office (sub-section (2) clause 2)). It should be considered to include these names already in the annual work schedule so that it becomes visible also for the Auditor General (and by this also part of his final decision) who is going to carry out which audit.

The chief auditors following sub-section (2) clause 4) ensure performance of audits in accordance with Acts and other legislation. This seems to be too restrictive as it does not mention internal rules, manuals, international or national professional standards etc. They should either be mentioned as well, or the clause should be formulated more generally.

According to sub-section (2) clause 5) the chief auditors sign the audit reports. As mentioned before this should be modified. All reports submitted to parliament should be signed by the Auditor General. For other reports (or management letters) the Auditor General could delegate his authority to the chief auditors.

### ***§ 33. Remuneration of employees of and experts involved by State Audit Office and***

### ***§ 34. Additional remuneration of employees of State Audit Office***

Both sections are closely related and should be placed in one section. In addition § 33 refers to the limits of the budget, § 34 however not. Also § 33 mentions the payment of additional remuneration, bonuses and benefits, § 34 speaks only about performance pay. This is rather confusing because it is not quite clear whether these are the same or different additional payments. A clarification would be helpful.

### ***§ 37. Planning work of State Audit Office***

According to subsection (1) the SAO shall decide independently on the conduct of audits and the time and nature thereof. This is not totally true taking into considerations §§ 45 and 47 of the State Budget Act. Here some audits are made compulsory, and also a deadline is given. This development should be reflected in the State Audit Office Act as well.

The fact that following sub-section (2) mandatory audit duties shall not be assigned to the SAO is a very strong indication of independence, however, there could be a conflict with the above mentioned sections of the State Budget Act concerning the annual auditing of annual reports. It would be clearer without reducing the strength of this statement to state that mandatory audit duties shall not be assigned to the SAO other than by law.

According to sub-section (3) the work of the State Audit Office shall be based on the annual work schedule approved by the Auditor General. This can only refer to the audit work as the other tasks carried out by the SAO (amongst other review of new acts) are not included in the work schedule. Therefore the text should be clarified.

Further to sub-section (3) is to mention that only an annual work schedule is mentioned. The audit act does not mention the procedure for changes of such a schedule that usually occur. As the work schedule is one of the most important documents for an audit office this possibility should also be clarified. Most probably the chief auditors may propose such changes to be approved by the Auditor General. In addition he might be entitled to change the annual work schedule himself.

### ***§ 38. Persons participating in audits***

According to sub-section (1) audits shall be performed by officials appointed by chief auditors. This does not seem comprehensive enough. A chief auditor himself can also carry out an audit as mentioned in sub-section (3). Also the Auditor General has the right to perform procedural rights (request for information, collection of explanations and inspection) as mentioned in § 41 sub-section (3); this is also a kind of audit. Also the SAO has the right to involve experts in audits (sub-section (2)). Therefore sub-section (1) should be phrased wider.

As mentioned before the SAO has the right to involve experts in audits (sub-section (2)). The experts are mentioned in some sections of this act as regards their payment (§ 33), their use (§ 38), exclusion (§39), the proceedings (§ 40) and the confidentiality (§ 47). However, there is nothing mentioned about the question who appoints the experts and what rights experts have. Usually they should be appointed by the Auditor General, and they should have the same rights as the auditors. It would be clearer to mention this explicitly in the audit act.

Following sub-section (3) supervision over audits shall be exercised by chief auditors. Only if an audit is conducted by a chief auditor, supervision over the audit shall be exercised by the Auditor General. This does not correspond to the usual Auditor General model as explained before. The Auditor General should have the final supervision over all audits. He delegates individual actual supervision to the chief auditors. This, however, does not affect his final responsibility. This should be reflected in sub-section (3).

#### ***§ 40. Notice of proceedings***

Following sub-section (1) a chief auditor shall prepare a notice of proceedings for the collection of information. The preparation of such documents is in fact a task for the secretarial staff (as it also happens in the SAO); the chief auditor should be responsible for the document and sign it. As we were assured that this is not a translation error, the wording should be amended accordingly.

This applies even more to sub-section (2) stating that if necessary, a notice of proceedings shall be prepared by the Auditor General personally.

#### ***§ 48. Prohibition on interference with work of audited entity***

According to sub-section (2) the SAO shall not disclose its positions and assessments concerning the results of an audit before disclosure of the audit report. Taking this literally would mean that no drafts could be presented for factual clearance to the auditee. The actual practice in the SAO is of course different. Already at an early stage the auditee is informed about the audit findings in order to factually clear them. This is a good and usually used practise although it does not correspond to the strict wording of the audit act.

It would be clearer to state that the SAO shall not disclose its positions and assessments concerning the results of an audit to the public (or to parties not involved in the audit) before disclosure of the audit report. A clarification would be useful.

#### ***§ 50. Preparation of audit report***

Generally we are of the opinion that this section is unnecessary. It does not seem necessary to elaborate in detail what an audit report may contain as this is a logical consequence of the tasks of the SAO and does not require additional explanations. It might be useful to mention that the audit report should contain proposals or recommendations as this was not always the case. However the rest does not seem necessary.

The consequence of such a detailed description often is that items are not included and by this excluded. So sub-section (1) clause 1 mentions only the internal control but not the internal audit. Nevertheless it is well understood that the SAO is not only entitled to carry out audits in this respect (although not mentioned in the audit act as explained before), but also to report about its findings. Therefore, unless the above recommendation is followed, the clause should be amended.

Another inconsistent statement is laid down in sub-section (4). Before being signed an audit report shall be presented for examination to the auditee. The person to whom a report is presented shall submit his or her written opinion concerning the recommendations regarding him or her. Firstly it should be avoided to refer to persons as audit reports usually are directed to ministries or other entities. In addition it does not make much sense to restrict the auditee to comment only on the recommendations and not on the facts and findings.

***§ 51. Disclosure of audit report***

When the SAO publishes (discloses) the report it shall according to sub-section (2) disclose written opinions which persons specified in subsection 50 sub-section (4) of this act have submitted concerning the report shall be together with the report.

The fact that it is better not to mention persons but entities in the act has already been mentioned above. In addition taking the wording of this sub-section literally would mean that the SAO has no right to comment on the opinions presented by the auditee.

The actual practise, however, is different. Actually the SAO incorporates a summary of the auditee's comments into its audit report and whenever necessary comments on it in the report. As summarising a statement automatically means changing it at least slightly this possibility including the right to give final comments to it should be foreseen in the audit act reflecting the current good practice of the SAO.

**ANNEX 3: THE IMPLEMENTATION OF THE RECOMMENDATIONS  
OF THE 1999 PEER REVIEW**

	<b>RECOMMENDATION OF SIGMA PEERS</b>	<b>IMPLEMENTATION BY RIIGIKONTROLL</b>
	<b>Legal Framework</b>	
1.	<p>1.1 Provide the SAO with a greater degree of financial independence by allowing the SAO to send its budget estimate directly to the Riigikogu instead of through the Government.</p> <p>1.2 Define SAO's mandate in terms of the INTOSAI standards terminology particularly on the audit scope (§38-40), i.e. regularity and performance audit.</p> <p>1.3 Require the SAO to perform full annual attestation type of regularity audit on the State Budget Execution and the other state bodies for which it has an external audit responsibility (see below our comments on type and scope of audit).</p> <p>1.4 Arrangements for an effective external audit of local government need to be put in place. These arrangements should consider carefully constitutional difficulties and resourcing restraints.</p> <p>1.5 To institute formal arrangements for a government response to the recommendations made by the SAO in its main reports.</p> <p>1.6 Provide for a sensible and useful intervention on the budget proposals of the government e.g. one that does not incur a great deal of time and does not pose any significant conflicts of interest.</p>	<p>1.1. Situation is the same, the budget still goes through Government.</p> <p>1.2 The right to carry out regularity and performance audit is clearly stated in the new SAO Act.</p> <p>1.3 The SAO carries out financial audits and gives its opinion on the implementation of the state budget in the annual audit report concerning the consolidated annual report of the state.</p> <p>1.4 The proposal regarding the amendment (has been discussed in the Constitutional Committee and the main political parties have expressed their support of it) according to which the SAO will be entitled to carry out audits in local governments passed the first reading in the Riigikogu. Amendments to the SAO Act were adopted in May 2005.</p> <p>1.5 The formal arrangement is laid out in the SAO Act. The auditee is obliged to answer in writing giving his opinion regarding SAO recommendations. The Government should respond to the Riigikogu Select Committee on the Control of the State Budget (Select Committee, see under 17) within a month.</p> <p>1.6 The Select Committee uses information provided by the SAO in reviewing the draft state budget and the AG participates in the Government sessions with the right to speak. He can express his position regarding the draft budget, if necessary, without any commitment to political decisions.</p>
2.	<p>SAO should analyse the exact role and function it should have in the audit of EU funds. The SAO should, under the proposed new audit law, consider the possible implications of EU legislation and a specific requirement to audit EU funds, which will include the clear ability to audit the end users of such funds.</p>	<p>According to the SAO Act the SAO now has the full right for the audit of EU funds. In its audits the SAO regards EU funds on an equal basis with the state budget (see strategy).</p>

	<b>Audit Methodology and Standards</b>	
3.	For the most important topics for which standardisation of the working process is necessary, manuals have to be prepared e.g the audit of EU Funds. But, the value of audit manuals must not be overestimated and alone these will not improve the standard of work of inexperienced staff. The SAO should re-evaluate its list of manuals and decide which ones are really important and which ones need updating.	<p>The Financial Audit Department (FAD), the Performance Audit Department (PAD), and the Audit of Operational Risks Department (AORD) were created in 2000.</p> <p>Each audit department designed guidelines/manuals for their own needs. Taking into consideration the structural change from December 2004, Guidelines for Preparing the Work Plan and Conducting the Audits (applies to all departments) were worked out in January 2005 and a guideline (financial audit) Audit Opinion of the SAO on the Consolidated Annual Report of the State was approved in April 2005.</p>
4.	Make maximum use of the practical experience of the auditors themselves. Develop manuals in workgroups consisting of auditors and people from MPRS. In this way not only the practical value of the manuals is safeguarded but also the first beginning is made for the introduction and the promotion of the manuals on the working floor. A working procedure could be used in which first small pilot audits are executed and next manuals are developed based on the experience with the pilot audits.	This has been done. The guidelines which the SAO already have, have been developed in audit departments based on audits carried out (mostly pilot audits) i.e. on practical experience. The MPRS (Methodology, Planning and Reporting Service) has reviewed and commented on them with the aim of harmonising the audit process. The recent Guidelines for Preparing the Work Plan and Conducting the Audits have been worked out by MPRS and are to a great extent based on the existing practice and routines of audit departments. The SAO is planning to compile a comprehensive audit manual.
5.	Manuals should be based on current best practice in the EU Member States e.g. the 15 Guidelines for the Implementation of INTOSAI Standards.	<p>INTOSAI auditing standards, 15 EU Guidelines for the implementation of INTOSAI auditing standards, INTOSAI Implementation Guidelines for Performance Auditing, Swedish Performance Audit Manual, have been fully or partly translated into Estonian and all SAO guidelines are based on international best practice. International manuals are used as guidelines when own manual has not been developed.</p> <p>In developing audit methodology the SAO has mainly taken example of the audit methodology of the Netherlands (within the framework of the special, so-called PSO programme) and United Kingdom (Heads of Audit Department participated in NAO training using the knowledge and materials in developing own guidelines). A publication (parallel text in Estonian and English) was compiled and translated by the SAO summarizing the PSO programme (3 years).</p>
6.	Once a manual is developed close attention has to be paid to the introduction in the organisation. This is the important bit and requires effort and resources. Every manual has to be presented and discussed in meetings with all the auditors of the audit departments. Communication is the key word. For some manuals a training module could also be a useful instrument. Introduce a 'sunset strategy': evaluate every manual once in a while to assess if it is up to date and being used by the auditors.	The specific audit guidelines have been worked out in audit departments with auditors participating. They have been introduced in the course of the induction programme for newcomers or practical work, also at in-house training. e.g. Internal training day was organised to introduce the Audit Opinion of the SAO on the Consolidated Annual Report of the State adopted in April 2005.
	<b>New Types and Areas for Audit</b>	

7.	<p>Consideration needs to be actively given to whether the scope and type of audit carried out by the SAO needs to be broadened to encompass the full range of audit work that INTOSAI standards (38 to 40) suggest an SAI should embrace. The full scope of public sector external audit should be considered for application in Estonia. Most importantly, whether an annual "attestation" audit of financial statements (cf. 39a and b) would be beneficial, and whether the continued development of a capacity and capability to carry out performance audit (CF.40) studies are necessary. In respect of the latter, we see this would build upon the pilot reviews of control systems that are currently being planned. Most audits currently being carried out by the SAO are of the legality type. The SAO are looking to develop a performance audit capability and are reviewing their arrangements for financial audit.</p>	<p>In 2000 the SAO established Departments of Financial Audit (FAD), Performance Audit (PAD) and Audit of Operational Risks (AORD). Financial audit was developed by means of pilot audits and training of staff towards annual attestation type of audit.</p> <p>From 1 December 2004 the SAO was reorganised (the structure based on audit types was changed into ministry-based structure). 4 audit departments (5<sup>th</sup> to be added for audit of local governments) were created, each of them carrying out both (financial and performance) types of audits.</p> <p>The SAO gives opinion regarding the consolidated accounts of the state (from this year according to the SBA adopted in 2004). The next objective is to go on to a new level with the attestation audit.</p> <p>The AORD carried out legality type of audits in the area of subsidies, licences and public procurement.</p>
8.	<p>To start performance audit we would suggest that for the near future it should primarily focus on the audit of financial management in the public sector. Adopting the Acquis means, namely, that Estonia has to build up a sound financial control in all ministries and other entities dealing with EU funds and resources. This financial control must meet certain specific requirements. The SAO could play a very positive role by regularly following up via audits how well the administration meets these requirements. A sound financial control is also equally important when it comes to national resources. And finally these types of audits (of the internal control systems) are also a regular component in all ECA and EC audits.</p>	<p>Following the recommendation the SAO created the PAD and first started to carry out performance audits (pilot audits within the framework of PSO programme) of financial management. At present the audit of financial management is carried out as a part of financial audit in the course of which the reliability of internal control systems is checked (see Guideline on Audit Opinion of the SAO on the Consolidated Annual Report of the State).</p> <p>The State Audit Office has been the initiator in establishing internal control and audit in the Government sector. As a result the amendment with regard to internal control and audit was introduced into the Government of the Republic Act in 2000.</p>
9.	<p>The SAO should review carefully its anti-corruption activities to ensure that they are effective and useful.</p>	<p>The responsibility to check the declarations of economic interest of local government officials went to the Ministry of Interior and is no more the SAO responsibility.</p> <p>The SAO has taken the decision to pay more attention to legality issues audit (risk-based approach) within financial detect fraud and corruption. A working group on legality audit has been set up for that purpose.</p>
	<p><b>Planning and Quality Assurance</b></p>	
10.	<p>A whole range of planning mechanisms needs to be considered for the SAO. The extent and structure of the new planning regime will need to be carefully considered and introduced over quite a long period so as not to displace direct audit work to an extent that will detract from the SAO's output but add to it in quantity and quality. The existing planning framework will form the basis for better planning as will the implementation of the requirements of the new audit manual. The new and revised planning structures should cover the following:</p> <ul style="list-style-type: none"> <li>• Operational job and detailed audit plans</li> </ul>	<p>The SAO has constantly paid attention to improving its planning system and it developed corporate strategic plans for 2000-2003 and 2003-2005, the corporate plan for 2005-2008 is under development. Audit strategy for 2002-2004 was developed. Departments worked on strategic plans in co-operation with MPRS. The SAO has annual work plan, the main part of which is the annual auditing plan. The recently adopted guideline (see under 3) gives detailed description regarding audit plan and is based on risk evaluation and materiality considerations.</p>

	<p>based on risk and materiality considerations;</p> <ul style="list-style-type: none"> <li>• Strategic plans for each department with assessments of staffing requirements;</li> <li>• Corporate plan that links with the budget and requirements for staff.</li> </ul>	
11.	<p>Appropriate information systems will need to be developed to support the planning framework and other business information needs, including adequate reporting to senior management. Time reporting is the tool that is required to both follow up audit plans and budgets and also improve planning and budgeting.</p>	<p>A new document register system has been bought (<i>Postipoiss</i>). The detailed audit plan includes time schedule. In <i>Postipoiss</i> all internal (including audit documents), incoming and outgoing documents are registered and available.</p> <p>The Time Reporting System (TRS) was introduced in 2000, has been modified but needs further improvement. Every audit in TRS has a number and can be followed.</p>
12.	<p>Key management related matters will need to be addressed, including the institution of procedures for the direction, supervision and review of audit work. This will require the exposure and training of senior and middle SAO managers in modern management techniques and concepts and auditing standards relating to these topics.</p>	<p>Management training (3 courses) for Heads of Services, Audit Managers and top management - (Chief Auditors/Heads of Departments, Director, AG) was carried out within the framework of PSO programme in the years 2000-2003, trainings were also arranged after that. The Heads of Departments and Audit Managers are responsible for the direction, supervision and review of audit work (see SAO Act and job descriptions). Audit team and managers, including the AG participate in internal discussions.</p>
13.	<p>The SAO should develop its mission and vision statements and devise corporate targets as a general framework for its operations. This should also be developed in conjunction with an internal results analysis systems for the SAO to assess and track the impact of their work.</p>	<p>The mission and vision statements have been developed together with developing the strategic plan.</p>
14.	<p>We recommend that SAO place a high priority on developing a comprehensive strategy for ensuring high quality throughout the audit process, from the beginning of audit planning to the completion of the audit report. Quality control policies will need to be considered for adoption and implementation by the SAO, which will need to cover the following key elements:</p> <ul style="list-style-type: none"> <li>• Professional standards;</li> <li>• Skills and competence;</li> <li>• Client relations;</li> <li>• Work assignment;</li> <li>• Delegation, direction, supervision, review and monitoring;</li> <li>• Consultation with external experts.</li> </ul> <p>The formulation and implementation of detailed practices and procedures to fulfil such a policy matrix will take a substantial effort over a considerable period of time. Solutions that fit the SAO's needs at</p>	<p>The recent Guidelines for Preparing the Work Plan and Conducting the Audits as well as personnel and communication related documents lay out procedures for quality control.</p> <ul style="list-style-type: none"> <li>• Guidelines in compliance with international standards;</li> <li>• Skills and competence are evaluated when recruiting people, skills and competence are regularly evaluated. Training is arranged to meet the needs, to improve skills and raise competence (see SAO personnel policy);</li> <li>• Client relations policy is set out in a corresponding document;</li> <li>• The responsible person for work assignment, delegation, direction, supervision, review and monitoring is the Chief Auditor (can further delegate parts of his/her responsibility).</li> </ul> <p>The SAO has used external consultants on the basis</p>

	the time will need to be considered as well as a careful assessment of priorities and the ability of the SAO to accommodate change.	of which a document was prepared by the MPRS regarding consultation with external experts. It was discussed by the management and the MPRS was asked to improve it. The strategic goals and priorities were defined by the Audit Strategy.
15.	Management and quality control systems will need to be developed to cope with the extra and more complicated demands for managing the quality of an expanded financial and performance audit beyond the legality area e.g. reviews of internal controls, financial attestation audits and for audits of economy, efficiency and effectiveness.	The Chief Auditor is responsible for quality control. Internal discussions serve as an important means of quality control. The Audit Manager and MPRS involved in the quality control.
	<b>Making Use of Audit Findings</b>	
16.		<p>It was the SAO initiative that within the framework of the PSO programme in 2003 a joint visit of the SAO and the Members of Parliament was organised to the SAI and Parliament of the Netherlands to get acquainted. SIGMA Paper No 33 (abridged) was translated and distributed in the Parliament.</p> <p>The Riigikogu Select Committee on the Control of State Budget was established on 17 February 2004. All SAO reports: overviews, annual and individual audit reports are sent to and reviewed by the Committee. The Committee discusses reports and important questions raised by the Auditor General and reviews public audit issues As a result of the deliberations of audit results the Committee is entitled to make inquiries to the Government. The Government must respond within a month. Communication with the Standing Committees is also their responsibility as well as organising joint sittings when necessary. The Committee informs the State Audit Office about the problems addressed to the Committee by authorities and persons and forms an opinion in cases of obstruction of the SAO activities. The Select Committee also has the right to make proposals to the other committees with regard to the preparation and amendment of legislation.</p>
17.	<p>The SAO should take greater interest and care with its relations to its clients and auditees. In particular the SAO should emphasise further developments of its relation with the Ministry of Finance, particularly in the area of the control and management of EU funds. There are many ways of improving working relations without jeopardising the independence of the SAO. Instruments that have been successful in other countries, and which SIGMA recommends the SAO to consider, are:</p> <ul style="list-style-type: none"> <li>• the practice of "cross-training" of staff with the Ministry of Finance e.g. mutual shorter secondments;</li> <li>• the development of its work plans: the SAO should seek information from the Ministry of Finance as to the areas of audit work, and the types of audits, that would</li> </ul>	<p>The procedure of communication with the auditee is regulated by the SAO Act and Communication Policy and Guidelines for Preparing the Work Plan and Conducting the Audits. The SAO has regular communication with the Ministry of Finance (MoF) based on:</p> <ul style="list-style-type: none"> <li>• cross training and secondment which was more practised in the first years after the 1999 Peer Review (PR), e.g. the SAO representatives participated in the Twinning Programme (Internal Control) of the Ministry of Finance;</li> <li>• regular exchange of information regarding work plans and contacts working on the consolidated annual report of the state, co-operation also in the field of methodology;</li> </ul>

