

# Peer Review Report: National Audit Office of Denmark





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# Purpose of the peer review

1. The National Audit Office of Denmark (NAOD) requested an external assessment of its audit practice. A team of international peer reviewers assembled to give the Danish parliament (Folketing), the Public Accounts Committee, the government administration, and the public an assessment of the NAOD's auditing practice. The peer review will determine whether the NAOD's auditing practice is independent and suitably designed, and whether it is operating effectively to provide the Folketing with objective information about the government administration. This report has been prepared for the use of the NAOD to conclude on the peer review assessment.

2. The peer review focused on whether the audits at the NAOD are effective, in accordance with established international standards and in keeping with the practice of professional Supreme Audit Institutions (SAIs). The review examined the performance and financial audit practices of the NAOD.

3. The peer review team used the auditing standards and guidelines that the

International Organization of Supreme Audit Institutions (INTOSAI) issued to assess the audit guidelines and procedures of the NAOD.

4. To assess whether the NAOD's audit processes are consistent with the INTOSAI standards and their own internal guidelines, the peer review team examined five major areas of the auditing practice:

- Independence and competence
- Planning
- Data collection and documentation
- Quality control and assurance
- Reporting and follow up

5. In the following report, the peer review team has focused only on findings representing good practices and those that we consider potential areas for improvement. We do not elaborate on areas that we consider in accordance with normal procedures and practices of other SAIs. If the NAOD acts on our suggestions regarding the areas for improvement, its procedures would become more consistent with both INTOSAI standards and the good practices of other SAIs.

## Background

6. The NAOD is an independent SAI under the authority of the Folketing. The Auditor General, whose responsibilities and duties are described in the *Auditor General's Act*, is the head of the NAOD.

7. Under the Danish Constitution, the Folketing's Public Accounts Committee is given the authority to audit the Danish state accounts. The Committee consists of politically elected members and its main function is to illuminate problems in government operations and pass this information on to the Folketing. As authorized by the

Auditor General's Act, the NAOD, as a professional institution of auditors, conducts the audits of Danish government operations. The NAOD prepares audit reports for the Committee, and the Committee presents them to the Folketing. This relationship between the NAOD and the Committee is unique to Denmark.

8. According to the Committee's constitutional authority, it can request that the NAOD audit particular matters. The NAOD is also able to determine the subject of its audits, an important safeguard that keeps



**Economy** refers to whether an institution has procured goods and services in the most cost-effective manner

**Efficiency** refers to the relationship between inputs and outputs

**Effectiveness** refers to the relationship between the objectives set and the outcomes

the office independent from the political and administrative realm.

9. The NAOD carries out financial audits and performance audits, thus fulfilling the full scope of government auditing, as described by INTOSAI standards. The purpose of a financial audit is to assess the soundness of state accounts and to ensure compliance with appropriations, acts, and agreements. Performance auditing involves examining whether state resources are being applied as the Folketing has determined. It also involves examining whether government reforms or programs are effective and meet the goals set up and whether government departments have achieved satisfactory results. Compliance audits provide verification whether transactions encompassed by the financial reporting comply with acts, other regulations, agreements concluded and usual practice. Compliance is also important in performance auditing, for instance when violations of laws or regulations may significantly affect performance and legality of public services. At the NAOD, separate departments conduct financial audits and performance audits. There are two main audit products: a report on the annual audit of the state accounts and the major examination reports. In addition, the NAOD

audits a number of state-funded or state-owned enterprises.

10. Current international trends in the audit community are to expand the traditional roles and scope of auditing. Financial auditing is expanding to include the understanding of an institution's operational systems – that is, its **economy**, management review, and performance measurement – more than its day-to-day transactions.

11. INTOSAI's standards state that performance auditing focuses on **economy, efficiency, and effectiveness** to improve performance in these areas and act as a catalyst for modernization and change in the public sector.

12. The *Auditor General Act* allows the NAOD to conduct audit tasks by working closely with internal audit groups in the government institutions. This legislation, and the resulting relationship between the NAOD and internal audit groups, makes the NAOD unique, compared to other SAIs. The NAOD depends on the capacity of the internal audit groups to fulfill its mandate. The NAOD directs and supervises internal audit groups within ministries and reviews their planning and practice to ensure it meets the NAOD's requirements.

