Overview of problems with the audit of the annual accounts of local authorities

Does the audit of the annual accounts of local authorities meet the needs of users?

Summary of the results of the overview

What did we investigate?

The National Audit Office of Estonia investigated which are the needs of the main users of the financial information of local authorities and to which extent their needs have been taken into account in the mandatory audit of the annual accounts (hereinafter also audit).

For this, a survey was sent to all the local authorities and private auditors (hereinafter auditor) who audited them in 2014–2015, a discussion was organised with the representatives of the revision committee, main users of the financial information of local authorities, i.e. the Ministry of Finance and Statistics Estonia, were interviewed, and the most important areas associated with the specifics of the public sector were determined. Results of quality control carried out on the audit and the work of auditors at the Board of Auditors were also analysed. In the course of the overview, the National Audit Office of Estonia did not look at the work of auditors of local authorities nor did it assess the quality of their work.

Why is this important to taxpayers?

An audit carried out in the public sector differs from that in the private sector foremost in terms of who use the information. Since the most important risks in the private sector and in the public sector are different, the audit has to pay attention to different areas. For example, with regard to one part of the public sector – local authorities –, it is important for the audit to ensure that financial information that the state's economic statistics is based on and on the basis of which the state carries out supervision of the economic activity of a local authority is correct and that the taxpayers' money is used in an honest and transparent manner.

In 2015, the expenses of local authorities totalled approx. 1.5 billion euros.

What did we find and conclude?

Local authorities and the public are unable find answers to questions that they are interested in from the audit, because the audit is based on the logic of auditing the private sector. The audit does not meet the needs of the users of financial information of a local authority for the following reasons:

- **More than half of the auditors who audited local authorities do not cover all the important areas associated with the specifics of the local authority** (e.g. compliance with the financial discipline or execution of the budget, transactions with associated parties), because they do not consider these as part of the audit. At the same time, the National Audit Office of Estonia has identified several violations of law in these areas in the course of earlier audits. One-quarter of the auditors who audited local authorities do not consider it important to assess whether the activities planned for overcoming a poor financial situation improve the situation.

- **83% of the auditors do not inspect the use of all the codes necessary for state and European Union reports.** This may have an effect on the accuracy of statistical data, because state authorities use this data to differentiate between transactions with a different content upon preparing economic overviews.

- **The current short form of the auditor's report does not provide information that the users require.** The reports should reveal what was audited in important areas, how it was audited and what result was derived.

- **The auditor exchanges little information with the government, municipal council and the revision committee in the course of the audit,** although the majority of auditors consider these three to be the main users of the annual accounts of the local authority.

The aforementioned reasons may be due to the following circumstances:

- **Auditors cooperate with the management of local authorities and the revision committee only a little.** Cooperation between the auditor and the local authority is also hindered by the local authority's lack of interest in the audit.

- **Auditors have not received enough instructions and preparation for auditing local authorities.** The majority of auditors require instructions in order to audit important areas (e.g. report of the execution of the budget, transactions with associated parties). Several auditors are of the opinion that the public law examination serving as a prerequisite for auditing the public sector has been prepared so that passing it does not imply sufficient knowledge and skills to audit a local authority.

- **The quality control of auditors does not emphasise the shortcomings associated with auditing local authorities**, because the risks associated with the specifics of the public sector are not taken into account.