	<p>be of particular interest to the Ministry of Finance in its budget formulation responsibilities and in the EU accession process;</p> <ul style="list-style-type: none"> <li>the strengthening of the financial management controls by co-ordinated audit with the newly created Internal Audit at the Ministries;</li> <li>the planning individual audits: the SAO, should seek to build evidence in support of recommendations focused on the setting up and improvement of the internal control, strengthening of budget procedures and accounting systems, efficiency and effectiveness of public procurement, and sound financial management in general;</li> <li>the training of staff in client relations skills and methods.</li> </ul>	<ul style="list-style-type: none"> <li>audit plans are coordinated with Department of Financial Control of MoF;</li> <li>training in client relations was carried out within the framework of the PSO. Programme auditors have been trained in interviewing techniques.</li> </ul>
18.	The risks of a high media profile do have to be carefully managed. It would be advisable for the SAO, despite its successful media outcomes to date, to consider whether they could usefully take advantage of other SAI's experience on this issue, e.g. make a study visit to an EU SAI with well-developed press and media operations	People from Public Relations Service (PRS) have paid visits to corresponding departments of Sweden and Denmark. The SAO developed communication policy. The SAI of the Netherlands arranged a training in communication skills based on their experience for the SAO staff within the framework of the PSO Programme.
19.	The SAO should modernise its current reporting systems and procedures to ensure fairer and more effective reporting. Layout and format of reports should be standardised, be subject to a more efficient management and review, and have a stronger contradictory procedure.	Reporting systems have been modernised step by step. Layout and format of reports have been standardised and further improvement is included in the work plan for this year. Contradictory procedure is stipulated by the SAO Act para 50 (4,5).
	<b>Management and Organisation</b>	
20.	The SAO should work out vision and mission statements and communicate these to staff. The management board should invest more time and effort in communicating changes and developments to staff. The Auditor General should be more involved at an early stage with significant audit reports and should delegate more administrative functions to his senior staff so that he has more time to devote to audit matters.	<p>The mission and vision statements and values of the SAO have been worked out and communicated to the staff with the strategy and are on the website, they are part of the induction programme. The AG has delegated more administrative functions to the Director.</p> <p>The AG is involved in audit by way of participation in the internal discussions (held to approve audit plan and audit report) or in case he decides to direct an audit.</p>
21.	The staff assessment process should be simplified and made easier to administer. It needs to be made less threatening and linked to personal development and training issues. The assessment process is already linked to a performance pay system and should be further developed so that performance bonuses are paid more often to highly effective and well performing staff.	The staff assessment has been simplified. Annual performance is evaluated with the direct manager as a result of which a proposal is made regarding the performance pay. "Good audit premium" has been introduced to reward people once a year (given to audit team).
22.	The IT facilities of the SAO should continue to be developed and enhanced. The SAO will need to	The software programmes used by auditors are IDEA and STATA. There have been discussions about

	develop a capacity and capability to undertake audits of computer systems and use audit interrogation software (e.g. Winidea).	buying TeamMate.
23.	The SAO should develop a graduate trainee programme to help attract highly qualified people to the SAO in order to meet the expected growth in professional staff numbers over the next few years	An induction programme for newcomers was developed and introduced. The newcomer will go through a test period under supervision, and someone is appointed to help and supervise a new employee for a 6-month period.
24.	The SAO needs to conduct, with some expert assistance, a training needs assessment and training gap analysis as a basis for drawing up a training plan that will deliver and help manage training demands for a professional internal and external training. In this respect it is most important to build up an effective facility for internal training and consider the need for a scheme of professional accountancy training. A steering committee could be set up, with support from outside educational experts, to advise on the development of training.	As a result of the SIGMA seminar in 1999 training needs were assessed and they are reassessed annually. A kind of Committee or Working Group (representatives from all departments) was set up in 2000 but its work stopped (members of the WG left SAO). Internal training (with own staff) has been arranged throughout the years as much as the limited resources allow covering various audit-related topics. There has been no special scheme for accountancy training.
25.	The SAO should institute an organised policy of job rotation. It is an important long-term investment in competence and should preferably be institutionalised as early as possible in the life of an SAI	There has been job rotation but no special policy. The personnel policy touches upon the issue.
26.	Ensure training is used as a tool to aid change and development. Link training to concrete work situations and the introduction of new methodologies for audit. Establish links with possible training partners and collaborators, such as the Ministry of Finance, Universities, Private Sector Accounting Firms	Training has been among the priorities of the office throughout the years. The SAO employees have participated in training arranged by the Ministry of Finance and vice versa. Auditors participate in trainings organised by Private Auditing Firms such as Price Waterhouse Coopers and KPMG. Co-operation agreement was signed with the Tartu University.
27.	Take part in the two-week Certification of Auditors training course organised by the Estonian Accounting Board. This will certainly help the SAO establish a high audit profile in Estonia and support the only currently available professional training of auditors in Estonia	A few SAO auditors have gone through the training, passed the examination and got the certificate but it has been done on their own initiative.

#### ANNEX 4: NUMERICAL INDICATORS OF ACCOUNTABILITY

		Estonia	Latvia	Lithuania	Poland	Czech R	Slovakia	Hungary	Slovenia
1.	TI Corruption Score 2003	5.5	3.8	4.7	3.6	3.9	3.7	4.8	5.9
2.	Election upset	?	2002	?	2001	1998	1998	2002?	?
3.	Annual average of bribery convictions 1997(98)-2001	35	18	48	325	117	28	279*	32
4.	Bribery convictions per one million inhabitants	25	7.8	13.7	8.4	11.3	5.1	27.6	16
5.	Special anti-corruption unit	No	Yes	Yes	No	No	No	No	No

*Sources:* Author's calculations and summary from Open Society Institute, *Monitoring the EU Accession Process: Corruption and Anti Corruption Policy* (Budapest, 2002), and Report on the Fight Against Corruption in Slovakia, October 2001, [www.government.gov.sk](http://www.government.gov.sk); and Transparency International website [www.transparency.org](http://www.transparency.org).

*Notes:* Row 1: Transparency International Corruption Perception Index: 10 = low, 0 = high corruption.

Row 2: Corruption is a leading issue in election, new government promises cleanup.

Row 5: Autonomous institution with investigatory authority, as of 2003.

\* Includes trafficking in influence

## ANNEX 5: INTERNAL AUDIT SET-UPS IN SOME LATIN AND ANGLO-SAXON COUNTRIES RESPECTIVELY

### France

In France, the State Audit Office is the external auditor that is responsible for providing an opinion on the Annual Statements of Government, reporting to the President on financial management and to the National Assembly on financial statements and reports. There is a centralized Inspector General for Finance who is the internal auditor for the Ministry of Finance, and who also carries out audit work in all Ministries and Agencies of Government. A Financial Controller appointed by the Ministry of Finance carries out internal audit type functions within the Ministries. The role performed addresses the pre-commitment stage of spending. Centrally appointed accountants then audit the post-authorization stage of spending. The Ministry's own internal audit function, the Inspector General of Finance, audits the overall financial management system that serves government and other important compliance requirements, but the scope of work is much reduced in light of the role of Ministry of Finance representatives located in the various ministries. The State Audit Office also carries out reviews of internal audit work. The work of the Inspector General of Finance is broader than financial audit and compliance with laws and regulations and can include a consideration of some performance issues.

### Sweden

In the Swedish central government sector the internal financial control of the execution of the state budget is largely delegated to the government agencies which are commissioned by the government to implement the approved budget. The structure of the internal financial control and the internal audit is described in the following.

#### *Management control*

For the government agencies there are fundamental rules laying down the responsibilities and duties of the top management. These rules require that the operations are carried out in an efficient way, that reporting to the government is accurate, and that the administration is performed in compliance with relevant laws, regulations and government decisions.

This means that it is the responsibility of the top management of a government agency to ensure that the internal management and control structure is organised so that these requirements are achieved. Thus, internal control is an integral part of the top management's administration and includes all essential activities which have a direct or indirect impact on the agency's possibility to fulfil its missions.

In summary, internal control is a tool the top management uses in order to achieve reasonable assurance that

- the objectives stated by the government are achieved,
- the operations are performed in compliance with laws, regulations etc.,
- accurate and timely reporting of the outcome of the operations is made.

#### *Internal audit*

In the larger government agencies, some 50 out of some 275, internal audit is organised as a separate and independent function. These 50 agencies manage some 95 per cent of the central government expenditures. The task of the internal audit is to monitor, verify and judge the quality of the systems for internal controls. The internal audit is a tool for the

top management (the board or the director general) when assessing the efficiency, the feasibility and security in the systems for internal control.

The internal audit works on behalf of the top management of a government agency. In order to make sure that the requirements of objectivity, independence and integrity are fulfilled the internal audit is not part of the line organisation but organised directly under the top management. It should be unequivocally stated that the internal audit is not independent in its relation to the top management.

The remit of the internal audit includes all parts of the management and internal control. The selection of areas of control and the design of the checks is based on an assessment of the risk for essential errors.

The examinations performed by the internal audit aims at verifying whether the operations are carried out economically, efficiently and effectively. Resources shall also be safeguarded against loss due to irregularities etc. Furthermore, the internal audit shall verify whether relevant laws, regulations and management directives are adhered to. As regards reporting, the internal audit shall verify whether the external reporting is reliable and fulfils the external reporting requirements, and if the internal reporting provides the top management with adequate information for its decision-making.

The internal audit can examine decisions a posteriori. The examination may regard regularity, performance and also non-financial data. The internal audit should give advice in financial issues and in issues related to the design and operation of internal control.

The internal audit shall carry out its work according to the INTOSAI standards and standards issued by the Institute for Internal Audit. The internal audit shall be performed in accordance with generally accepted standards for internal auditing. This means that the internal audit shall be carried out in an objective way, be independent, be professional, have a high degree of integrity and use generally accepted working methods. An internal auditor may not be operationally involved in an activity that is being reviewed.

The top management shall approve a plan for the internal audit in the beginning of each year. Before the approval the SNAO shall be consulted. The SNAO may suggest improvements of the audit plan. One purpose of the contact with the SNAO prior to the approval of the plan is to provide the SNAO with an opportunity to assess to what extent the work of the internal audit can be used in the planning and execution of the external audit.

The internal audit reports its observations to the top management of the concerned government agency. The internal audit does not issue a certificate stating whether the internal control operates in a satisfactory way.

Presently, there is no specialised body in the central government sector for internal financial control and internal audit issues. There is no reporting from local internal audit units to officials in political posts. No separate control body exercises any control before a government agency concludes financial commitments or payments. The responsibility for these measures rests with the top management of each agency.

If the internal audit unit reports a case of mismanagement or abuse in a government agency it belongs to the top management to take the necessary steps. Disciplinary measures can be taken against an employee. These measures can have the form of a warning, a reduction of the salary, or dismissal. If an employee can be suspected of having committed a serious crime the issue shall be referred to the

### ***United States of America***

The Government Accountability Office (GAO) that reports to Congress performs external audit in the Government of the USA. Internal Audit, by contrast, reports to the Chief Executive Officer of the Agency it carries out its work for. An Inspector General (IG) leads the Internal Audit service. The IG reports to the head of the Agency, but is kept separate from the rest of the agency itself. He/she is to have direct access to the Head of the agency at any time. The reports of the IG are submitted to the Head of the Agency, but he/she is also expected to keep Congress informed of the work performed. Once the IG submits the internal audit report to the Head of the Agency, the Head has 30 days to respond to Congress on the contents of the report. This external reporting to Congress has reduced the decentralized focus of internal audit and provided an external accountability for results.

### *United Kingdom*

The United Kingdom has a decentralized model of internal audit. The internal audit group is within a ministry and reports to the Chief Financial Officer. The Treasury prepares standards and guidelines centrally for internal audit. The external audit function is performed by the Comptroller and Auditor General of the National Audit Office. There is also an Audit Commission that is responsible for appointing auditors for local government, police and the National Health Service. It regulates their services. In this decentralized model, management is supported by internal audit. There is also a reinforcing role performed by the National Audit Office in reviewing the work of internal audit where useful and in ensuring that an external evaluation and verification is performed.

## **ANNEX 6: EXAMINATION OF INDIVIDUAL PERFORMANCE AUDIT REPORTS**

In general it became clear after having looked through some reports and after having spoken to audit staff and managers that SAO has made significant progress in its performance audits. But there is always the opportunity for further improvement.

Various subjects have been chosen for examination but selections of audit subjects is not always done in a very transparent way. It is not clear to the reader of a report why a subject was chosen and in what kind of strategy or other overall-aim it fits. We found a number of aspects that SAO should consider:

-we noted that because of the recent loss of significant numbers of staff that that audits are not always performed in teams. It was admitted that occasionally auditors, even new staff, sometimes work alone. This practice although in part forced on the SAO should be avoided where possible to reduce the risks of inconsistency in depth of an audit, in the collection and examination of sufficient relevant and reliable evidence, and in drawing conclusions from the evidence examined. It also brings risks in report writing. We recommend that, where possible, performance audits should always be done in teams preferably led by auditors with some seniority.

Conclusions and recommendations are the message to the auditee and parliament about what the results of the SAO's work. So it is necessary to take time to think about the message of a report and the best way how to frame the messages. This should be discussed with management and agreed by the AG after discussing the audit findings and preliminary conclusions with the auditee before producing the report with its conclusions.

Also timing of the publishing of a report should be considered. The strategic question: when should we publish to get the most impact should be answered far in advance, in fact when selecting an audit subject.

Editing the reports is also essential to ensure consistent quality and the use of appropriate language. The reports that were reviewed differ in style, structure and in the way conclusions are made. In principle the responsibility for this lays with the Methodology, Planning and Reporting unit of the SAO. But the guidance issued to date seems to have been fairly modest and their resources are quite limited. The SAO might care to give consideration to some expert outside assistance to help in the training of auditors and all levels of management in writing reports. There may also be some advantage in adopting a "House style" without necessarily restricting innovation.

### **Matters arising from the examination of two recent reports**

Two performance audit reports were examined by the peers: 'Organisation of primary emergency medical care' and 'Effect of enterprise support on creating jobs in regions'.

Both audits were made under the 'old' regime so the following comments should be placed in the context of any organisational or procedural changes which have occurred since. They represent the views of the advisors based on an examination of the planning documents and other material presented to them by the teams (in their translated versions) and were also based on discussion with team members. In view of the limited time available, the comments should not regarded as the results of a detailed critique but the matters which struck the reviewers as being areas which need to be considered when planning and delivering performance audits in future. Also the reviewers have not had an opportunity to discuss all their comments with the audit teams.

## **Organisation of primary emergency medical care'**

### ***First reviewer's comments***

#### *Planning of the audit*

The planning of the audit was apparently done late in 2003 and a Preliminary Audit Plan (PAP) produced in January 2004. This indicated that a budget of some 442 hours would be devoted to preparing an audit proposal by the end of March 2004.

The PAP identified the subject for audit as being "Access to Primary Health Care" and addressed the following:

- significance of the subject and problems to be audited
- selection of focus
- possible objective and aspect of audit
- expected messages and proposals
- audit team
- topics to be examined and questions to be answered
- time schedule

The document shows however that the real subject for examination was to be the way in which emergency medical care is provided in which case the title is rather misleading (see later internal comments on this aspect). The document seems to start from the premise that the service is not functioning as it should. However the system/s currently in operation are not comprehensively described and analysed in a way which justifies such a 'conclusion'. There is insufficient explanation of what services are provided by whom under what regulations and what the aims and objectives of the existing system are and how it would be assessed to judge whether it was working as required.

The document speculates on how the audit work will be focused but does not seem to make any positive recommendations. The same comment applies to the objectives of the audit and the aspects it would address.

The section on expected messages and proposals is also lacking in logical argument and again does not seem to be based on analysis of existing evidence but on a premise that the way in which the family physician system operates is the root of the problem.

#### ***Audit report/proposal***

Early in April 2004 the project was subjected to the internal negotiation process. The documents we have seen however do not make it clear it is a formal audit plan which is being considered although this can be implied. The situation is somewhat confusing in that there seems to have been two sets of minutes for the same meeting with different participants but essentially discussing the same subject although one refers to a report and the other to a proposal. The main messages which the audit should bring out are also different depending which version is read.

The inappropriate nature of the title was picked up and recommendations made to change it to the above title. Continuing to include the word 'primary' in the title seems to maintain the confusion as the discussion centred around the need to focus on the provision of emergency medical care which in itself implies the first point of contact at which such care will be provided.

The impression created by the internal negotiation questions/comments/answers is that the project lacked analysis and focus even though some questions raised e.g. 'How do you feel about the role of nurses in health care' seem to widen the subject to be examined rather than bring it into focus. It was also evident from other questions

asked that the paper presented did not provide clear evidence whether such care was accessible or not. Such information is fundamental to understanding the field before making a case for an audit. It is clear from discussions with the team that a lot of work was done leading to the proposal. What is lacking is presentation of argument in such a way as to provide a persuasive case for doing the audit in this area, what aspects the study will address in depth, how the evidence will be gathered and the criteria against which it will be assessed and the linkage to the conclusions the work is likely to lead to.

Doing this well is not a task to be underestimated. It is all too easy to have pre-conceived ideas, get too close to the topic and lose perspective and take some evidence at face value. Where possible it is better to form findings and conclusions from evidence that can be supported from more than one source. One also needs to maintain a clear "trail" through from the initial hypothesis through the information gathered, to the conclusions drawn. Conclusions also need to be reconfirmed before being presented.

### *The Audit Report*

The audit resulted in a number of important findings many of which were accepted by the Ministries for action or were already being considered. Some conclusions and recommendations were disputed however which reduced the impact of the report. We understand that it generated hostility in some areas and was criticised by (some of) the personnel involved in providing emergency medical care.

It is to be expected that not all audit reports will be warmly welcomed. But we feel that certain aspects of the report could have been presented more clearly. Also some conclusions and recommendations were potentially contradictory and expressed too strongly in the light of the evidence presented. It was also clear from the contradictory opinion of the Ministry in some cases, that the potential impact of some of the recommendations had not been assessed objectively.

It is regrettable that the internal negotiation process did not generate input to address these areas.