## Overall assessment

### Meeting the standards

13. The peer review team found that, overall, the NAOD's internal guidelines, for its auditing practice, comply with international standards, and that its work is consistent with those guidelines.

### Openness

14. The NAOD meets very high standards of openness in the office and invites external reviewers to examine their products.

- Managers and auditors communicate openly.
- Auditors at the NAOD can access all audit files to enable them to share knowledge.
- Managers and auditors share a foundation of trust that each can fulfill their respective audit objectives.
- Auditors are entrusted with a high degree of freedom and responsibility to complete their work.

15. All audit staff can make suggestions

about which audits should be conducted. Suggestions are put through a planning process, which is founded on assessments of risk and financial materiality. The results of the process are discussed with the Auditor General before approval.

16. The NAOD has demonstrated its openness to external perspectives of its audit products, by engaging specialists to review finalized audit reports and asking those specialists to suggest ways to improve the reports. The NAOD also requested that a peer review be conducted by other SAIs, to help improve its audit processes.

17. Danish law fosters openness, by ensuring that NAOD documents that support audits are made available to the public upon request.

18. Although the NAOD has very high standards of openness, it does not interact directly with the media. Rather, it presents its reports to the Public Accounts Committee, and the Committee may discuss the results and maintain media relations.

## Adding value

19. In order to guide NAODs performance audit topic selection, the strategic planning process could usefully consider the interests of the Danish public. This may enhance the NAOD's ability to set the correct long-term priorities for topics in performance auditing. In order to add value and come up with useful recommendations, the NAOD could give higher priority to effectiveness issues.

20. The NAOD's performance audit objectives tend to have a compliance focus and, to a lesser extent, address the areas of economy, efficiency, and effectiveness. This compliance focus may influence the ability of the NAOD to contribute to modernization and change in the public service.

21. Risk analysis conducted in financial audit planning is done to focus an audit on

the most important areas. The NAOD conducts risk analyses in its planning stages, but the examination stages of the audit process do not reflect that risk analysis consistently.

## Suggestions

22. During our assessment, the peer review team identified good practices and areas for improvement in the NAOD's audit practice.

23. The following are some suggestions for the NAOD to consider in its efforts to improve its performance.

### Maintain a high level of openness

- Continue to pursue external perspectives of the quality of audit reports and the effectiveness of the audit practice.
- Pursue new ideas by staying in close contact with other organizations like universities, other SAIs, and think-tanks.
- Consider adopting a media relations policy to ensure that major concerns and messages are appropriately communicated to the public.
- Continue staff development through their involvement in internal decision making.

### Add more value to the citizens

- Develop strategic planning and priorities and base them on analyses of what is most important to the Danish public.
- Focus more on effectiveness audits and problem analysis.
- Clarify its policy on making recommendations.
- Continue to develop non-traditional areas of financial auditing and let risk analysis guide audit work more consistently.



# Major areas

## Independence and competence

24. The Folketing has established legislation to uphold the NAOD's independence from the government administration.

25. To safeguard the independence of audit staff from the entities they audit, the NAOD places the onus on employees to make managers aware of any concerns they have that their independence may be compromised.

26. The NAOD emphasizes their audit staff's competencies. Managers do so by identifying their needs for future audits and training or recruiting appropriate employees.

### Good practice

27. **Active staff development.** The NAOD managers are responsible for defining general and specific audit competencies related to their mandate. It is their responsibility to ensure that they have qualified staff members who can perform the audits they deem necessary. Every year, managers assess employees responsible for financial and performance auditing against their competencies. Through this process, the NAOD is able to identify who to train and whether to recruit additional staff.

28. An example of the NAOD's proactive thinking about its competency needs is its decision to introduce financial audit certification for government auditors. Given the NAOD's experience in financial audits of government institutions, it has developed a certification system for auditors with other public auditors. The system consists of training, practical experience, and written examinations, and will enable those taking the course to conduct quality audits.

29. Another example of how the NAOD has successfully increased its office's competency is the incorporating of many aspects that are traditionally part of its per-

formance audit practice into its financial audit practice. Expanding the financial audit practice has increased the competencies of financial audit staff, by expanding their traditional responsibilities to include the legislative aspects and required outputs from their audit subjects.