It is difficult to gauge the reception it received at the PAC as the minutes give no indication of what matters were raised by the Committee with the SAO or the representatives of the responsible Ministries who were present for the 1.25 hours for which it was apparently discussed. The Committee did however "take note" of the report and refer it to the Committee of Social Affairs for them "to consider initiating amendment of the legislation in order to eliminate problematic areas for implementation". They also said the subject would remain in the sphere of attention of the Committee who hoped the Ministries of Internal and Social Affairs would co-operate to find an optimal solution.

We have commented elsewhere on the need for the PAC to be more rigorous in its approach and to produce robust recommendations for which the Government will be held to account.

We comment below on the general structure of the Report and individual Parts. The Report contains a Summary followed by four Parts dealing with various aspects.

### *Summary*

The opening paragraphs do not give a very clear presentation of why the audit was carried out. The explanation of the overall system of provision of medical care is also weak. Some of the comments are contradictory in that it says in one place that emergency medical care is provided by ambulance crews only to say later in the same paragraph that they are not the sole provider. The report indeed focuses on the provision of emergency medical care by the ambulance service but does not put this into its proper context.

Some of the titles confuse the reader when one gets into the detail. For example the first one is not justified as later in the report it is claimed that elementary statistics are not available. Also the title "Organisation of the ambulance crew service is too expensive" is not justified by the evidence presented later in the report nor is the claim that tens of millions of Kroons could be saved. The audit suggests that the staffing of ambulance crews might be possible to change but the calculations are based on flimsy evidence and not subject to comparative analysis of the consequences of change.

Some of drafting could be more precise as in ‘Management of the emergency medical is occasionally weak’. The report effectively shows it is weak therefore they don’t need to soften the impact by implying the failure is only occasional.

### *Introduction*

The audit objective is badly described as it does not, and could not, set out to reduce the workload of the emergency medical service. The purpose of the paragraph dealing with the object of the audit seems superfluous except that it seems to express the audit objective more reasonably i.e. to examine the organisation and provision of services and the impact of the family physician system on this.

### *Overview of the area*

This is a confusing paragraph for the reader as it says that management and administration are managed by separate organisations but not why and how. This lack of clarity of the roles of the various players is also not adequately addressed in the main report.

The paragraphs relating to response performance against targets seem wholly out of place in the summary and would have been more relevant in the section on organisation of ambulance crews which also discusses performance.

### *Description of the Audit*

This does not describe what it claims but explains the structure of the report which should be its title.

The last part of this section sets out the audit methodology which should have its own section combined with an indication of the scope of the work carried out.

### *The main report*

The report could have benefited from a more logical structure which would have benefited from trying to provide back up for an overall conclusion which could have been expressed thus:

“Examination of the operation of the emergency medical care services provided by the ambulance service has shown that it is often being used inappropriately by the public due to the lack of general medical practitioner services after normal working hours. This puts additional strain on the ambulance services which do not always meet their performance targets. The extent of referral to hospitals for what turn out to be non –urgent treatment also creates unnecessary pressure on their resources and increases their costs. In the following report we examine how the services are structured at present and how they might be improved both to reduce the abuse of the system and improve performance as well as reducing costs without any loss of effectiveness.”

The subsequent parts could perhaps have been better organised as follows:

- the role of emergency ambulance crews – how many should there be and where and what are they required to do
- the extent of the service in the country/counties examined
- the skills required
- the ways in which crews can be structured in terms of number o, qualifications required and comparative costs
- how they are structured in practice ( stats by type) plus comparisons of costs and actual qualification v required
- analysis of performance in relation to the extent of referrals to hospital by different types of crew

- the extent of ‘‘emergency’’ calls analysed by type and time of call
- call handling procedures including classification of calls and selection of type of crew to be sent
- call processing and ambulance response times covering also covering difficulties in locating suitable crews
- the extent of suspected or known non emergency calls and the reasons for these
- the impact on hospital services ( an issue not really discussed in the report)
- ways in which the extent of non – emergency calls might be reduced
- impediments to change i.e. lack of trained staff, lack of flexibility in 24 hour service provision, impact of availability of access to normal medical advice through family practitioner system
- what can be done to improve situation and what would the benefits be in service provision and financial terms
- analysis of secondary impacts of possible changes

As a consequence the messaging of the report is too distributed among different parts of the report.

We have other 'editorial' comments on individual areas of the report as follows:

*Skills required by emergency staff*

This is a highly technical area where prudent (and preferably expert) interpretation is needed but explained in terms a layman would understand. As it stands it is not very persuasive although it is seeking to make a key point for the report.

*Performance of nurse s v physicians*

The fact that nurses refer about the same number of patients to hospital requires careful interpretation as one does not know the basis of the diagnosis particularly as the following paragraphs comment on the lack of appropriate qualification of all types of crew members.

*Ambulance crews*

Sometimes the language used is contradictory e.g. 'the majority of emergency staff is women the only man is the driver'

The claims made for savings are too selective and not well argued in the overall context. Also assumptions are made that the lower grade and smaller crew proposed would provide the required level of service.

*Frequency of dispatches unequally distributed over time*

It really refers to the uneven distribution of demand and should say so. This part would also have benefited from a comparison with another emergency service provider e.g. the fire service to see how they manage organise staffing in the face of uneven demand.

*Shortage of professionals*

The arguments made in favour of substituting nurses for physicians need to be related more clearly to the lack of availability of trained nurses. The method of qualification in emergency care for nurses and technicians is addressed but not for physicians.

### *Family physicians do not make enough home visits*

There is considerable discussion about the decline in home visits by GPs which one assumes supports why people are reluctant to or do not call them out at night. However the real significance is lost as the report goes on to say that it is not possible to analyse the impact of this on the number of emergency calls. This seems to contradict what has been implied so why say it at all?

### *Time limits for processing are exceeded in the alarm centres*

This paragraph uses imprecise language which is undesirable e.g. 'one of the reasons may be that', it is also possible', different techniques might contribute to widening the gap'. If one does not know one should avoid such comments or say why the supposition is reasonable even in the absence of tangible evidence.

It is relatively easy to cherry pick individual failings in report details but as they say the devil is in the detail. The question of good structure is however more important still as it affects the way in which one communicates with the reader. It should be the responsibility of the staff, managers, chief auditors and ultimately the Auditor General to ensure that all reports meet the required high standard of structure, logic and appropriate linkage between evidence, conclusions and recommendations to which the SAO should aspire. The effort invested in achieving the right standard consistently will be repaid by greater interest in and greater impact from the work.

### ***Other comments***

The reason for the selection of the subject is given as being that much money is involved. This can be a valid reason but can never alone be the reason for this audit.

It appears that the present organisation of the primary emergency medical care service in Estonia is as we understood quite new. We think this aspect should be more explained to the reader. There is as we see it still some reorganisation under way in the field of medical care and that means that the conclusions could well have been better expressed and received in a less harsh language particularly as some of the conclusions could be and were challenged by the Ministry as having consequences which were not addressed in the report.

The methodological approach in collecting the data is described. In many cases in the audit data from other databases and other reports are used. This is of course a very legitimate way of working. But on the other hand there is a risk that the quality of these databases and reports is not good. So we suggest that if information from databases is used there should be some check on the quality of it. Also when referring to a report, always make sure to a certain level that the data are correct and the conclusions drawn in these reports are sound and come logical from the analysis made in that specific report.

This paragraph should go in the light of what I have already said above. It is a good point but only if what they say can be backed up. It was challenged by the Ministry and I have already covered this.

The service of primary emergency medical care is free.

The public knows this very well and in the absence of general practitioners services after normal working hours it is used not for actual emergencies but also for all other kinds of medical care and advice. This may not always be deliberate misuse and may vary from region to region given the dispersed nature of the population.

In view of the comments made about fees and the need for the fees charged by the various health service organisations for services to be reviewed it is quite surprising that more is not made of the option to charge for call outs. Medical care provided by ambulances is in many countries not free and in fact far more expensive than normal medical care or emergency care in hospitals. E.g. the calling of an ambulance in the Netherlands will cost the caller 600 euros. Of course there is insurance but then again the fact that (private) insurances in the Netherlands have normally a high level of own-risk (1000-3000 euros) makes anyone think twice before calling an ambulance for emergency care. Such charges would be too high for the situation in Estonia and would need to be set out an

appropriate level to discourage abuse but not deter those who have a genuine emergency need. The report could have benefited from suggesting that the option could be tried out and evaluated.

## **Remarks on the audit report Effect of enterprise support on creating jobs in regions**

### ***Choice of audit-subject and focus***

The reason for the selection of the subject is only briefly explained but does not seem to fit in an overall strategy or idea of what should be done by SAO in the coming years. On the other hand the audit-problem itself is quite clearly stated. The choice of counties seems justified.

Surprising: EU-regulations have not been taken into account, while being very relevant to the audit-subject (national policies on state-subsidizing must meet EU-demands). This is not explained.

### ***Methodology***

The report mentions that many interviews were held. Interviews can be very useful but only to a certain extent. Interviews give you an insight in many problems but for an audit written information remains essential. In this audit this seems the case and it looks well balanced. The auditors can be complimented for their initiatives to compare and verify data with statistical and fiscal information. But on the other hand the findings of these comparisons are not in the report.

The justification of the interviews is rather poor: analysis of the interviews is lacking (no percentages or other specifications of the interview data).

It is also unclear why 84 (+3) enterprises were visited. Was this a statistical sample? What are the consequences of the size of the samples in terms of representatively (e.g. p.25, note 19). These questions should be addressed in a final report.

### ***Structure of the report***

All in all the report is adequately structured and informative. However, an overview of the policies and regulations should be given in the first chapter (which would involve a summary of the previous audit). The aims should be analysed to make the report more accessible. It is the normal convention for a report to start with a summary and then follow a logical trail: from aims of the policy of the state to implementation and effects of the support measures. This approach is only partly followed.

### ***Some editorial comments***

There are too many summaries

### ***Quality of the conclusions/recommendations***

The conclusions could have been be formulated sharper and in a more concise way

p. 13: the conclusions can be restated in an overall conclusion: 'subsidies are given on invalid grounds'. In fact, the conclusions as they are formulated now, are merely findings. In our view a conclusion is an audit finding on which the auditor has formulated judgment.

The recommendations partially overlap and can also be formulated in a sharper and more concise way. Editing is necessary.

The logical but rather drastic overall recommendation could in fact be this:

‘Problems with evaluating of applications and possibilities of granting subsidies for the same project should be avoided by restructuring and reducing the amount of support regulations. Furthermore problems in the coordination of these regulations should be reduced by concentrating responsibilities in one ministry.’

It would be advisable to present specific findings on the separate forms of support. In the annex assessment criteria and target groups and other requirements to the projects are given, but the findings are presented on a much higher level. This is important to know for a better understanding of the defects of the support measures and for more focused recommendations.

The conclusions on p.19 all point in the same direction and indicate that the government is not gathering enough relevant information and the formulated conclusions (in fact they are audit-findings on a higher level) can be put together in an overall conclusions which may sound:

‘The government gathers to little information and incorrect information to get insight in the reaching of the aims of the regulations. The audit by the SAO shows that less jobs are created than could be expected.’

Because of the fact that the existing subsidies-regulations are taken into account as a given fact the recommendations of the SAO in this report are also on this level. They are correct if nothing on the regulations will change. However the recommendations on gathering more information then of course will create a lot of extra bureaucracy and this is not the way that the SAO should want to go. Better we think is to put all the regulations together in one regulation and then construct a sound monitoring system for the whole in the way the SAO recommends.

Overall: we were quite impressed by this audit en the way it was done. The audit was done as told to us by rather inexperienced auditors. It could well be an example for other audits.

Some of the statistical images were not complete, or a misprint, we do not know whether this was also the case in the official report.

We think the most important part of a report are the conclusions and the recommendations. To take more time for an audit team to think and rethink conclusions and recommendations is a wise thing. Also we think that the AG should be involved in formulating the message of a report. For instance in the Netherlands CA sometimes when discussions about conclusions and recommendations get all mixed because to many small conclusions and recommendations come up, a time out for 2 days in a small hotel somewhere in the country is organized for the whole team to try to get the message of the report on a higher level. This usually works out very well.

## **ANNEX 7: STRATEGY AND AUDIT SUBJECT SELECTION IN THE NETHERLANDS COURT OF AUDIT**

The mission of the Netherlands Court of Audit is of course the starting point for the audit subject selection-procedure: “The Netherlands Court of Audit aims to audit and improve the regularity, efficiency, effectiveness and integrity with which the State and its associated bodies operate. It also audits compliance with the Netherlands’ obligations under international agreements. As part of this process, it passes on information based on its audits and its accumulated experience to the government, to parliament and to those responsible for the bodies audited. This information consists of audit findings, opinions and recommendations concerning organisation, management and policy and is, as a rule, also available to the public. Another of the Court of Audit’s tasks is to contribute to sound public administration by means of cooperation and information-sharing at home and abroad.

The Court of Audit sees quality, reliability and utility as the hallmarks of its products, and independence, efficiency and effectiveness as the hallmarks of its working methods. It strives to be a transparent organisation, continually investing in the quality of its staff and procedures.”

Last year was the first year in which the activities of the NCA were based on a new strategy, which revolves around the performance of public administration. ‘Sound public administration’ has now become the key factor in the work of the NCA.

The UN has defined eight characteristics of sound public administration. Based on the statutory responsibilities NCA believes that four of these apply to the NCA: transparency, public accountability, effectiveness and efficiency, and responsiveness. The NCA has translated these four aspects into two pillars underpinning our strategy: accountability and supervision on the one hand, and the link between policy and practice on the other.

### **First pillar: effectiveness of public administration**

Working towards the dual aims of systematically improving budgets and accounts and completing the accounting and supervisory cycles, the NCA assess the way in which ministers account for their actions to the House of Representatives. The NCA also examines the way in which organisations that receive funding from central government (such as educational and health care institutions) explain the use they have made of public money. The question the NCA wishes to answer in this respect is how the government monitors law enforcement. Within this particular area of its work, the main activity is the annual regularity audit, i.e. examining the central government accounts and the ministries’ financial statements.



### Second pillar: performance of public administration

As part of our quest to close the gap between policy and practice, the NCA assess the government's performance and identify its impact. Is government policy being implemented as agreed? Is this being done properly and is it producing the intended results? If not, what are the potential reasons for this failure?

Against this background, the NCA **prefers to examine issues that have a bearing on the provision of basic services for citizens**. After all, that is where the effects of any gap between policy and practice are most keenly felt. For this reason, the NCA decided to prioritise audits of public services. A second priority is security and a third is sustainable development.

The strategy has led to the following changes in the audit process of the NCA:

- Audits are planned on the basis of social problems;
- When planning an audit, the point of departure is a particular social problem. The audit is geared largely towards assessing central government's ability to deliver on its promises;
  - The NCA look for explanations;
  - The NCA does not simply ascertain that a gap exists between policy and practice. The NCA also tries to ascertain the causes. Why is the government not implementing its policy as planned? Why have targets not been met?
  - The work of the NCA is based on an effectiveness strategy;
  - The NCA tries and finds the right form and timing for our information.

## **Monitoring and selection of audit subjects**

Within the framework of this strategy, the NCA keeps track of key trends in the world around so as to be able to select the right subjects for our audits. In 2004, the NCA looked into ways of further professionalising this monitoring system. Potential improvements include identifying issues that have a direct bearing on its work (the question being, for example, whether the right aspects are emphasised) and giving the NCA- staff better access to this information.

A number of factors are relevant to the selection of audit subjects within the framework of our strategy. The more the following criteria are relevant to a given issue, the greater is the desirability of conducting an audit:

- the activities should have added social value;
- we should be dealing with a complex policy chain;
- risks should be involved;
- the field in question should be one in which the NCA has unique powers;
- the NCA intervention should be of a structural nature;
- a large amount of money should be involved.

## **Review**

All the audit reports contain a number of recommendations for solving the problems they identify. Sometimes ministers promise to take action on the basis of these recommendations. So, what happens as a result of recommendations and the undertakings given by ministers following the publication of our reports? Do the NCA- recommendations help? These are important questions to which the NCA is keen to find out the answers. This is not simply because the problems the NCA identifies need solving, but also because the NCA needs to know whether the recommendations serve their intended purpose, i.e. whether they specific enough and provide a basis for action on the part of the ministries.

In 2004, the NCA devised a system for measuring the impact of our recommendations. This involves spending a relatively long period – if necessary five years or more – monitoring the extent to which ministries act on recommendations and keep their promises. This monitoring process is based not only on interviews with officials, but also – as much as possible – on progress reports and other information provided by the ministries themselves.

For each individual audit, this means deciding how often the NCA needs to reassess the situation and which particular recommendations and undertakings it wishes to track. This is logical enough: after all, some recommendations relate to issues that take many years to mature, whilst others can be implemented much more quickly.

We publish the results of our monitoring activities in the form of brief reports that are posted on our website.

Each year the Court publishes a programme of its planned auditing and development projects. It also gives advance warning of its audits to the Ministries or institutions that it intends to visit. If there is a possibility of the standards on which the audit will be based not being entirely clear, we first consult with the organisation concerned to reach agreement on realistic standards. This rules out disagreement after the event about the criteria upon which we base our assessment.

The Court takes the view that independence must go hand in hand with openness and accessibility. The aim is to be directly accessible to our target groups, which include not only the government, Parliament and the organisations the court audits but also the media, foreign sister bodies, research institutions and universities, organized interests, supervisory bodies, advisory boards and the general public.

The Court makes use of a wide range of means of communication, including the Internet. Anyone interested will find the results of our completed audits on our web site. The actual reports, provided they do not contain confidential information, are published as public parliamentary papers.

The Court gears the way in which it publishes the results of its audits to the target groups in the particular sector. If required, along with each report we provide a briefing for Members of Parliament whose portfolios include the subject in question. We also offer the Ministers concerned a private oral briefing prior to publication of the audit. These presentations have proved worthwhile in recent years, influencing the ultimate effect of the audits. Sometimes other parties are also involved in the audit, e.g. when a company or institution with a public function has been audited. We intend to step up the provision of explanations of audit reports to outside organisations. Each report the Court publishes is accompanied by a press release, and if appropriate one of the members of the Board gives comments to the media in person.

## ANNEX 8: SAO RELATIONS TO PARLIAMENT AND A CASE STUDY FROM THE NETHERLANDS

There is comprehensive advice on this topic, with many country examples, available to EU SAIs in the Sigma paper No. 33: Relations between SAIs and Parliament at [www.oecd.org/gov/sigma](http://www.oecd.org/gov/sigma) . Set out below is a detailed description of how this relationship is arranged and dealt with in the Netherlands.

### Netherlands Case Study

The general role and objectives of parliament and parliamentary committees in relation to the Netherlands Court of Audit can be described by the phrases control and information. To start with the first phrase we can say that the Dutch parliament of course controls the government, as any parliament that takes its role seriously. In the Netherlands as in other countries parliament has only limited possibilities in controlling the government with its thousands of civil servants. The 150 members of parliament only have (at best) one assistant each, but every minister has literally thousands of civil servants that can assist her or him in the interaction with parliament. Following this line of reasoning the Dutch parliament makes use of, among other external reports, audits of the Netherlands Court of Audit in its controlling function of the government. The Netherlands Court of Audit has a staff large enough and with the relevant qualifications to seriously evaluate the work of a ministry. Parliament can, using the SAI-audit, formulate a political judgement about the responsible minister.

The second phrase that can be used describing the objectives of parliament in relation to the Netherlands Court of Audit is, as said above, information. Just as her capacity to control government is limited, the possibility of the Dutch parliament in seeking information about public affairs is also limited due to its small staff. Therefore parliament is happy to make use of the information of independent institutions such as the Central Bureau of Statistics, the Central Planning Bureau and the Netherlands Court of Audit. Reports published by these institutions contain information that members of parliament can use for the evaluation of the state of the country, (thereby) the functioning of government and (thereby) the formulation of political points of view.

The composition and mode of operation of parliamentary committees towards the Netherlands Court of Audit is generally not very different from the composition and mode of operation of parliamentary committees towards other institutions. The committees consist of members of all political parties represented in parliament, and the contact with the Netherlands Court of Audit is with the parliament as a whole or a representative committee, not with any individual political party. The audits of the Netherlands Court of Audit are published either for the attention of a minister or for the attention of parliament. In the latter case, the Court offers to give a briefing about the audit just before publication. The State Expenditure Committee receives this offer, mostly accepts it and invites other committees for the briefing. Mostly the relevant parliamentary committees are present at the briefing, as the audits addressed to parliament can easily be used for a political debate with the responsible minister(s). It's quite difficult to say whether there are any regulations to ensure the non-political character of parliamentary committee activities towards the Netherlands Court of Audit, as (committees of) parliament are by nature political institutions. Of course there are regulations to ensure that the Court can not be influenced by a single party or a minority of parties, such as the rule that a request for an audit can only be made by the majority of parliament. The Netherlands Court of Audit also makes sure that the political debate is a debate between parliament and government, not involving the Netherlands Court of Audit as a third party. The audits often provide grounds for such a political debate, but if (members of) parliament for instance ask the Court whether in its opinion a minister should resign, the answer will always be that the Court doesn't have opinions in this matter and that this issue is up to parliament. Also questions about the desirable content of future policy are generally not answered (in great detail), except for matters such as the controllability of all types of policy.

The parliamentary committee's role in reviewing SAI-audits starts with the above mentioned briefings. The relevant committees are invited for a briefing, which is closed to the public and takes place in the parliamentary buildings. As

mentioned before, all the parliamentary committees consist of members of all political parties, but most briefings of the Netherlands Court of Audit are (only) attended by members of the five largest parties, that is the three, currently, governmental parties and the two largest opposition parties. The smaller opposition parties do not have enough members in parliament to frequently attend the apparently not so important briefings. The briefings are given just before the audit is free for publication by the press, and all the members of the relevant parliamentary committees will receive the audit under embargo a day before the briefing and publication. The briefing consists of a presentation by a member of the Board and staff members of the Court, after which the members of parliament can ask questions. Mostly the members of parliament do not ask political questions of the sort that cannot be answered by the Court, such as the afore- mentioned ultimate question of whether or not a minister should resign.

Some time after the briefing and publication of an audit the Netherlands Court of Audit often receives written parliamentary questions. Other than the oral questions asked at the time of the briefing, the parliamentary committee as a whole, issues written questions. The Court always answers. Similarly to the parliament, the relevant minister(s) can ask written questions about the audit, and he or she also receives the briefing that the Court plans to give to parliament.

The degree of independence of the Netherlands Court of Audit in its relation with parliament can be considered quite large. Parliament has in a few ways formally some influence on the SAI's operations. In practice however this influence is very limited.

a) The audit programme of the Netherlands Court of Audit is strictly a responsibility of the SAI itself, except for the fact that the Court is obliged by law to perform an annual regularity audit and that it is required to devote attention to the efficiency of government. The programme is conceived in close cooperation between the Board and the staff. A selection from a large number of possible audits and other activities is made based upon the strategic programme of the Board and extensive monitoring of relevant policy areas. The programme is presented to parliament in a closed session of the State Expenditure Committee (and made public). During this session there is a possibility for members to ask questions and discuss the content of the programme.

b) Parliament (not a parliamentary committee) has the possibility to request an audit. A parliamentary majority is required. The following steps are involved:

- the idea for a request usually originates from one or more members of one of the committees;
- if discussion in this committee shows a majority exists, the request is put before the State Expenditure Committee for advice;
- the State Expenditure Committee provides advice regarding the content of the request (e.g. is an audit feasible) and the appropriateness of an audit by the Netherlands Court of Audit (given its powers and constitutional position);
- the proposal is formally brought before the full parliament and is put to the vote.

During this process there is frequent contact on a staff level between the Netherlands Court of Audit and parliament. In this way it is ensured that the request is acceptable and feasible for the Netherlands Court of Audit. Therefore the Netherlands Court of Audit's response is almost always positive.

c) The Netherlands Court of Audit provides assistance to the State Expenditure Committee on a regular basis by temporarily stationing a staff member with the staff of the State Expenditure Committee.

Other parliamentary committees and/or parliament as a whole receive support on an ad hoc basis, by providing either knowledge or manpower.

d) The Netherlands Court of Audit's methodology is a matter of the SAI itself, parliament is not involved.

e) The Netherlands Court of Audit has no formal role in the law-making process, however the SAI has the possibility to communicate any comments it has to parliament or the minister involved. This happens not very often.

Formally the Netherlands Court of Audit's budget (together with that of other High Councils of State) is part of the budget of the Minister of Home Affairs, it is therefore she or he who puts the proposed budget before parliament. In case of disagreement, the Netherlands Court of Audit may raise the issue with the State Expenditure Committee, but must rely on members of the lower house to propose amendments to the budget. The unwritten rule is that parliament is cautious in exercising its budgetary rights, since too much involvement might interfere with the SAI's independence. Formally, however, it is possible for parliament to reduce or increase the Netherlands Court of Audit's budget.

The work of the Netherlands Court of Audit is not evaluated by parliament in the strict sense of the word. Annually the Netherlands Court of Audit presents its Report to parliament in a closed session of the State Expenditure Committee. During this session and other meetings between the Board and the Committee, members have a chance to express their opinions regarding the Netherlands Court of Audit and its work. In addition, members of parliament frequently comment in the media on audit reports and the institution as a whole.

f) The regularity of the Court's expenditure as the state auditor must, of course, also be audited. The Court hires for this an external auditor who audits the annual accounts and financial management for the year in question. The external auditor reports to the Audit Committee. The Ministerial Audit Department of the Ministry of Home Affairs uses these findings, carries out additional auditing if necessary, and reports to the Minister. The cycle is complete once the Court, as part of the regularity audit of all budget chapters, reviews the audits of the Ministerial Audit Departments, including that of the Ministry of Home Affairs on the High Councils of State (which include the Court itself). In the process, the Court might come across shortcomings in financial management, which it would then report on in its regularity audit. The Court realizes that it has to set an example and tries to act accordingly.

g) The Board of the Netherlands Court of Audit consists of three members appointed by Royal Decree; in a separate process one of them is appointed President. This Royal Decree is in fact a government decision.

In case of a vacancy on the Board parliament is notified and the Netherlands Court of Audit provides a list of six candidates. Based on this list and possible new candidates proposed by parliament itself, a recommendation is made to the government (which decides). Members are appointed for life, but retire (at the latest) at the age of seventy. A member can only be dismissed by the Supreme Court of the Netherlands.

The legislation concerning the Netherlands Court of Audit is laid down in the Government Accounts Act. In the Act it is stated that the Minister of Finance has the obligation to consult the Netherlands Court of Audit regarding changes to the Act with an impact on the Netherlands Court of Audit.

## ANNEX 9: BASIC SCREENING OF IT SECURITY

### To be examined by the ordinary Financial Auditor and the IT-responsible at the client

7. How many staff does the IT-department have? How is it organised? Which systems is the IT responsible for? How is the responsibility distributed within the IT department?
8. How do the premises for the running look like? Are the possibilities for entry restricted? Are there alarms and fire protection in the premises? Is eventual spare equipment located outside the premises?
9. Is IT also responsible for system development? Are the systems developed by themselves? Who owns the source codes?
10. Are there external contracts about the service etc? Do they contain anything about emergencies or catastrophes?
11. Are there logs for stops/break downs with date, time and reasons? Are they followed-up on a regular basis?
12. Is there a special plan for emergencies or catastrophes? If not do they plan for such a one?
13. Has the auditee access to reserve electricity in case of a longer cut in electricity supply?
14. What kind of preparedness has the auditee if the whole or parts of the hardware need to be replaced without any previous notice? Are there any contracts with somebody to deal with this scenario?
15. Is there an emergency plan to restart the whole operation in other premises if needed?
16. Are there fire walls and/or other security systems to protect the systems against hackers? Is there a log for non legitimate attempts to get in?
17. How often does the auditee take back-ups for the different systems?
18. What do the back-ups contain? Do they also include soft ware programme versions?
19. How do they secure that registry information about 'collections' (equivalents) does not disappear in the systems? How do they secure that there are always up-dated security copies of all catalogues, databases and registries containing information about the auditees 'collections'?
20. How do they store the back-ups? Sometimes in a fire protected cupboard within the premises. A more reliable solution would be to have them stored outside the premises...
21. Are there special security systems for legitimate users in all the systems, catalogues, databases and registries as the auditee administers?
22. How do they look like the security systems for legitimate users? Are there also any group ID - users applied? How are these systems administered? Is there a defined follow-up procedure at regular intervals? Are there any guarantees that no users with old and expired rights still have access to them?

23. Are there any special controls/follow-ups of the most entrusted people (highest access rights)? Are all changes of programme software logged in a way that it cannot be manipulated and it is always possible to see who has made a change?
24. How do they handle external consultants working with the systems? Temporary user IDs and passwords? Are their work and changes logged as well? How is the follow-ups of these logged information performed?
25. Are there any security controls made of the persons with the rights to add new information in catalogues, databases and registries?
26. Are there any controls made of possible other external users in the security access systems?

**Summing-up:**

*I. Issues to follow-up...*

*II. Improvements/deteriorations since last year's audit...*

XXX 2005-06-08

For the NAO

For the Auditee

## ANNEX 10: EU GUIDELINES ON AUDIT QUALITY

This article discusses a newly developed set of *Guidelines on Audit Quality* setting out specific measures that an SAI should take to ensure high quality in its audit work. These guidelines are applicable to all types of SAIs and to all types of audits.

### Background

Recently, concerns have arisen about the reliability and quality of audit activity in the private sector. Since an SAI's work is, in many ways, comparable to that of a private firm, the Heads of the former network of SAIs of Central and Eastern European Countries, Cyprus, Malta, Turkey and the European Court of Auditors (ECA), at their annual meeting in Limassol in 2001, agreed that quality in the audit process should be discussed, studied and reported upon.

The SAIs of Hungary, Malta, Poland and SIGMA were appointed as an Expert Group for an initial study to:

- ❖ Identify the principles and requisites required in an audit institution to ensure that it is adequately organised in order to assure effective audit work and reports of high quality.
- ❖ Analyse the situation of participant SAIs vis-à-vis their quality control practices and procedures relating to audit planning, execution and reporting.
- ❖ Identify good practices in an SAI to ensure high quality.

SIGMA was asked to provide technical support.

The Expert Group circulated a questionnaire in 2002 to obtain information about the state of quality management systems in participant countries and other advanced SAIs. Based on the analysis of replies, the report was completed and presented to the Heads of SAIs at their meeting in Bucharest, December 2002.

After discussing the report, the heads of SAIs extended the mandate of the Expert Group and requested them to prepare comprehensive and detailed guidelines on audit quality, which they did during 2003-2004. The SAI of France joined the Expert Group at this stage to ensure the concerns of the court type of SAI were covered.

The *Guidelines on Audit Quality* were presented at the last meeting of the Heads of the former network of SAIs in Riga in April 2004. This body approved the document and recommended that it be forwarded to the Contact Committee of EU SAIs (during the annual meeting of EU Heads of SAIs in Luxembourg in December 2004) and to the INTOSAI and EUROSAI General Secretariats for their information and consideration.

### The Guidelines in general

The Guidelines contain four sections:

- ❖ Section 1 – Introduction
- ❖ Section 2 – Quality Control
- ❖ Section 3 – Quality Assurance
- ❖ Section 4 – Institutional Management

The Guidelines are intended to be applicable to all SAIs, both “courts” and “offices” and to all audits, both regularity and performance, however, within these categories of SAIs and audits there exist wide variations. Each guideline is accompanied by an explanatory text.

### **Quality Control – ‘Hot Review’**

Quality control is a process through which an SAI seeks to ensure that all phases of an audit (planning, execution, reporting, follow-up) are carried out in compliance with the SAI’s rules, practices and procedures.

A quality control system should ensure that audits are timely, comprehensive, adequately documented, performed and reviewed by qualified staff. In this context, “quality” takes account of the following factors, amongst others:

- ❖ The significance and value of matters addressed in the audit.
- ❖ The objectiveness and fairness of assessments and opinions.
- ❖ The scope and completeness of the planning and performance of the audit.
- ❖ The reliability and accuracy of findings, conclusions and other matters presented in the audit report.
- ❖ The effectiveness in terms of results and impacts achieved.

To assure quality, direction, supervision and review must be present in each phase of an audit. The qualifications and experience of the audit team should be considered in deciding the type and extent of direction, supervision or review.

The selection and timing of audits may depend on:

- ❖ Priority, including legal requirements.
- ❖ Financial and human resources available.
- ❖ Work of other auditors, such as internal auditors.
- ❖ Risk and Materiality assessments.

The Guidelines then set forth recommended procedures to be followed in audit planning, audit execution, audit reporting and audit follow-up. Some of the key points are:

- ❖ **Audit planning** should consider the number and skills of available staff, the time, financial and other resources and external expertise available, and the risks that may be encountered. The plan should lay out the schedule, the tasks and the responsible person, and should be reviewed by an experienced auditor.
- ❖ **Audit execution** should be performed in accordance with the approved plan. That fact and the results should be documented by the individual performing each audit task. The principal auditor should review that documentation. The working papers should be organised to facilitate subsequent preparation and review of the audit report.
- ❖ **Audit reports** should be clear, timely, concise and objective. All findings and conclusions must be supported by adequate, reliable and fair audit evidence in the audit working papers. Proposed reports should be reviewed internally by experienced auditors who are independent of the audit and by the auditee. Auditee comments should receive fair consideration.
- ❖ Some time after a report is issued, the SAI should determine what action, if any, the auditee has taken to address problems raised in the audit.

## **Quality Assurance – "Cold Review"**

Quality assurance is an assessment process focusing on the operation of the quality control system. It is a review after the audit has been completed by persons who are independent of the audit under review. Quality assurance necessarily involves the examination of specific audits. However, the purpose of the review is not to criticise specific audits. Rather, it is to determine what controls were intended to be applied to those audits, how those controls were implemented, assess any gaps in the controls and other ways of improving the audit quality system.

There are four main types of quality assurance:

- ❖ Internal Review
- ❖ External Review
- ❖ Peer Review type processes (including the Sigma type of Peer Assistance)
- ❖ Feedback from Auditees

One approach to internal review is the establishment of a separate office, independent from the audit units, reporting directly either to the President in an "audit office" or to the relevant collegium in a "court of audit". Another possible approach is conducting reviews by staff members from different structural units, independent from the audit being reviewed. In either case, the reviewer selects a sample of audits, examines them in detail, and reports the results, along with recommendations for improvement.

The peer review technique assesses the extent to which an SAI meets international standards. Such a review generally involves experienced auditors from other SAIs. Sigma has organised peer assistance reviews of the SAIs in new EU member states, and in candidate countries. Other peer reviews have been the result of agreements between particular SAIs or groups of SAIs.

The Guidelines include checklists to facilitate internal, external or peer reviews and to help assure the comparability of assessments. Feedback from auditees can help the SAI understand auditees' needs and expectations. The Guidelines recommend an Annual Quality Assurance Report for each SAI, summing up general findings and recommendations for improvement.

## **Quality Management System**

The SAI's management is responsible for establishing, operating, maintaining and improving the quality management system to ensure that the SAI is competently organised to deliver high quality work, irrespective of the type of SAI and the type of audit it performs. It is also responsible for creating an environment conducive to consistent high quality and continuous improvement, requiring it to give high priority to managing:

- ❖ Human resources
- ❖ Institutional risks
- ❖ External relations

Individual auditors and managers play key roles in the performance of audits. SAIs should spend time, energy and budgetary resources on managing their human resources. An essential element is a strategy for recruiting and selecting new members of the staff. The SAI should seek excellence in the people it employs, anticipate its future needs and recruit staff to fill those needs.

SAIs should also provide effective training, including:

- ❖ Introductory training to help new arrivals adapt to the SAI.
- ❖ Technical training to equip auditors with the skills to perform audit tasks.
- ❖ Managerial and leadership training to acquire skills to direct the work of audit units.

- ❖ Continuing education to assure that auditors maintain and enhance their capabilities.

An SAI should also give attention to the career development of its personnel through effective performance appraisal systems and individual development plans.

SAI management should allocate resources to minimise institutional risks. Not all audits are equally difficult and risky. Inappropriate management of those risks can undermine the SAI's credibility. The SAI's management should establish a procedure for assessing institutional risks considering:

- ❖ Controversy associated with the audit.
- ❖ Complexity of the audit.
- ❖ Audit resources.
- ❖ Co-operation or resistance by the auditee.

To maximise its effectiveness, an SAI should create good contacts and co-operate with the parliament and its committees, the ministry of finance and other line ministries, the media and private sector auditors, amongst others. This requires a clear strategy in each case.

## Conclusion

Audit quality is an increasingly important issue for SAI staff, managers and leaders, and should be a useful area of exchange of national experiences and identified good practices. The Guidelines are available in electronic format from the following website:

[http://www.eca.eu.int/cooperation/publications/docs/report\\_29\\_october\\_04.pdf](http://www.eca.eu.int/cooperation/publications/docs/report_29_october_04.pdf)

SIGMA has also prepared a paper on "Achieving High Quality in a SAI" and this can be found at:

[http://appli1.oecd.org/olis/2004doc.nsf/linkto/gov-sigma\(2004\)1](http://appli1.oecd.org/olis/2004doc.nsf/linkto/gov-sigma(2004)1)

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1. These 15 SAIs (Albania, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia and Turkey) as well as the ECA formed a co-operative network in 1997 with the aim of assisting the accession to the European Union. The network no longer exists in this form since 10 of these countries have joined the EU as of 1 May 2004.
  2. Mr Jacek Mazur for Poland, Mr Janos Revez for Hungary and Mr Brian Vella for Malta.
  3. SIGMA is a joint initiative of the Organisation for Economic Co-operation and Development and the European Union, principally financed by the European Union. SIGMA participants included Mr Nick Treen, Mr Harry Havens, Mr Bo Sandberg, Mr Joop Vrolijk and Mr Jens Piontech.
  - 4.. Assistance was provided by Ms Anne-Marie Boutin and Mr Christophe Perron of the French Court of Accounts.