### Areas for improvement

30. **Safeguarding employees' integrity.** The NAOD does not have any formal procedures that require staff to declare their independence from the entities they audit. Instead, it relies on its employees to inform their managers if they believe their independence may be compromised. Some SAs require their staff to sign formal declarations of independence annually, which not only supports an auditor's integrity, but serves as a reminder about all the factors that may compromise one's independence. Other SAs also consider their auditors' biases or attitudes, toward entities or a particular subject matter, when assigning audits to safeguard the organization's objectivity and integrity.

31. The NAOD has not adopted job rotation requirements. They find the experience and efficiency the auditors gain by working on the same entity outweigh the possibility of compromising independence. Some SAs do require managers who audit the same entities annually to rotate to different positions or serve for limited appointment periods. Other SAs realign their organization periodically.

### Planning

32. To meet INTOSAI standards, the NAOD prepares background material on the entity to be audited, the financial materiality, major risk areas, a budget, and schedule. The planning process for both the financial and the performance audits are founded on assessments of risk and financial materiality.

33. The NAOD incorporates risk analysis into its financial audit planning and learns about



the systems of controls that the entities it audits employs. Staff communicate the annual audit plan to the **audited entities**.

34. The Public Accounts Committee requests more than one third of the performance audits the NAOD undertakes. The NAOD may elaborate on these requests, subject to the Committee's approval, in order to for instance relate the audit more closely to the economy, efficiency, and effectiveness of the entities audited.

### Good practice

35. **Follow up on previous recommendations during planning.** One of the NAOD's planning requirements for financial audits is to follow up on whether the entity has taken appropriate actions based on findings and recommendations made in previous audits. INTOSAI requires SAs to follow up on previous findings, and doing so in such a structured manner is recognized as a good auditing practice.

36. **Involvement of staff in planning.** All audit staff are expected to participate in the NAOD's planning process by suggesting proposed topics or subjects for future audits. Staff members must analyze their suggestions according to specified risk factors. Senior managers discuss the proposed plan with the Auditor General. All staff can view the final plan on the internal website.

### Areas for improvement

37. **Orientation of performance audits.** Performance audits add value to society and **government administration** by focusing on the areas of economy, efficiency, and effectiveness. Within these three areas, it is important that the NAOD prioritize important topics. By evaluating entities on their economy, efficiency, and effectiveness, performance auditors are able to analyze and identify the root causes of problems. This means that effectiveness issues would have to play an important role in setting priorities.

38. To prioritize the audit topics, the NAOD identified a number of broad focus areas. These should reflect what is most important

to safeguard: economy, efficiency, and effectiveness in government administration. However, these areas were too broadly defined to guide the selection of audit topics. They did not seem to be the results of clear analysis about topics of major importance and interest to the Folketing and the Danish public, from a government-wide perspective. The NAOD plans to redefine its focus areas in order to better guide audit selection.

39. For financial audits the NAOD has restricted its own flexibility in choosing which entities to audit, by stipulating that each ministry should be audited within a four- to six-year period. By doing this, the NAOD believes it covers all aspects of government administration better. The inherent risk in this approach is that more significant areas are not audited when the need arises.

40. To promote efficiency and timely reports, all performance audit units at the NAOD are expected to produce three audits per year. The fact that each audit is expected to be finalized in about a year may affect both the auditors' and the NAOD's flexibility to conduct varying sizes of performance audits. Some topics are more limited and require less effort; others require more resources and cover more extensive subjects. In addition, this regulation may create an incentive for conducting major audits even when preliminary analyses indicate that an audit may not result in significant findings.

41. During the past decade, the NAOD has been conducting more compliance-oriented audits. In our review of a sample of performance audit reports, we confirmed that the audits did not necessarily focus on economy, efficiency, or effectiveness. Rather, the NAOD is now focusing on compliance issues.

42. The following factors may have contributed to adopting a more compliance oriented approach:

- The NAOD's Audit Planning Memorandum does not require that the

*The **audited entity** can be an institution, activity, program, or operation*

**Government administration** refers to public sector institutions, public services, programs and operations



performance audit objectives address economy, efficiency, or effectiveness.