**ANNEX 11: SECOND STAGE REVIEW PROCESS – CHECKLIST USED  
AT THE USA GAO**

<b>SECOND PARTNER CONCURRENCE TOOL</b>				
<b>PRODUCT DATA</b>				
Job Code: _____			Asst Director: _____	
Report #: _____			First Partner: _____	
Report title: _____ _____ _____			Anticipated date to Agency: _____ Committed issue date: _____ Date sent to Second Partner: _____	
<b>SECOND PARTNER CONCURRENCE (Before Agency Comments)</b>				
<b>Reporting Standards:</b> M = Met    ND = Needs Discussion    N/A = Not Applicable				
	<b>M</b>	<b>ND</b>	<b>N/A</b>	
Presentation	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Product choice appropriate; title reflects message; and product is concise and written in straightforward, easy-to-understand language with appropriate use of technical language; visual aids help convey message
Linkage	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Organised so that there is clear linkage between objectives, RIB summary; sections; and, when appropriate, conclusions and recommendations
Highlights	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Presents the significant points of a report or testimony. The linkages between the Why GAO Did This Study, What GAO Found, and the Recommendations (if applicable) are clear and accurately reflect the products message
Results in brief	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	RIB summary answers objectives directly; is fair and balanced; and highlights bottom-line summaries of our analysis findings, and, when appropriate, conclusions, recommendations, and affected party (ies) reaction (s)
Background	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Sets up material (purpose, authority, and functions of programme activities) but is limited to what is necessary
OSM	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Objectives are stated neutrally and are clear, fair, balanced and consistent throughout links scope and methods to

				objectives, emphasises methodological rigor, states time period covered, identifies limitations, and ensures conformance with government auditing standards, if appropriate.
Findings/Evidence	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Evidence is clear, adequate, and appropriate for objectives and findings; condition describes existing situation; criteria state what we are comparing to; cause reflects reason(s) why conditions/criteria differ, effect describes the result of this difference
Conclusions	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Highlight the impact (positive, negative) of the facts presented, are fair and balanced and set up recommendations are short, concise, and do not repeat or summarise findings
Recommendations/Matters	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	Linked to evidence and conclusions and clearly state what needs to be done: should be reasonable, doable and cost effective
<b>Components Related to GAO's core values</b>				
	<b>M</b>	<b>ND</b>		
Professional	<input type="checkbox"/>	<input type="checkbox"/>		Provides appropriate contextual sophistication in that work reflects on understanding of the issues, an awareness of the external environment, including sensitivity to relevant trends and a practical approach to what can be done to deal with the problems noted
Accurate	<input type="checkbox"/>	<input type="checkbox"/>		Presents information or findings accurately; contains no notable errors in logic or reasoning
Objective / Fair / Non-Partisan / Non-Ideological	<input type="checkbox"/>	<input type="checkbox"/>		Presentation is fair and impartial ; the tone is constructive and objective ; appropriately presents officials' positions on key issues
Fact Based	<input type="checkbox"/>	<input type="checkbox"/>		States information and findings completely, includes all necessary facts and/or explanations, distinguishes between fact and unproven or uncorroborated information, opinions, and assertions and allegations, resolves conflicting evidence
Balanced	<input type="checkbox"/>	<input type="checkbox"/>		Presents sound and logical evidence to support conclusions; does not use adjectives or adverbs to characterise evidence in a way that implies criticism or conclusion by innuendo; where appropriate, recognizes positive aspects of the issues/programmes revised
Timely / Useful	<input type="checkbox"/>	<input type="checkbox"/>		Work should provide relevant information in time to respond to the requester's legitimate needs
Clear / Concise	<input type="checkbox"/>	<input type="checkbox"/>		Presentations should be clear, concise and well organized; message is presented logically; writing style should be adapted to our audience
This report / product is consistent with GAO's reporting standards and components related to GAO's score values. Suggestions in the draft are solely for the consideration of the First Partner				

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Second Partner Name /Title		Signature	Date
Signature indicates the appropriate disposition of all Second Partner comments related to GAO's reporting			
<b>SECOND PARTNER CONCURRENCE</b> (After Agency Comments – if agency disagrees or First Partner requests concurrence)			
	<b>M</b>	<b>ND</b>	
Agency Comments	<input type="checkbox"/>	<input type="checkbox"/>	Indicates type of comments obtained (oral, written); identifies title of the most senior official(s) involved; accurately characterizes general agreement / disagreement with report; describes substance of comments; and resolves all substantive comments
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Second Partner Name /Title		Signature	Date
Signature indicates the appropriate disposition of all Second Partner comments related to compliance with reporting standards and / or GAO's core values pertaining to Agency comments			
October 1, 2003 OPR : ORM		GAO Form 132 Rev.1002)	

## **ANNEX 12: CERTIFICATION AND TRAINING OF FINANCIAL AUDITORS IN THE SWEDISH NATIONAL AUDIT OFFICE**

This annex presents and summarizes the experiences within the Swedish National Office development of a new training and assessment programme in financial (annual) audit.

In many ways we in Sweden have of course used the same principals and methods as you when developing our own competence development plan. Each country, each state audit office, must of course due to differences in institutional and cultural environment establish their own educational and assessment programme. The needs vary. We hope that it can be of some help to share our experiences. How did we define the goal of education and experience? What are the essential components of knowledge, skills and professional values in financial audit and in what way can you assess an auditor's professional competence? What are the problems and how did we in Sweden try to solve them.

### **1 The Swedish model**

In order to understand the principles behind our training and assessment programme it is necessary to first describe some basic facts in the way we work as auditors in the RRV.

First of all - the goal of our work as financial auditors is the auditor's report. In this report the auditor each year expresses an opinion on whether a statutory annual report is true and fair in all essentials. In most countries this auditor's report is a statement given to the Parliament and concerns a statutory annual report from the government. This is not the case in Sweden because of a very distinctive structure in the Swedish public administration in relation to comparable countries. This structure is characterised by a government, which, in all essentials, has strict political responsibilities, while the actual activities of government are primarily executed by independent government agencies. The responsibility of the government agencies is to perform government activities within the framework of the resources allocated to them by the Government and Parliament for their operations and in accordance with legislation passed by Parliament and rules and written directives issued by the Government. This means that funds presented in the government budget, both income and expenditure, are administered in essentials by the independent agencies. This structure has old historical origins.

The Government governs the agencies through instructions and written directives, which stipulate financial ceilings and expected results. There is naturally scope for a regular dialogue between the Government and the management of agencies but the formal controls are expressed in written rules and other directives. The Government may not, in principle, intervene in an agency's administration of an individual item of business.

In consideration of this relatively great degree of freedom enjoyed by the agencies, there are extensive requirements in respect of reports by agencies to the Government. All central government agencies are required to maintain accounting records and to draw up an annual report containing a balance sheet, income statement, appropriation accounts and a statement of financial position. In addition the annual report shall also contain a - usually detailed - report on the results it has achieved in comparison with those stipulated by the Government.

The audit office shall audit the annual reports of the agencies -which thus include almost all activities included in the government budget - each year. In Sweden we have some 280 independent government agencies which means that the audit office each year are obligated to express an opinion on each annual report. This is also the reason why we in Sweden refer to financial audit as annual audit.

Another significant aspect of our work as financial auditors is the range and content of the statement in our auditor's report. The annual report that the government agency has to draw up contains not only financial information but also the results of its operations. Of course these results are seldom possible to describe in just financial terms,

which requires a different way of conducting audits and a deep knowledge in the management and operations of each agency.

If we summarise the aspects above - financial auditing in Sweden requires that:

Audit management and the auditor general to a large extent must rely on the assumption that the individual auditor performs his/her work correctly from the beginning and the individual auditor must have great confidence in his/her own ability. Our system of quality assurance must be performed quickly and reliably and carried out by a limited team of auditors. A method where analyses, assessments and decisions are tested at many organisational levels is not possible.

A highly decentralized way of organising the audits. Each government agency is audited by an audit team, which bears the full responsibility of conducting the audits. An experienced auditor leads the team. It is the team-leader who signs the auditors report, not the auditor general, so of course it is vital that this auditor has the highest professional competence because he or she alone represents the national audit office.

We need that the auditor, the audit team has knowledge and skills not only within the area of traditional financial auditing as accounting, financing and so on. The duty as financial auditor requires both a broad and deep knowledge in the function of the state, the operations of agencies, laws and regulations, relations and so on.

So in order to successfully audit the agencies with limited resources and in accordance with good standards, the individual auditor must be prepared to take great personal responsibility. This is why we in many ways have stressed the importance of the competence of the individual auditor when we have built and developed our new training and assessment programme. And this is also the reason why we as an organisation have had the need to assess our auditors actual competence through tests and examinations.

## **2 The need of developing training and assessment programmes**

Why do we need to develop and implement training and assessment programmes? One answer is that INTOSAI says so. In the Code of Ethics for Auditors in the Public Sector it is stated that:

- Auditors have a duty to conduct themselves in a professional manner at all times and to apply high professional standards in carrying out their work to enable them to perform their duties competently and with impartiality.
- Auditors should use methods and practices of the highest possible quality in their audits. In the conduct of the audit and the issue of reports, auditors have a duty to adhere to basic postulates and generally accepted auditing standards.
- Auditors have a continuous obligation to update and improve the skills required for the discharge of their professional responsibilities.

The reason why INTOSAI stresses the importance of professional manner, high quality and improvement of skills is of course that an auditor plays an important role in all societies whether or not he or she works in the private or state sector. The auditor works in an environment in rapid change where the organisations are engaging in more and more complex arrangements and transactions. Information technology is advancing at a rapid pace. Trade and commerce have become more international. Privatisation has become an increasingly important goal in many countries. Concern for the environment has grown. Because of these trends, the need for accountability and the resulting demand on the auditor continues to increase. We have seen rapid changes in these aspects in Sweden. There has been a clear shift in recent decades in perspectives on state control, follow-up and inspection. During the 1950s and 1960s up to the first half of the 1970s state activities were strongly characterised by major reforms aimed at building up the welfare state. Resources were available and continuously growing. During 90s like in many other countries we have instead seen a series of crises in state finances. More and more people started to ask what actually came of the resource investments in the public undertakings. The focus shifted from reform development to follow-up, assessment and inspection. The importance of reporting, inspection, responsibility and auditing increased

considerably. At the same time state activities have become more complex and more difficult to overview. There are more organisations in action, a larger number of and more complicated forms of association, changed market conditions, more complicated regulations, etc. More and more reports, accounts and other information are produced and these are more easily available than before. It is in this situation that many people are putting their hopes in the assumption that the auditors know everything about which information is correct and relevant.

These challenges brought about by change we must of course stress the importance of the individual auditor. The means we have is mainly a combination of education and experience so it is in these areas we must aspire to increasingly higher standards. We must also be able to show outwardly that we possess the competence required. This is essential for maintaining and strengthening others' confidence in us.

### **3 Professional competence – How to achieve it**

Today's auditors, in addition to acquiring different skills and knowledge, must have skills to enable them to be financial analysts, excellent sales persons, good communicators, capable negotiators and public relations specialists, as well as good managers. This requires that a program of education and experience must go beyond the traditional approach with learning defined and measured strictly in terms of knowledge of principles, standards, concepts, facts, and procedures at a point in time. Emphasis must instead be placed on a set of knowledge, skills, and professional values broad enough to enable adoption to change. The goal of the education and experience must be to produce a competent auditor capable of making a positive contribution over their lifetimes to the profession and society in which they work.

We need to work in the following areas to achieve this goal of a lifelong learning:

- Knowledge
- Skills
- Professional values essential to professional competency.

#### **3.1 Knowledge**

You could divide the knowledge that an individual auditor must gain into four major categories:

- General knowledge
- Organizational knowledge
- Information technology knowledge
- Accounting and accounting related knowledge

*General knowledge* - You need a as an auditor an individual who is able to think and communicate effectively, who can carry out abstract logical thinking, critical analysis, to place decisions in the larger context of society, to exercise good judgment, to interact with diverse groups of people.

In Sweden we don't believe that these abilities can be the result only through a training programme. Instead we have to focus on our recruitment-policy. What kind of general knowledge is required to begin the training into the profession as an auditor.

*Organizational knowledge* – Our work requires both a broad and in some areas deep knowledge about the organisations we are auditing. This is also something that should be regulated by the auditing standards and the auditing guidelines that we should implement in our work and our organisation. In our audit guide we must focus and stress the importance of organizational knowledge.

In Sweden we need knowledge not only of het agencies we are auditing but also about government, parliament, relations between them, budget process, how the state is organized, financed, and managed and so on – in order to fulfil our work in professional way.

Information technology knowledge – As in any other profession information technology has transformed the role of the auditor. The auditor not only must use the technology – he (she) must also be able to evaluate information systems and sometimes play a role in the design and management of such systems.

This requires the use of modern technology in our audit work. We must as audit organisations give priority to investments in modern technology and the development of efficient auditing tools based on information technology.

*Accounting knowledge* – Of course is accounting knowledge the strong technical background essential to a professional financial auditor.

Most of our auditors get their basic accounting knowledge from studies in university or from experiences in the private sector. If that knowledge is useful depends on what kind of regulations and accounting systems that are used by the agencies we are auditing. In this area we have seen a very positive change in Sweden. Now a day every organisation independent of if it is private or governmental in principal uses the same basic regulations and system in accounting. This change has of course the benefit to us as a state audit office that more and more of our employees have relevant knowledge already when they begin the work as auditor.

### 3.2 Skills

If the auditor should be able to use the knowledge that's acquired through training and experience he (she) must have certain skills:

- Communication skills
- Intellectual skills
- Interpersonal skills

These skills are like general knowledge not usually acquired from specific courses but instead as the total effect of the educational program and the auditors professional experience.

*Intellectual skills* – We need the auditor to be able to solve problems, make decisions, and exercise good judgement in complex situations. This requires f. e. ability to:

- identify and solve unstructured problems in unfamiliar settings
- select and assign priorities within restricted resources
- adapt to change

*Interpersonal skills* – We need the auditor to be able to work with others for the common good of our organization. He (she) must be able to:

- work with others,
- organize work
- motivate others
- withstand and resolve conflict
- lead a group.

*Communication skills* – We need the auditor to communicate in an efficient. He (she) must be able to:

- present, discuss, and defend views
- communicate in a formal and informal way, written and spoken
- listen and read effectively
- locate, obtain, organize, report, and use information

The demands of these skills stress like general knowledge the importance of implementing a recruitment policy. We must carefully select those individuals that have the potential skills we need. The importance of different skills has also an effect on the use and choice of education-teaching methods. We must for example:

- Use case studies and other means to simulate actual work situations and emphasise problem-solving
- Work in groups and encourage our auditors to be active participants.
- Measure and evaluate the changing knowledge, skills, and values.

### **3.3 Professional Values**

The program of education and experience must provide potential professional auditors with a framework of professional values for exercising good judgment and for acting in an ethical manner that is in the best interest of society and the profession. Professional values comprise the attitudes that identify professional auditors as members of a profession. They are essential to making a continuing contribution to the development of the profession and the society in which it operates. The attributes, which collectively comprise the values and attitudes of professional accountants, are:

- A commitment to act with integrity and objectivity and to be independent.
- A knowledge of the standards of professional ethics
- A concern for the public interest and sensitivity to social responsibilities
- A commitment to lifelong learning

You can't transmit professional values to auditors only by education and experiences. In this area a vital aspect is to stress the importance of ongoing discussions concerning professional values between the auditors. In a professional audit organisation it is vital that professional values are discussed on a nearly daily basis and this is something that is responsibility of the top management.

## **4 Educations and experience**

To achieve the above goal of education and experience and the knowledge, skills, and professional values the auditor needs it is important to consider the following elements:

- Entry requirements, general education background
- Professional education
- Assessment processes
- Experience requirements

### **4.1 Entry Requirements - General Education**

An individual must have at least a minimum level of prior education to provide the foundation necessary to acquire the knowledge, skills, and professional values needed to become a professional auditor. A broad-based general education is critical to lifelong learning.

The first we did in Sweden was to find out the background and experience of our present staff. We noticed that more than 90 % of the staff had a university degree. In order to increase and secure this competence in the future we decided that an absolute requirement when recruiting new auditors should be a university degree in economics with special studies in accounting.

Another vital part of our recruitment policy is that everyone who wishes to begin work in the national audit office first must pass a "personal assessment test". This test gives us a first indication if the individual has the skills and general education, the background that is needed of an auditor.

## **4.2 Professional Education**

The professional education, the training programme, must build on and develop further the intellectual, interpersonal, and communication skills provided in the individuals general education. The length and content of the professional education depends on the individual's general education and experience.

### *Starting points*

In Sweden we decided on the following starting points for the direction and extent of the competence development plan and the build-up of our training programme:

- The duties as the state audit office
- Good auditing standards – The Handbook
- Integration
- Successive competence development
- Certification/Examination
- Each auditors own reasonability
- Exchange of experience

### *The duties as the state audit office*

The content of the plan was designed on the basis of the duties as the audit office of the Government and with the aim to produce a structured and recurrent course of education/training to assure high quality in the office work.

### *Good auditing standards – the handbook*

Another starting point was of course that the office should follow good auditing standards as this concept is defined in the Audit Guide for Annual Auditing (the Handbook). The content of various parts of the plan are thus designed to take into consideration the new direction of auditing as given in this handbook. This means for example, that internal control applies to the wider perspective as given in the Audit Guide.

### *Integration and holistic view*

The plan takes into consideration the principles given in the handbook that administration, auditing and accounting should be viewed as a whole. This means, for instance, those aspects of auditing will also be included in courses that do not have auditing as a title. This holistic view should also be applied where practical work is concerned. The course of education must illustrate the whole perspective, but also refer to methods for the inspection of individual items.

### *Successive competence development*

An important starting point in the build-up of the training plan was also that the auditors should be offered a successive course of training, an "educational stepladder" interlaced with actual auditing. This also requires that the organisation must ensure that all personnel are given the opportunity of planned "job rotation". During the first three years auditors should work with and supervised by experienced auditors in different types of agencies e.g. subsidy-financed and self-financing, corporate authorities, subsidies, tax-levying, transfer payments, etc. In that way the theoretical parts of the education could be interlaced with practical examples thus bring them closer to reality.

### *Certification/Examination*

We also wanted to design the plan so that as far as content and quality was concerned, it would form the grounds for examination. To be able to participate in examination we require attendance records from all the courses in the ladder or, alternatively, that the auditor can demonstrate that equivalent courses have been taken in some other

way. We also focused the need of a structured assessment of each course held in order to secure that it would meet the demands for examination.

#### *Each auditor's own responsibility*

We did not want to force the individual auditor into an education programme and coming examinations. We decided that auditors who not were aiming for examination could regard the various sections of the education plan as a menu from which to select courses in collaboration with the unit manager and based to the needs of each person individual. At development meetings a joint assessment should be made by the auditor and unit manager as to where on the educational stepladder the auditor was and if the aim should or shouldn't be a final examination. We believe that we in many respects have gained from this policy. Every one of our auditors attends one or more of the courses each year and 25 % of our auditors have already conducted at least one examination test.

#### *Exchange of experience*

Finally we decided to a large extent purchase the courses externally. The reasons were on the one hand that we are a relatively small organisation and will not have a long-term possibility of continually producing the extensive training material which is required, training teachers and running the courses. On the other hand and of greater importance we wanted an exchange of experience with external auditors outside the Audit Office. We would benefit from outside ideas and ways of thinking which would be of value to us in our continuous work on development. The need of a holistic view would, however, require – for several of the courses – that auditors from the department participated in the courses and mediate what is specific for the state and the ideas in the Audit Guide.

### **4.3 The training programme**

The new training programme, our professional education that was implemented in 1998 according to these ideas was divided into three separate programmes:

- Basic training
- Further training
- Specialist training

#### *Basic training programme*

We offer 5 years of Basic Training. The needs naturally differ between employees. The courses in year one are mainly aimed for the newly recruited. Then you can enter any year according to your experience and former training. The suitable year to enter the course in the stepladder is decided in development meetings between the auditor and his/her Head of section. The different courses are run during periods where they will come into as little conflict as possible with the regular duties and fixed work deadlines.

The basic training programme includes in total 22 different courses within the following subject areas:

- Public administration
- Economic Management
- Auditing Methodology
- Auditing and IT
- Auditing and accounting
- Taxation and personnel issues
- Commercial law

The different courses cover some 80 hours per year, thus a total of 400 hours over the five-year period. The content of the different subject areas are shortly described in appendix.

### *Further training programme*

After five years in the auditing profession (inside or outside the RRV), the training programme includes a compulsory programme of further education of 40 hours per year per member of staff. The further education programme assumes knowledge corresponding to all stages of the first five years of the education staircase.

The further education programme mainly includes courses in the following areas:

- Courses to update knowledge of accounting and auditing
- Project management and evaluation methods
- In-depth courses in special subject areas
- Project manager
- Exchange of experiences of auditing
- Specialist training programme

The annual audit contains a large number of working duties, which require different skills. To enable us to discharge our responsibilities this requires, in addition to certified auditors, access to different types of specialists, staff functions etc. In addition to the basic education and further education programmes there are therefore opportunities to participate in different forms of specialist education. The difference between specialist education and further education is that specialist education refers to a specific area and can be undertaken during years one to five. The specialist education and training offered is adjusted to meet the specific needs of the audit each year.

## **5. Assessment of Professional Competence**

In some way a process of assessment of our professional competence must be implemented. There is no single preferred method but it is important that the assessment process is appropriate to the knowledge, skills and professional values that ought to be evaluated. This assessment process often includes a component of examination, a test, of the auditor's competence. These tests should contain a significant part of answers in writing to provide an independent basis for assessment of the individual's knowledge and skills but tests may also include elements of oral and group assessments.

It is important that assessment of professional competence measures more than just theoretical knowledge. For example, auditors should be able to demonstrate that they:

- Have an ability to apply theoretical knowledge in an analytical and practical manner
- Are able to extract from various subjects the knowledge required to solve multiple topic problems
- Can identify information relevant to a particular problem by distinguishing the relevant from the irrelevant.
- Are able, in multi-problem situations, to identify the problems and rank them in the order in which they need to be addressed
- Appreciate that there can be alternative solutions and understand the role of judgment in dealing with these
- Have an ability to integrate diverse areas of knowledge and skills
- Can communicate effectively to the user by formulating realistic recommendations in a concise and logical fashion
- Have knowledge of the ethical requirements of the profession

### **5.1 Examinations and tests**

In Sweden we decided to perform an examination, tests, after three and five years in the training programme. We discussed two alternative ways of carrying out these examinations. One way was to use only our own resources and run the examinations ourselves. The advantage of performing examinations with in-house resources was of course the possibility to use our own definitions of key concepts, our own design of the auditing process and so on. The main disadvantage was of course that it would be difficult to externally gain an acceptance of our quality and

competence if the examination was run completely by our own organisation. What we wanted was at complete or partial assistance of outside consultants or agencies. The aim was to secure the quality and trust in the examination procedure. After discussions this led to that we in 1999 started our examinations or tests in cooperation with the Supervisory Board of Public accountants in Sweden. This agency conducts the examination of chartered accountants.

The aim is that the tests or examinations mainly should measure the ability to practically apply what has been learned during the professional training. In the examination of our auditors we use the same tests that are performed by auditors from the private sector in order to be chartered accountants. Some changes are done in order to fit the tests to our competence profile. These changes are discussed and approved by an examination committee within the Supervisory Board of Public accountants.

As mentioned above we decided on two tests:

- Examination I after three year in training is constructed to test whether the auditor has the required knowledge in all relevant areas that are required for auditing smaller and medium-sized authorities and also has the ability to apply this knowledge in practice.
- Examination II, after five years in training and after an approved examination I is aimed to test whether the auditor has a deeper knowledge of all relevant areas for larger authorities, corporate authorities and authorities which for some other reason are difficult to audit. This test is focused on the ability of putting theory into practice.

So far three tests have been made. In 1999 we started with the first examination I. Out of 13 auditors who made the test 7 passed and 6 failed. Before the test, we estimated that about 50 to 60 % should pass, so the result was very much inline with our expectations.

In November 2000 we conducted both examination I and II. 21 auditors made the examination I test and 5 auditors the examination II test. 13 auditors passed the examination I test and which was very positive none failed the examination II test.

In short each test consists of two parts including 20 to 25 different questions. Each question gives the auditor a background, some facts concerning an agency and a short description of the problem. In the question the auditor is often asked to describe not only in what way there is a problem but also in what way the auditor would handle the situation. This requires answers that in fact is short essays and as a whole shows the auditors ability to reason and discuss from a holistic view. Each part of the test is conducted in 4 hours and the limit of passing the test is 75 % correct answers. This means that the auditor must answer more or less all the questions to be sure of a positive result. The number of questions and the limited time to answer also shows the auditors ability to work and perform under stress.

If we summarize this we have tested 28 auditors in two years. Five auditors have passed both tests and twenty auditors have passed examination test I. This also means that some 25 % of our staff already has conducted at least one of the tests. This is perhaps the most positive experience from the examinations because no has been forced to conduct the tests. It has been up to each individual to decide whether or not to participate. But of course we have tried to motivate our auditors to perform the tests. The first group who attended the tests was given a gratification and those who have passed have been given a higher salary. But we believe that the one thing that motivates our auditors is the opportunity to verify their competence.

## ***5.2 Experience Requirements***

An appropriate period of relevant experience in performing the work of professional auditors should be a component of a competence development program. This period should be long enough to permit the auditor to demonstrate that he or she has gained the knowledge, skills, and professional values sufficient for performing with professional competence and for continuing to grow throughout the career. Relevant experience provides a professional environment in which the auditor for example develops the appropriate professional ethics and values in

practical, real-life situations and has an opportunity to work at progressive levels of responsibility. It's also important that the experience is conducted under the direction and supervision of experienced auditors.

In Sweden we have decided on the following Experience Requirements.

- To become in charge of the audit of a small and medium sized agency the auditor has to document at least 1 500 auditing hours during the past three year period. The hours should mainly consist of auditing different types of government agencies. Another requirement is at least 250 hours of qualified investigations.
- To become in charge of the audit of a large and more complicated agency the auditor has to document at least 2 500 auditing hours during the past five year period. The hours should mainly consist of auditing different types of government agencies. Another requirement is at least 500 hours of qualified investigations.
- It is the audit office that has to ensure that the experience gained is acceptable. This requires that the office for example:
- Establishes a monitoring system and keep records of the experience actually obtained by the individual auditor.
- Assess and approve previous work experience environment before employment. In Sweden we approve to a certain degree work experience from private audit firms.

## ANNEX 13: SIGMA PAPER ON MODERN ARRANGEMENTS FOR INTERNAL AUDIT

### Introduction

The Institute of Internal Auditors defines internal audit as an:

*Independent, objective, assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.*

This is a definition that recognises the increasingly widening and important role which internal audit has to play in any organisation. The elements of independence and objectivity are vital in giving an assurance on the state of internal control in transition countries and have always been an essential feature of any effective internal audit activity. The definition in addition focuses for the first time on an organisation's corporate governance and risk management processes.

Thus internal audit is positioned quite clearly in the forefront of ensuring transition countries develop and implement sound practices and processes for the custody of EU and national funds, a position totally underpinned by the European Commission's support and expectations of the benefits an effective internal audit service can bring to transition countries.

### Where is IA Generally in Countries Seeking Accession?

Most candidate countries have little or no tradition of modern internal auditing as it is widely practised throughout many parts of the world. Instead there is the tradition of a "government control office" or "control activity" based on the practice of the pre-independence regime. These units investigate complaints received about staff from members of the public and may also investigate allegations of irregularity or fraud before turning the cases over to the fiscal or criminal police. There is thus a very large element of "the policeman" associated with this type of activity, something not uncommon with the role and perception of internal audit in other parts of the world in its earlier "pioneering" days.

In each transition country, it is likely that there will be different levels of capability. Currently those units in the SAPARD and ISPA agencies, together with the internal audit units of the National Fund, associated and supplying the agencies with EU money will have had to meet criteria for internal audit as a condition of accreditation of the agency. They will have received considerable external support in achieving this position and will probably be the leaders in the field in their particular country.

Following that, there will be pockets of very good practice in individual ministries but generally the picture throughout the public sector will be one of being very much in the developmental stage with internal audit units struggling to create a different environment from the traditional "control" culture.

### Where IA needs to get to

This is most definitely not the case for modern internal audit globally. Internal audit these days is generally recognised as being positioned to promote good practice and act in a positive proactive way without the negative connotations associated with a "control" or "checker" type of approach. The best internal audit units have a very positive role to play in the running of an organisation and their value in helping to keep the organisation out of trouble is being increasingly recognised by management and staff alike.

Nowhere could the need for good internal audit be more evident than for transition countries in preparing for and after achieving accession to the European Union. The European Commission auditors have clear views of the standard of organisational stewardship they demand from countries receiving EU funds. These are heavily biased towards sound internal control and good governance. Who could be better than well-trained and professional internal auditors to provide guidance and advice in these circumstances? Existing Member States and the Commission have long recognised the role internal audit can and should play. It is essential that new countries coming into the Union are equally committed.

### **Need to Adopt and Execute Internationally Accepted Standards for Internal Audit**

At the forefront of the drive to provide effective internal audit throughout the EU is the recognition that internal audit must recognise and follow standards for internal audit which are laid down and practised globally. These are in two parts and cover:

#### ***Attribute Standards***

- Purpose Authority and Responsibility.
- Independence and Objectivity.
- Proficiency and Due Professional Care.
- Quality Assurance and Improvement Programme.

#### ***Performance Standards***

- Managing the Internal Audit Activity.
- Nature of Work.
- Engagement Planning.
- Performing the Engagement.
- Communicating Results.
- Monitoring Progress.
- Management's Acceptance of Risks.

### **Need to move from Traditional Emphasis on “control” to Modern Internal Auditing**

Historically, internal auditing has focused on financial systems and financial controls within an organisation and it is certainly true within transition countries that what would be classed as "internal auditing". This is auditing inside the organisation, comes from the offices of controllers by people generally trained more in line with external auditing work-business continuity.

The focus of internal auditing has shifted, and is continuing to shift, quite dramatically. This is also closely associated with the greater understanding and relative importance being placed on internal control, good stewardship and corporate governance.

**Table 1: KEY CHANGES WHICH TOOK PLACE ARE:**

<b>Historic Role</b>	<b>Modern Role</b>
Policemen	Partners in the organisation
Financial focus	Business focus
Focus on hard controls	Focus on soft controls
Focus on tangible assets	Focus on intangible assets
Compliance based	Risk based
Functional focus	Process focus
Self-sufficient	Shares of the best practice
Reactive	Proactive

### **Overall objectives for IA-internal control**

#### **What does Internal Audit do?**

Ultimately, management is responsible for managing risk and establishing an effective control framework. Internal audit can assist management in this and can also provide advice to management on what it needs to do to establish appropriate policies, systems of control, and procedures necessary to manage risk effectively and efficiently.

The scope of work of any internal audit function will invariably need to be agreed with management but nevertheless the following list, drawn in part from the IIA Standards, is a commonly pursued range of work for internal auditors:

- Understanding the key business risks and reviewing the adequacy and effectiveness of the processes in place to manage the risks.
- Reviewing the controls which ensure the reliability and integrity of management information and the means used to identify, measure, classify and report such information.
- Reviewing the processes and systems established by management to ensure adherence with those policies, plans, procedures, laws and regulations which could have an impact on operations and determine whether the organisation is in compliance.
- Reviewing the means of safeguarding assets (including both tangible and intangible assets such as people and information).
- Appraising the economy, efficiency and effectiveness with which resources are employed.
- Reviewing operations and projects to establish whether results are consistent with established objectives and whether the projects are being carried out as planned.
- Monitoring corrective action plans to ensure they are implemented effectively and promptly.

What is key to the success and contribution of internal audit is that it must focus on the critical risks to the organisation and review the adequacy of the underlying activities to manage those risks. This will add value to the organisation and strengthen its ability to deal with the issues and risks facing it.

The understanding and evaluation of the risks will generally come together in to an audit needs assessment which identifies those aspects of the organisation which should form part of the overall strategic and annual plans for internal audit. From these plans comes the day-to-day work of internal audit.

### **Structure-Viable Critical Mass**

At present the establishment of internal audit in ministries is minimal. There is little by way of meaningful capacity to provide internal audit services. In effect there are many one-man audit units, each of which has to provide an effective service:

- Over a whole range of tasks.
- Generally provide information to the MoF.
- Carry out certain laid down pieces of work.

It may be in the early stages of the development of internal audit units, but not in the longer term, that benefit could be gained if resources were centralised. This would also have the effect of:

- Creating a critical mass of auditors which would enable a wide range of skills to be acquired.
- Ensuring the service could continue in the absence or in the event of the departure of individual officers.
- Enabling a structure for the unit to be created which could provide a career progression for auditors.
- Ensuring experience is built up and passed on so as to enable a better quality and more effective end product.

The thin spread/dissipation of resources which exists at present, whilst possibly understandable in the overriding need to provide internal audit functions, is not necessarily the most effective use of scarce resources.

### **Need for Independence**

The internal auditor should be responsible to the minister or the Secretary-General of a ministry or agency, giving technical advice on the efficient management of resources without becoming involved in political questions. It is important to be clear about the nature of the internal auditor's independence. It should not be compared with the independence of the external auditor (*e.g.* the supreme audit institution) who reports directly to the parliament or budgetary authority and whose independence is normally reinforced by the tenure and security of his appointment and safeguards against unjustified dismissal. The internal auditor is responsible to the head of the ministry and is part of the staff of the ministry or agency.

The Institute of Internal Auditors requires that the head of internal audit should have organisational independence and "should report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities".

The IIA also lays down that "The internal audit activity should be free from interference in determining the scope of internal auditing, performing work and communicating results". Since the internal auditor is not completely independent of the ministry or organisation in which he functions it is essential that the internal audit function achieves an appropriate status and weight in the organisation.

### **Relationship with Management and the Organisation**

One of the most vital roles internal audit can play is in the support and assurance it can give to the head of any organisation. With an honest, objective approach coupled with operational independence, internal audit is well placed

to tell the minister what is really happening in the ministry and not what officials would like the minister to know. When so much of good governance is dependent upon the minister having a realistic idea of what is involved in certain courses of action, or having unbiased facts on a particular case or situation, then the internal auditor can really prove his value.

In order to establish awareness of, and gain support for, good governance, internal control and risk issues, it is good practice to establish regular contact with the minister/state secretary.

**Pillars on which IA should be constructed:**

These can be summed up as the four P's:

**Pre-requisites – things such as:**

- HIA independence.
- Effective audit committee.
- ANA.
- Strategic plans.
- Annual and assignment plans.
- Audit charter.

**Pay and conditions**

- Adequate salary levels.
- Career structure for internal auditors.
- Working conditions which take account of the specific needs of internal auditors such as confidentiality.
- Security etc.

**Professionalism**

- Working to internationally accepted standards.
- Professional training and qualifications.
- Membership of IIA.
- Attitude of mind.

**Practices**

- Good planning.
- Risk analysis.
- Documentation/manuals.
- Quality assurance.
- Effective reporting.
- Good communication skills.
- Systems/risk based approach.
- Performance indicators.
- Follow-up systems.
- Internal/external audit communication.

**The Need for Internal Audit**

Over the last 10 to 15 years in areas where internal audit has had solid foundations, there has been a change to internal auditors becoming advisers to management, helping them to deal with risk and to establish an effective

framework of internal control. This has been a concerted move from internal financial control to internal control through to risk management activities.

This more modern role for internal audit assists management at all levels to carry out their duties and meet their responsibilities more effectively. It also helps to ensure:

- The business of an organisation is conducted in an orderly and efficient manner.
- Assets are protected.
- Accuracy of records.
- Minimisation of opportunities for fraud.

This is the role that for transitional countries is largely aspirational in their early days in joining the EU but which must be the goal.

### **Benefits of Internal Audit**

An effective internal organisation can give the following benefits to an organisation:

Assurance regarding the adequacy and effectiveness of the organisational control framework in the context of the organisation's critical business risks.

Identification of major control weaknesses and recommendations to reduce risk exposure.

Advice on and facilitation of best practice in risk management and internal control.

Value for money performance reviews looking at economy efficiency and effectiveness.

Education of line management and their staff in elements of risk management and control.

Advice on the most appropriate controls to be implemented in projects and new systems.

The potential deterrence of fraud and other illegal activities across the organisation.

An early warning of potential problem areas.

### **Making Internal Audit Effective**

Internal audit needs to be set up and managed in the best way to ensure that it assists in the achievement of organisational objectives and that it operates in an effective manner within the organisation. Internal audit can be most effective if the following are in place:

- The objectives of internal audit are agreed at the highest level in the organisation and are clearly understood across all levels of management and staff. This may be partially achieved by the production and circulation of an internal charter or terms of reference but there will also need to be a continuing and concerted educational process to ensure the message is properly spread.
- The scope of internal audit work should cover the entire organisation, not simply the financial aspects or those systems or processes which management decides are appropriate for audit review.
- Internal audit must have totally unrestricted access across the entire organisation, endorsed by the minister or other head of an organisation.

- The head of internal audit must have a direct reporting line to the minister/ head of the organisation and where one exists, the Chair of the Audit Committee.
- Internal audit must be, and must be seen to be, completely independent from the day to day operations of the organisation.
- Internal audit should not undertake non-audit work, but where it is absolutely essential, it is understood that they are not operating as internal audit.
- The results of internal audit work must be effectively communicated and be seen to be acted upon.

### **Options for Providing an Internal Audit Service**

- Several options exist for providing an internal audit service.
- The conventional arrangement is to have an internal team which is directly employed by the organisation. Size and cost of providing the service are among the determining factors when considering in-house provision. The in-house team may be reinforced by contractors who can provide specialist skills and additional resources as appropriate.
- Alternatively the whole service can be contracted out.
- Smaller organisations should consider the use of consortia to take advantage of the flexibility this arrangement can produce. Additional skills or expertise can be brought in on a short or long term basis.
- In some countries it is possible that there will be a central strong function, perhaps under the Ministry of Finance, which could be used to provide an internal audit service whilst the in-house facility is being developed. It is also possible that this additional expertise could be called on when an area demands specific expertise, as in some IT Audit situations.

### **Is the Internal Audit Function Adding Value?**

Although we have spoken in a previous section of the ways of making internal audit effective, the other side of the coin is that internal audit needs to demonstrate the value it adds to an organisation. The questions you may wish to ask in determining whether or not your internal audit unit is delivering the value that you both want and need might include:

- Does the internal audit plan focus on the achievement of the organisation's objectives?
- Does internal audit provide you with adequate assurance on the state of risk and control within your organisation?
- Does your internal audit function have the correct blend of skills, knowledge and experience of your business?
- Is internal audit invited to become involved in all major projects that the organisation sets up?
- Is internal audit responsive to changes in the business and does it offer constructive advice in relation to those changes?
- Is there a constant demand for internal audit staff to move into line management positions within the organisation?

- Does internal audit enjoy good and strong relationships at the most senior levels within the organisation?

The Institute of Internal Auditors also recommends that each internal audit function should have an independent peer review on a regular basis. Such a review will also inform you of the value added by your internal audit function and will enable comparison with best practices from other organisations.

It is also important to develop a set of performance measures for your internal audit function.

### **The Internal/External Audit Relationship**

Although internal and external auditors have different end result objectives and, to some degree, different reporting lines, their work is complementary.

External auditors have a wide experience of a number of different organisations and related systems and controls whilst internal auditors have an unparalleled knowledge of their own organisation and an understanding that outsiders are never ever likely to have.

Both sets of auditors should be striving to work for the public good to ensure that systems and controls are strong, to ensure that fraud does not happen, or where it does, that it is picked up at the earliest opportunity and that lessons are learnt and immediately put into practice.

Many of the recent corporate governance initiatives should virtually “force” auditors to focus on clarifying what controls need to exist within an organisation and defining the most efficient way for senior management to satisfy themselves that controls are working effectively. The following issues will certainly need to be addressed as part of this process:

- How should an organisation define its control standards?
- How can line management be motivated to take on their responsibilities for managing risk and internal controls?
- What is the right split of responsibilities between internal and external audit work?
- How can the value of the work be maximised?

Where there has been an internal audit function, historically external auditors have used it to carry out a range of its own work. This is not a course to be recommended or continued.

- The aims and purposes of the two are different although complementary.
- It is not in an organisation’s interest to have an internal audit function that spends considerable time carrying out external audit work.
- Many organisations use internal audit as a training ground for future.
- Organisation managers.

The two sets of auditors need to communicate on a regular basis. Frequent communication will lead to:

- More effective working for both parties.
- Lack of duplication of work.

- Stronger reports leading to better implementation of recommendations and a stronger control environment.

What internal audit is not responsible for:

- It cannot ensure the success of the organisation.
- It cannot ensure the survival of the organisation.
- It cannot ensure the effectiveness of internal control.
- It cannot ensure the reliability of financial reporting and accounts.
- It cannot ensure the absence of fraud or other irregularities or that they are detected.

All of the above remain, as they always have been, clearly the responsibility of management.

## ANNEX 14: THE INTERNAL AUDITOR AND EXTERNAL AUDITOR RELATIONSHIP

**The prime advice for the external public sector auditor (the SAI) governing relationships with Internal Audit is the IFAC International Auditing Standard No. 610 on the Reliance on IA. This requires amongst other things that the SAI reviews IA each year and gives guidance on how to rely on IA work. See <http://www.ifac.org>.**

Other sensible advice on IA and EA relations has been prepared by the UK treasury and the UKNAO. See <http://www.nao.org.uk/guidance/InternalAudit.pdf>

**The SIGMA advice below is more practical guidance for this very important area.**

### **Background**

Internal and external auditors pursue different objectives, have different lines of accountability, possess different qualifications, and engage in different activities. But they have mutual interests that call for co-ordination of their talents and resources for the benefit of an organisation.

The internal auditor's objective is determined by management and professional standards: usually that objective is to review the efficiency and effectiveness of the operation, compliance, and the adequacy and effectiveness of internal control throughout the organisation. The external auditor's objective is that which is required by law and is usually to express an opinion on the fairness with which financial statements have been prepared.

Internal auditors are accountable to management. The external auditors in the public sector are accountable in general to the governing body and/or the parliament.

Internal auditors' qualifications are generally those that management thinks appropriate and range from certification to nothing more than on the job training. The qualifications for external auditors are generally set by law and require membership of a professional body.

Internal auditors are concerned with all aspects of an organisation's activities – both financial and non-financial. External auditors are concerned primarily with the financial aspects of the organisation.

### **Co-ordination**

Co-ordination between internal and external auditors is important because it increases the economy, efficiency and effectiveness of the total audit activity for an organisation. Neither form of auditing can replace the other. However, in many ways they impinge on each other, and if the two types of audits are uncoordinated there will be overlaps and duplications that unnecessarily increase audit costs and create inefficiency and unnecessary demands on the time of the people/organisation being audited.

Co-ordination must be based on mutual respect and integrity. Each group must be able to regard the other as professionals of equal competence. Trust must be the keystone of the co-operative bridge. Neither should try any tricks on the other. Neither should be ashamed or reluctant to admit to not having been especially clever in the way they handled a particular task. With the feeling of mutual respect and trust, they can soundly construct that all-important bridge.

## Benefits of Co-operation

Here are some of the benefits which co-operation can bring:

- More effective audit based on a clearer understanding of respective audit roles and requirements.
- A reduced audit burden resulting in less disruption.
- A better informed exchange of views on the risks facing the organisation leading to more effective focusing of audit effort and consequently to more useful advice to management.
- Better co-ordinated internal and external audit activity based on joint planning and communication of needs.
- A better understanding by each group of auditors of the results arising from each other's work which may inform respective future work plans and programmes.
- Increased scope for use by both internal and external auditors of each other's work.
- The opportunity for each party to draw on a wider and more flexible skills base.

## Achievement of Co-operation

This can be assisted in a number of ways:

- Senior management actively encourages and supports co-operation.
- Opportunities for co-operation are identified from respective audit plans, and documented along with the agreed procedures for co-operation.
- Regular and structured dialogue between interested parties.
- Both sets of auditors adopt an active role in seeking opportunities for co-operation.

## Building effective co-operation – the four C's

Effective co-operation demands:

- Commitment
- Consultation
- Communications
- Confidence

**Commitment.** Commitment is an attitude of mind in which both parties understand and embrace the value of co-operation in developing co-ordinated and effective audit services and are prepared to be flexible and understanding to achieve that end.

**Consultation.** Regular consultation between internal and external auditors provides the basis for identifying opportunities for beneficial co-operation and the mechanism for helping to bring it about. Even where internal and external auditors are not working together in a particular area there may be circumstances where they wish to consult with each other on particular issues or on specific audit findings.

**Communication.** This is a two-way process. Regular and open communications between internal and external auditors is essential, for example, in regular meetings to look at future plans to identify opportunities for co-operation. There should also be a desire and recognition of the value of being able to communicate informally when issues of mutual interest arise.

**Confidence.** This is founded on the recognition that internal and external audits are conducted in accordance with appropriate professional standards. There also needs to be confidence that any information exchanged is treated professionally and with integrity.

## **Co-operation in practice**

### ***Internal Control***

Measuring and evaluating effectiveness of the system of internal control is the primary objective of internal audit. External auditors are required to make a preliminary assessment of the adequacy of the accounting system and the control environment as a basis for the preparation of the financial statements and the design of audit procedures. Exchange of information about internal control is therefore important. When internal audit can provide positive assurance that internal control is adequate, external audit can use that information in determining the extent of its audit procedures.

### ***Reporting and Financial Statements***

Parts of internal audit work can help external audit when reporting on financial statements. In addition to internal audit's opinion on control, any relevant specific testing work undertaken will be of use. There may also be opportunities to conduct joint testing work which can serve the purposes of both internal and external audit.

### ***Compliance with Laws and Regulations***

Internal auditors will invariably consider controls over compliance with laws and regulations as part of their compliance and systems based audit work. This will be of use to external auditors who may have to give a view on the regularity of transactions and whether or not activities have been carried out in accordance with laws and regulations passed by the country's parliament.

### ***Fraud and Corruption***

Internal and external audit both have an interest in the prevention and detection of fraud. External audit should consider the work of internal audit when assessing the risks of fraud in the context of the financial statements.

### ***Developing Systems and Major New Initiatives***

Internal auditors may review the development of new systems. This work will be particularly important to external audit when new accounting systems are reviewed.

### ***Testing Programmes***

The interrogation of computerised systems for testing purposes can be expensive both in the preparation of the testing techniques and in the running of the testing programmes on computer systems. When there is an overlap in testing plans, co-operation can allow more economic approaches to meet the needs of both parties.

### ***Audit of Regional Organisations***

If the audited organisation has regional/functions or offices there is obvious scope for co-ordinating the planning of visits. Chances to work in joint teams or for one party to carry out work on the other's behalf is more economical and limits disruption.

### *Audits by European Commission Officials*

The EC auditors will often choose to derive much of their assurance that European funds have been dispersed in line with regulations, by examining the work of both internal and external auditors. The two parties can usefully liaise to provide essential background information; assurances on the basis of work carried out or indicate a willingness to put resource into areas where the Commission auditors consider there is a need for further activity.

### **Conclusion**

Effective co-operation between internal and external audit leads to a range of benefits for both sides, and also for the organisation being audited. Whilst their respective roles are different, co-operation helps both parties achieve their objectives and also helps them provide a more effective, efficient and economical service to the organisation they work for and ultimately to parliament and the public.

## **ANNEX 15: INTERNAL AUDIT COMMITTEES - SUMMARY ADVICE FROM THE (CIPFA)**

### **General**

Ministries and Public sector bodies and Institutions should establish an Audit Committee, comprising non-executive members, with responsibility for the independent review of the systems of internal control, internal audit and of the external audit process.

### **Establishment**

The Audit Committee should be independent of the organisation's executive management. It should be established as a high level committee, constituted formally as a sub-committee of the main executive board. Membership should be confined to non-executives, although committee members need not all be members of the main board.

### **Composition**

The chair of the Audit Committee should not be the chairman of the board or have an executive role in the organisation. However, he/she should be a member of the board, although other members may be independent of the board. The chair of the board should not normally be a member of the committee.

The responsible finance officer or director of finance, the chief internal auditor and the external auditors should normally attend meetings of the committee and should have direct access to the committee at any time.

### **Responsibilities**

The functions of the Audit Committee should include the following:

To review with management the:

- Adequacy of the internal controls system.
- Adequacy of policies and practices to ensure compliance with relevant statutes, directions, guidance and policy.
- Compliance with relevant standards or codes of corporate governance.
- Financial statements.
- Risk assessment and management process.

To ensure that the internal audit function is effective, is properly resourced and has appropriate standing within the body.

To review the activities of the internal audit function, including its annual work programme, co-ordination with the external auditors, the reports of significant investigation and the responses of executive management to specific recommendations.

To manage on behalf of the board all aspects of body's relationship with the external Audit Office.

## ANNEX 16: THE PERFORMANCE OF PUBLIC ACCOUNTS COMMITTEES

### World Bank Policy Research Working Paper 3613, May 2005

The Policy Research Working Paper Series disseminates the findings of work in progress to encourage the exchange of ideas about development issues. An objective of the series is to get the findings out quickly, even if the presentations are less than fully polished. The findings, interpretations, and conclusions expressed in this paper are entirely those of the authors. They do not necessarily represent the view of the World Bank, its Executive Directors, or the countries they represent. This paper has used the SIGMA paper No 33: SAI Relations with parliament, referred to in an Annex above in its considerations. Policy Research Working Papers are available online at <http://econ.worldbank.org>.

#### Abstract

In 2002, David McGee wrote a comprehensive report on two important elements in the system of public financial accountability, namely the office of the Auditor General and the parliamentary oversight committee commonly referred to as the Public Accounts Committee (PAC). The purpose of the present paper is to deepen McGee's analysis of PACs. In particular, we define PAC success and identify those factors that impact on PAC performance. We use data that were collected by the World Bank Institute in 2002, when a survey questionnaire was sent to 51 national and state/provincial parliaments in Commonwealth countries in Asia and Australasia and Canada and the United Kingdom.

We find that the institutional factors which most account for the success of the PACs are the focus on government's financial activity rather than its policies, the power to investigate all past and present government expenses, the power to follow up on government action in response to its recommendations, and its relationship with the Auditors General.

#### Conclusions of the paper:

In his study of Public Accounts Committees (PAC) and Auditors General, McGee (2002) identifies three main priorities for action. First of all, given the importance of institutional capacity of the overseers for the effective financial oversight of the government expenditures, McGee suggests that the ability of the parliament, of the PAC and of the Auditors General to carry out their oversight functions should be improved. In his view, this result (capacity building) could be achieved by providing staffing and resources, training and access to information.

Second, McGee underlines that a key determinant of the success in the activity of Auditors General is represented by their independence from partisan and political influence. Auditors General need to have the freedom to carry out their duties independently and impartially.

Finally, McGee stresses that a key determinant for success in the activities of the PACs is represented by the availability of information and information exchange. McGee argues in fact that PACs need to exchange information and ideas in order to stay up-to-date with developments, changing standards and best practices as they emerge.

The evidence presented in this paper is to a considerable extent consistent with the conclusions formulated by McGee. The PACs Chairs surveyed in the study conducted by the WBI reported that information availability and bipartisanship/non-partisanship are critical conditions for the success of the PACs as two of McGee's three conclusions previously suggested. But the analysis conducted in this paper allows one to gain a much better understanding of how the capacity of the PACs can be built. Two sets of factors seem of great importance in this regard. One concerns the institutional design of the PAC, while the other concerns their behaviour and functioning.

The success of the PACs depends to a large extent on how they are institutionalized, on what institutional features and characteristics they have, that is their power and mandate. In this respect, we suggest that PACs should focus on governments' financial activity and accountability rather than evaluating or assessing the content of the governments' policies.

Second, we believe that PACs should have the power to investigate all past and present government expenses regardless of when they were made. Third, PACs should be given the power to check whether the government actually undertakes some steps to implement the recommendations of the PAC itself. And finally, PACs must have a close working relationship with the Auditors General.

The success of the PACs does not depend exclusively on institutional design, but it also and more importantly depends on the behaviour of its members and the functioning of the committee itself. Here we have been able to identify some obvious best practices: PACs' members must act in a non partisan fashion and should try to have a good working relationship with other committee members in spite of possible partisan differences. In its functioning the PAC should always strive for consensus.

Second, our study has revealed that effectiveness in the PACs' activity increases whenever the PACs members study the documentation and prepare themselves before the PAC meetings. Third, the PACs should keep the transcripts of their meetings, they should publish their conclusions and recommendations, and they should involve the public and the media. Public opinion can in fact provide a strong incentive for governments to improve their financial accountability and avoid possible allegations of ineffective management of public resources.

In the light of these conclusions, we are now able to present, however cautiously, some aspects of an ideal PAC:-

- The Committee is small; committees seem to work well with 5-11 members, none of whom should be government Ministers;
- Senior opposition figures are associated with the PAC's work, and probably chair the Committee;
- The Chair is a senior parliamentarian, fair minded and respected by parliament;
- The Committee is appointed for the full term of the parliament;
- The Committee is adequately resourced, with an experienced clerk and a competent researcher(s)
- There is clarity on the Committee's role and responsibilities;
- The Committee meets frequently and regularly;
- Hearings are open to the public; a full verbatim transcript and summary minutes are quickly available for public distribution;
- A steering committee plans the Committee's work in advance and prepares an agenda for each meeting to the full Committee;
- The typical witness is a senior public servant (the "accounting officer") accompanied by the officials that have a detailed understanding of the issues under examination;
- The Auditor's Report is automatically referred to the Committee and the Auditor meets with the Committee to go over the highlights of the report;
- In addition to issues raised by the Auditor, the Committee occasionally decides to investigate other matters;
- Committee strives for some consensus in their reports;
- The Committee issues formal substantive reports to parliament at least annually;
- The Committee has established a procedure with the government for following up its recommendations and is informed about what, if any, action has been taken;

- In all its deliberations, the Committee uses the Auditor as an expert advisor;
- Parliaments hold an annual debate on the work of the Committee.

## **ANNEX 17: FIGHTING CORRUPTION – SUPREME AUDIT INSTITUTIONS AND THE ANTI-CORRUPTION AGENDA**

### **NAO/UK and the TCPN -- Some food for thought**

#### **Background**

There is today an increased focus on development places and increased expectations that monies will be spent well.

SAIs are part of broad range of players who can help make a difference. The key partners are the Ministries of Finance, Accounting professions, judiciary, anti-corruption agencies, civil society organisations (press and non governmental organisations).

#### **What do SAIs traditionally do?**

- They support broader public sector financial management reforms.
- If they identify fraud and/or irregularities, they do report to the appropriate authorities. Hopefully they also make sure that the reports are properly dealt with and/or exercise judicial powers on their own if entitled.
- The traditional role, if well performed, can help ensure that adequate internal controls are in place and are functioning properly.
- It can also give civil servants way of resisting corruption or at least act as a deterrent through fear of being caught.

#### **A growing role for SAIs?**

But let's ask ourselves:

- What more can SAIs in developing countries do?
- What can SAIs in developed countries do?
- What ways can our partner SAIs combat risks of corruption?

#### ***What more can SAIs in developing countries do?***

Much is actually done and/or currently underway to modernise SAIs, develop and retain staff and increase visibility of SAIs contributions.

But efforts could be better focused, e.g. the SAI could:

- Carry out cross-government oversight reviews to identify and disseminate good practices in implementing modern financial and management controls and areas for improvements
- Participate in anti-corruption consortia
- Run workshops on issues of ethics, corruption to help foster cultural change – awareness of the possible

- Run IDI courses on fraud and corruption eg. ASOSAI
- Focus audits on high risk areas and areas of concern to the public – what types of corruption really kill...

They also could:

- Perform audits of police and judiciary - e.g. system based internal control audits and/or performance audits
- More pro-poor audits – MDG focus – school meals
- Prove their worth – demonstrate impacts and responsiveness. Make sure the way they work does not add to the problem or doesn't stifle innovation
- Seek to be more innovative in the way information is shared – especially with civil society organisations, the general public and civil servants
- Prosecutions are one form of sanctions – but not always possible to use - look more creatively at others for example strengthen internal civil service disciplinary procedures and/or use media exposure
- Maintain a dialogue with donors on good procurement practices...

They also could:

- Perform a close monitoring to ensure audit reports are not delayed without clear reasons
- Establish a consultative group with civil society organisations and others engaged in anti-corruption work
- Carry out on-going monitoring of the speed, efficiency and effectiveness with which courts handle corruption cases
- Look for innovative ways of increasing the coverage of audits of regional, municipal bodies – e.g. Brazil – lottery
- Ensure that all funds including donor funds are put through the government and audited - Single Treasury Account
- Set up a guarantee for a whistle blowing system – with staff protection
- Demonstrate a willingness to practice what they preach....

### ***What can SAIs in developed countries do?***

Developed countries often export corruption but SAIs could do more to make sure this risk is reduced, for example:

- Audit own development agencies to ensure that they have robust anti-corruption and anti-fraud controls
- Examine the scope to do performance audits of money laundering initiatives, implementation of anti-corruption legislation, programmes aimed at penalising companies found guilty of paying bribes, asset recovery agencies
- Assisting with forensic audit work
- Run joint audits with developing country SAIs.

### **What sources of internal corruption face our partner SAIs?**

In countries where corruption is entrenched, SAIs also face risks, for example:

- Politicised appointment processes – leading to a reluctance to criticise political allies

- Low wages encouraging rent seeking behaviour and excessive turn-over of staff
- Auditee capture - location in audited body – no staff rotation
- Traditional fraud – procurement, T&S, allowances, vehicles...

#### **Possible ways our partner SAIs can combat risks of corruption**

- Push for external audit – and transparent arrangement for selecting auditors
- Push for internal audit – and independent audit committees to receive reports
- Establish audit committees, chaired by an external person, to receive the audit reports of the SAI (in the case where they don't have a special Committee in Parliament in charge for this)
- Ensure that internal governance systems are in place and functioning properly – with proper minutes of meeting, clear financial delegations, etc
- Work with champions/donors to seek opportunities for legislative reform or administrative reform affecting appointments of senior persons and/or staff remuneration
- Implement strict staff rotation rules – no more than 5 years on one audit area....

They should also:

- Not locate staff in auditee offices on a permanent basis
- Work on the supply side of audit/accounting skills to reduce risk of losing good staff
- Make the audit selection process transparent
- Make staff recruitment and promotion process more transparent and based on merit rather than longevity
- Make sure codes of conflict and strict declaration of interest codes are in place and operating
- Keep register of all audits started and reasons for lack of completion....

#### **Sources of assistance**

- IDI courses on fraud and corruption
- Partnership projects between developed and developing SAIs
- Partnership projects as Parallel audits in the region
- Regional and/or Local branches of Transparency Index

## **ANNEX 18: SIGMA SHORT PAPER ON THE CORE PRINCIPLES OF SAI INDEPENDENCE**

The subject of SAI independence is treated at a conceptual level in Parts II, III and IV of the Lima Declaration of Guidelines on Auditing Precepts (1977) and also covered in the INTOSAI Code of Ethics and Auditing Standards that are derived from the Declaration. The following core principles find their basis in those documents and in the various declarations on the topic of SAI independence that have resulted from INTOSAI and regional groups Congresses<sup>14</sup> over the years.

These core principles are generally recognised in the SAI community as essential requirements of proper public sector auditing by SAIs.<sup>15</sup>

### **Core Principles**

- An appropriate and effective constitutional/statutory/legal framework and effective application provisions of this framework.
- Independence for the SAI Heads and Members (in collegial organisations), including security of tenure and legal protection in the discharge of their duties.
- A sufficiently broad mandate and full discretion in the discharge of SAI functions.
- Unrestricted access to information, persons and documents.
- The right and obligation to report on their work.
- The freedom to decide on the content and timing of their reports and to publish and disseminate them.
- The existence of effective follow-up mechanisms of SAI recommendations.
- Financial and managerial/administrative autonomy and the availability of appropriate human, material and monetary resources.
- An effective relationship between the SAIs and Legislature (see III 8 of the Lima Declaration.)

### **Application Provisions of the Core Principles:**

The Application Provisions constitute a more detailed explanation, vision and a goal that SAIs should strive to achieve when applying the Core Principles.

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<sup>14</sup> For example the subject of the EUROSAI Congress in Paris in 1999 was “SAI Independence”.

<sup>15</sup> Taken from the Report of the 17<sup>th</sup> UN/INTOSAI Symposium on the Independence of SAIs, Vienna, April 2004.

**An appropriate and effective constitutional/statutory/legal framework and effective application provisions of this framework.**

Adherence to this principle can be demonstrated with provisions as follows:

27. SAI independence should be firmly rooted in the constitution and legislation of the country. It can only exist within the confines of the mandate granted to SAIs. The constitutional provisions provide the basis for legislation that spells out in detail the extent of SAI independence and powers. These do not exempt SAIs, however, from adherence to the laws that govern the environment that they operate in.
28. This can take different forms, depending to a certain extent on the various cultural, legal and administrative traditions that are present. For example, certain courts of accounts are 'supreme' in the sense that they are independent of the three branches of government (legislative, executive and judiciary); certain audit boards are independent as a whole but representative of the political spectrum that they are based on; whereas in some Westminster-inspired parliamentary systems, the head of the audit institutions is an officer of Parliament and reports to the Legislature.
29. However, the constitutional /statutory guarantees of independence can only be fully realised or develop their full meaning only, if they are enacted in practice. Indeed, in effect SAI independence and its performance are affected by the extent to which sufficient human, material, and monetary resources are available.
30. Moreover, the interpretation and effective application of the concept of SAI independence and of related constitutional/ statutory guarantees are very much affected in practice by the particular political and civil society structures and systems of countries within which SAIs operate. For example, SAI independence is more difficult to establish and safeguard in an environment where good governance and other proper checks and balances do not exist or are severely limited. It is also dependent, to a considerable extent, on the degree of democratisation of the environment in which SAIs evolve. Accordingly here the challenge for the SAIs and Legislature is much stronger and the need to work towards these goals more urgent.

**Independence of SAI Heads and Members in collegial institutions including security of tenure and legal protection in the normal discharge of their duties.**

Adherence to this principle can be demonstrated with provisions as follows:

1. Heads of SAI and Members (in collegial institutions) should be appointed re-appointed or removed by the Legislature or by the Head of State on approval of the Legislature. Conditions for their appointment, re-appointment, employment, retirement and removal should be specified in the constitution, statutes or applicable legislation.
2. The appointment should be for a sufficiently long and fixed term to allow Head of SAIs and Members to carry out their mandates without fear or retribution. SIGMA would themselves propose a fixed term of at least twice the length of the period of the relevant Parliament and non renewable for Auditors General and slightly less for Members in collegial SAIs.
3. Current and former heads of SAIs and Members should have a special legal protection in respect of prosecution for any past or present act that is part of the normal discharge of their duties.

### **A sufficiently broad mandate and full discretion in the discharge of SAI functions.**

Adherence to this principle can be demonstrated with provisions as follows:

In order to avoid audit-free areas in the public sector the audit mandate for the SAIs should be as broad and comprehensive as possible. Mainly SAIs should be empowered, by legislation, to investigate the use and stewardship of public money or assets by a recipient or beneficiary regardless of its legal nature, as well as the collection of revenues owed to the government. The mandate should include the audit of the legality and regularity of all government accounts and entities, the quality of financial management and reporting. It should also comprise the economy, efficiency, and effectiveness of government operations as well as the fulfilment of their jurisdictional control or granting privileges and exemptions of responsibilities where applicable.

1. Except when specifically required to do so by legislation SAIs should not audit government policy but restrict themselves to the audit of policy implementation (and the result of it, the impact) and to the issuance of audit observations, conclusions, advice and recommendations.
2. Although they must be respectful of laws which apply to them, SAIs should be free from direction and interference by the Legislature and by the Executive in the selection of audit issues as well as in the programming, planning, conduct, reporting, and follow up of audits. (Unless this is expressed specifically in a law like the obligation to issue an annual report to Parliament, an opinion on the financial statements etc.)
3. SAIs should also be free from direction and interference, within the legal framework decided by Parliament, and by the Executive in the organisation and management of their offices. However the SAI should be regarded as a good employer and follow all reasonable and statutory requirements for health and safety and labour protection etc.
4. SAIs should avoid all cases or appearances of conflict of interest in their relationships with audited organisations. They should not be involved in the management of audited organisation. They should ensure that their personnel do not develop too close a relationship with the entities they audit.
5. It is recognised however that although SAIs should have full discretion in the discharge of their responsibilities, they should be responsive to the interests and wishes of the Legislature and should cooperate with the government in order to improve the use and management of public funds)
6. SAIs should apply the same standards to their own operations that they apply to organisations that they audit in order to establish and maintain their reputation and credibility. To this effect, they should:
  - Use appropriate audit and work standards, as well as adhere to a code of ethics, all of which are based on INTOSAI Standards.
  - Provide evidence of the good stewardship and economy, efficiency, and effectiveness of their own activities and operations.
  - Establish an appropriate internal audit function.
  - Even if it is not laid down in the audit law as it is often the case submit themselves to an independent audit of their accounts SAIs should also be open for regular external review of their quality and performance. It is accepted as good practice that the results of these periodic audits and reviews are made public.
  - Submit an annual activity report to the Legislature and to other state organs as should be required by the constitution, statutes or legislation and make this report available to the public.

### **Unrestricted access to information, persons and documents**

Adherence to this principle can be demonstrated with provisions as follows:

1. SAIs should have unfettered, full, direct and free access on a timely basis to all the documents and the information necessary for the proper discharge of their statutory responsibilities.
2. In case the access to information required for the audit is restricted or denied the SAIs should have the possibility to address Legislature or a commissions thereof, or to take the matter to court.
3. When it comes to sensitive personal and other classified information the SAI Heads should make sure that the access is restricted to specific persons. The Heads should delegated this access right carefully and supervise its correct ethical and legal use.

#### **The right and obligations to report on their work**

Adherence to this principle can be demonstrated with provisions as follows:

1. SAIs should not be restricted from reporting the results of their audit work.
2. SAIs should be required by law to report publicly and at least annually on the results of their audit work.
3. SAIs should strive to establish a good working relation with Legislature or their committee responsible in order to achieve the greatest possible impact out of their audit reports.
4. In order to do this SAIs should supply Legislature or their committee responsible with strong audit reports restricted to important matters with practical recommendations for corrective actions. (as mentioned before I think this aspect is very important and not enough developed)

#### **The freedom to decide on the content and timing of their reports and to publish and disseminate them.**

Adherence to this principle can be demonstrated with provisions as follows:

1. SAIs should be free to decide on the content of their audit reports and to make observations and recommendations, taking into consideration, as appropriate, the views of audited entities. However, legislation should specify minimum audit reporting requirements for SAIs, where appropriate, as well as specific matters that should be subject to a formal audit opinion or certification.
2. SAIs should be free to decide on the timing of their audit reports except where specific reporting requirements are prescribed by law. However the SAIs should keep in mind that timeliness of reports is essential for their impact.
3. Whilst there should be no obligation to do so, SAIs should co-operate to the extent possible to accommodate specific requests for investigations or audits by the Legislature as a whole (or a commissions thereof) or by the government.
4. SAIs should be free to publish and disseminate their reports once they have been formally tabled as required by law. These reports should consider or include as appropriate, the views of audited entities.

#### **The existence of effective follow up mechanisms on SAI recommendations**

Adherence to this principle can be demonstrated with provisions as follows:

1. SAIs should be able to make their audit reports available to the public should they so wish.7.2 SAIs should submit their audit reports with specific recommendations for corrective actions to the auditee and also the Legislature or a commission thereof for review and for follow-up. SAIs should have their own internal system of follow up to ensure that their observations and recommendations as well as those of the Legislature (or a commission thereof) have been properly addressed by audited entities.

2. SAIs should regularly prepare and submit follow-up reports to the Legislature (see above) for its consideration, and for its action even where they have their own statutory power for follow-up and sanctions. **Financial and managerial/administrative autonomy and the availability of appropriate human, material and monetary resources.**

Adherence to this principle can be demonstrated with provisions as follows:

1. Access by SAIs to necessary and reasonable human, material, and monetary resources should not be under the control or the direction of the Executive.
2. The Legislature (or a commission thereof) should be responsible for ensuring the proper resourcing of SAIs, to enable them to fulfil their mandate.
3. SAIs should prepare their own budget and submit it directly to the Legislature (or a commission thereof) for approval.
4. SAIs should manage their own budget and be free to allocate it as appropriate.
5. SAIs should have the right of direct appeal to the Legislature if the resources provided are insufficient to allow them to fulfil their mandate.
6. Heads of SAIs should be free to determine the organisation of their office, including personnel and contract management systems and material acquisition/disposal policies and procedures.
7. SAIs should be free to determine their own personnel policies, including the selection, recruitment, training, remuneration, promotion, discipline and dismissal of staff and contract personnel.

#### **An effective relationship between the SAI and Legislature. (See III 8 of the Lima Declaration.)**

Adherence to this principle can be demonstrated with provisions as follows:

1. Both the parliament and the SAI are mutually and legally independent, but the relationship must have synergy
2. All public bodies need to be subject to the law, and for the provision of budget. This is the same for the SAI and the Parliament should make good practical provisions for approving the SAI budget and holding them accountable for it ie arrange an annual audit. It is better, where the size of parliament allows, for this to be not done by the same parliamentary body or committee who deals with the work reports of the SAIs.

#### **General**

The above conditions do not preclude SAIs from entering into arrangements with executive government agencies with regard to industrial relations, personnel management, property management, or purchasing of equipment and supplies, in as much as these arrangements do not infringe in any way upon the independence of SAIs. In this as in other cases, SAIs must observe the national and international laws that apply to them.

#### **Independence checklist**

As an aid to Self Assessment below (**Attachment A**) you will find a checklist of the key aspects of independence necessary for an SAI.

#### **Maturity of SAI Independence**

Attached to this paper (**Attachment B**), and based on the section on independence from the “SAI maturity model” developed by the UK NAO and DFID as part of a technical assistance project with the Romanian Court of

Audit, is a table of the stages of development of SAI independence. This gives clearly and relevantly a good idea of the progressive stages SAs will often need to go through in establishing legal and actual independence.

**SIGMA, August 2005.**

### Checklist for Reviewing the Independence of a Supreme Audit Institution

Although the status of the Supreme Audit Institutions differs from country to country, there is one essential requirement that is common to all: the independence of the Supreme Audit Institution and its members and auditors, which is necessary for the credibility of the audit results. Supreme Audit Institutions can accomplish their tasks objectively and effectively only if they are independent of the audited entity and are protected against outside influence.

As mentioned above the independence of the Supreme Audit Institutions is the main concern of the Lima Declaration which postulates that this status should be firmly laid down in the Constitution and that a supreme court should provide legal protection against any interference. Therefore it is important that the Supreme Audit Institutions review their level of independence and wherever the ideal amount of independence is not yet achieved endeavour working towards it.

This checklist is supposed to be a practical tool helping to facilitate the self-evaluation of Supreme Audit Institutions in respect of their independence. It cannot be complete and also not fully applicable to every individual Supreme Audit Institution due to various national differences. Still if many questions cannot be positively answered this indicates a lack of independence and discloses problems that should be solved.

#### A. Constitutional Requirements

1. Is the establishment of the Supreme Audit Institution laid down in the Constitution?
2. Is the type of the Supreme Audit Institution (audit office or a court of auditors, Auditor General or collegiate leadership, etc.) mentioned in the Constitution?
3. Is the independence of the Supreme Audit Institution embedded in the Constitution?
4. Is the independence of the Auditor General of the Supreme Audit Institution or its members, the decision making persons, guaranteed in the Constitution?
5. Are the nomination, term, removal and dismissal of its head (and members, in the case of collegiate bodies) laid down in the Constitution?
6. Is it foreseen that the Head of the Supreme Audit Institution is appointed by Parliament or by the Head of State for a fixed term or until a specified retirement age?
7. In the case of collegiate bodies is it laid down that the members are appointed by Parliament or the Head of State?
8. Does the Constitution foresee that their removal is only possible by Parliament and is not within the prerogative of the executive and be exercisable only by means of a special process laid down by law?
9. Does the regulation in the Constitution prevent that removal and dismissal of head or members impair their independence?
10. Is adequate legal protection by a supreme court against any interference with a Supreme Audit Institution's independence or that of its members and the audit mandate guaranteed in the Constitution?
11. Are the basic audit powers and duties and reporting responsibilities of the Supreme Audit Institution embodied in the Constitution?
12. Is the Supreme Audit Institution empowered and required by the Constitution to report its findings annually and independently to Parliament or any other responsible public body and to publish this report?
13. Does the Supreme Audit Institution have the right to report to Parliament on particularly important and significant findings during the year?

14. Is the relationship between the Supreme Audit Institution and Parliament and also government clearly defined in the Constitution according to the conditions and requirements of the national situation?
15. Is there a reference to an audit law in the Constitution?

## **B. Legal requirements**

16. Is there a specific audit law?
17. Does the audit law complement the Constitutional provisions regulating the establishment, powers and duties of the Supreme Audit Institution?
18. Does the audit law guarantee the functional and organisational independence of the Supreme Audit Institution, its head, members and its auditors?
19. Does the law ensure that head, members and audit staff are not influenced by the audited organisations in their professional careers and do not be dependent on such organisations?
20. Is the method of appointment and removal of members and auditors laid down?
21. Does the audit law provide for the Supreme Audit Institution's financial independence that means financial resources enabling the office to accomplish its tasks?
22. Is the Supreme Audit Institution entitled to apply directly for the necessary financial means to Parliament?
23. In case the executive interferes does the Supreme Audit Institution have the right to address Parliament to request additional funds if it considers its budget insufficient for the discharge of its tasks.
24. Is the Supreme Audit Institution entitled to use the funds allotted to them under a separate budget heading as they see fit?
25. Does the audit law provide for a broad audit mandate including all public financial operations, regardless of whether and how they are reflected in the national budget?
26. Does this include the authority to audit all EU revenue and expenditure regardless of public budgeting?
27. Does this also include the possibility of auditing on the premises of any body managing revenue or expenditure on behalf of the EU including audits on the premises of any natural or legal person in receipt of payments from the EU budget?
28. Is the Supreme Audit Institution empowered to audit the collection of taxes and examine individual tax files?
29. May the Supreme Audit Institutions also examine the system and efficiency of tax collection, the achievement of revenue targets?
30. Is the Supreme Audit Institution entitled to audit enterprises under private law if the government has a substantial participation in them?

31. Is the Supreme Audit Institutions empowered to audit the use of subsidies granted from public funds?
32. Does the Supreme Audit Institution have the mandate to carry out the full range of audits including regularity, financial and performance audits?
33. Is the Supreme Audit Institutions free to decide on the nature, timing and extent of its audit tasks and the contents of its reports including the type of audits although minimum reporting requirements may be specified in the law?
34. Does the law include the unrestricted right of access to records, documents and information?
35. In case the access to information required for the audit is restricted or denied does the Supreme Audit Institution have the possibility to address Parliament or to take the matter to court?
36. Does the audit law cover the relations with Parliament?
37. Does the audit law deal with the relations with government and other state bodies?
38. Does it cover the relations with auditees and the public?
39. Does it allow the Supreme Audit Institution co-operation on auditing with other Supreme Audit Institutions?
40. Is the Supreme Audit Institutions entitled to provide Parliament and administration with their professional knowledge in the form of expert opinions, including comments on draft laws and regulations?
41. Is the Supreme Audit Institution entitled to call on external experts as necessary?

SAI Maturity Model for Independence

Excellence Factor	Basic	Developing	Performing	Excellent
Independence <sup>1</sup>	<ul style="list-style-type: none"> <li>Mandate does not provide independence</li> <li>Carries out executive functions</li> <li>Often subject to political influence</li> <li>Resources are insufficient to discharge mandate</li> </ul>	<p>The constitution and law provides<sup>2</sup></p> <ul style="list-style-type: none"> <li>Freedom to set priorities and programme<sup>3</sup></li> <li>Freedom to make public reports to Parliament when necessary<sup>4,5</sup></li> <li>No part in audited entities operations<sup>6</sup></li> <li>Legislature provides resources sufficient to discharge responsibilities<sup>7</sup></li> <li>Is able to freely recruit and dismiss staff; determine remuneration , and buy/dispose of equipment<sup>8</sup></li> </ul>	<ul style="list-style-type: none"> <li>Clear channels of communication with the public<sup>9</sup> politicians and audited entities to ensure that they understand independence and rationale<sup>10</sup></li> <li>Process in place to ensure that opinions and reports are objective and fair<sup>11</sup></li> <li>Audit outputs demonstrate independence</li> </ul>	<ul style="list-style-type: none"> <li>Independence understood in the community</li> <li>Audited entities see organisation as objective and fair</li> <li>Politicians understand, respect, value and support independence</li> </ul>

1. INTOSAI General Standard 51(a). The auditor and the SAI must be independent.

2. Lima Declaration Section 5.3 "The establishment of Supreme Audit Institutions and the necessary degree of their independence shall be laid down in the Constitution; details may be set out in legislation. In particular, adequate legal protection by a supreme court against any interference with a Supreme Audit Institution's independence and audit mandate shall be guaranteed. Recommendations Concerning the Functioning of Supreme Audit Institutions in the Context of European Integration 1999 (henceforth The 1999 Recommendations), recommendation 1: SAIs should have a solid, stable and applicable legal base that is laid down in the constitution and the law and is complemented by regulations, rules and procedures. Paragraph 2 continues: To ensure stability, certain fundamental principles of an SAI should be laid down in the constitution, as it is not easily amendable. Constitutional provisions should include the establishment of the SAI, its status and type (an audit office or a court of auditors, a single executive or collegiate leadership, etc); nomination, removal and dismissal of its Head (and members, in the case of collegiate bodies); basic auditing powers and duties; reporting responsibilities; necessary independence of the SAI, including a clear definition of its relations with parliament and government; reference to an audit law.

3. INTOSAI General Standards: Is free to set priorities and programme its work in accordance with its mandate (60, 67); Able to decline requests for audits from the executive (67); Free to determine how it conducts all its work (61); The president is appointed until a specified retirement age or for a lengthy fixed term (72); The president can be removed only by a process akin to that of a judicial office holder (72); The independence of court members is assured (73); Brings disputes and disagreements with audited entities to the attention of legislature (57); Avoids participation in the executive's functions where this would militate against independence and objectivity (64, 80); Not responsive to the wishes of political interests (59). The 1999 recommendations (recommendation 2) state that in the case of collegiate bodies, removal from office should not be the province of the executive.
4. INTOSAI General Standards: Arrangements for reporting to the legislature are flexible, although there may be minimum requirements (62); Cannot be obliged to suppress or modify audit findings, conclusions and recommendations (65).
5. The 1999 Recommendations (recommendation 2, paragraph 5) and the Lima Declaration.
6. INTOSAI General Standard 78. The SAI should not participate in the management or operations of an audited entity. Audit personnel should not become members of management committees and, if audit advice is to be given, it should be conveyed as audit advice or recommendation and acknowledged clearly as such.
7. INTOSAI General Standard 63. It is necessary that the legislature provide the SAI with sufficient resources, for which the SAI is accountable, as well as for the effective exercise of its mandate. General Standard 68. A sensitive area in relationships between the said and the executive concerns provision of resources to the SAI. In varying degrees, reflecting constitutional and institutional differences, arrangements for the SAI's resource provision may be related to the executive branch of government's financial situation and general expenditure policies. As against that, effective promotion of public accountability requires that the SAI be provided with sufficient resources to enable it to discharge its responsibilities in a reasonable manner.
8. INTOSAI Independence of SAI's project final task force report March 31 2001: page 19 Core principles of SAI independence includes "financial managerial autonomy".
9. INTOSAI General Standard 74. In order that the SAI not only exercise its functions independently of the executive but be seen to do so, it is important that its mandate and its independent status be well understood in the community. The SAI should, as appropriate opportunities arise, undertake an educational role in that regard.
10. INTOSAI General Standard 76. The SAI must remain independent from audited entities. It should, however, seek to create among audited entities an understanding of its role and function, with a view to maintain amicable relationships with them. Good relationships can help the SAI to obtain information freely and frankly and to conduct discussions in an atmosphere of mutual respect and understanding.
11. INTOSAI General Standard 89. The SAI must be, and be seen to be, objective in its audit of entities and public enterprises. It should be fair in its evaluations and in its reporting of the outcome of audits. [Processes might include training; guidance; review; quality assurance.]