- Compliance audits generate statistical evidence of a compliance rate - the rate at which the subject of an audit has complied with regulations or objectives. This means that auditors can be completely assured of the validity of their overall assessment. However, audit topics that focus on efficiency, economy, or effectiveness require more professional judgment on the results of the audit entity's operations. Auditors who strive to be 100 percent correct may not wish to conduct audits that require this level of judgment.
- The NAOD has adopted a maximum timeframe of one year for completing major examination reports, including three months for preliminary study and three months for clearance procedures for the auditee and for the NAOD. Auditors often do not have the necessary time to address economy, efficiency, or effectiveness. Tight deadlines force auditors into familiar subject areas.
- Requests from the Public Accounts Committee often concern specific areas of possible non-compliance or problems in public administration.

43. The NAOD has developed competencies to address issues of economy, efficiency, and effectiveness. However, its compliance orientation means the NAOD is not completely fulfilling its mandate and is not using those competencies effectively.

**44. Using risk analysis to guide financial audit procedures.** Planning financial audits includes risk analysis. The methods that the NAOD auditors use to prepare risk analyses vary across audit teams, ranging from detailed analyses that are tailored specifically to the audit entity to analyses that only consider past audit coverage. Risk analysis should consider potential problems that could arise for each audit entity.

45. Including risk analysis in planning meets INTOSAI's requirements. However, one of the goals of risk analysis is to revise an

audit approach and to take into account the way those risks could affect the financial audit opinion. There was no documentation in the files we reviewed to show that after identifying risks, the auditors modified their audit approach or that they assessed how those risks would affect the final audit opinion.

**46. Improving the understanding of controls reliance.** International standards require that auditors understand an entity's information technology (IT) control environment as they plan their audit. If the auditors detect no significant weaknesses in the IT environment, they can consider relying on computer controls to help improve the efficiency of their audit. To rely on general computer controls, auditors must perform detailed testing on IT applications. At the NAOD, and at many other SAIs, IT audit specialists help to assess the IT control environment and test IT application controls. However, communication among financial audit practitioners and IT audit specialists is crucial to confirm what needs to be tested and how testing results will affect the audit approach. The NAOD must consider training in this area to support their auditors' decisions about how to approach audits.

## Data collection and documentation

47. The NAOD uses an electronic management system to document financial and performance audits. The office designed this system to make the way files are organized more consistent and to make important guidance and audit procedures available to audit staff.

48. The NAOD has developed a wide range of analysis techniques and methods to collect data, to support its performance audit work.

### Good practice

49. The NAOD ensures that auditors use a consistent approach at each stage of the audit process. An electronic management system enables auditors to respect guide-

lines and standards. The system prompts teams to follow the mandatory procedures. This system makes it easier to retrieve documents and provides electronic evidence of the way working papers are reviewed during an audit. In addition, the system automatically tracks changes to documentation and team members' comments.

50. Audit teams use this system to maintain their working papers and their analyses during an audit. Although the way an audit is executed may differ from product to product, we found that the audit approach was consistent, the audit procedures were documented consistently, and their associated responses were linked to the work. In addition, for financial audits, any findings related to audit procedures were clearly identified, and appropriate evidence was provided to support final audit reports.

51. This system, with its consistent structure and built-in auditing guidelines, not only helps meet e-government requirements in Denmark, but is a good practice.

### Areas for improvement

52. **Using a variety of methods.** Using a variety of methods to collect and analyze data can help auditors meet their audit objectives. In order to assess economy, efficiency, and effectiveness, the NAOD would need to use a wide range of methods. The NAOD has a long tradition of developing and using a variety of innovative methods in performance auditing. However, auditors are not currently using all of those methods.

53. **Widening the range of audit evidence.** The NAOD's performance audit guidelines are not clear about what constitutes audit evidence and audit findings. In addition, there are no specific guidelines for the development of audit evidence, except the requirement that the evidence should be relevant. In performance auditing, different types of audit evidence support conclusions in the areas of economy, efficiency, and effectiveness. As noted earlier in this report, the NAOD is currently focusing on

compliance issues. This tends to lead auditors to gather a narrow range of audit evidence that supports compliance auditing.

## Quality control and assurance

54. The NAOD has an open approach to quality assurance. Every year, senior managers try to improve their operations by examining a sample of audit files to identify best practices and systemic weaknesses.

55. During a performance audit, the NAOD's internal quality review includes management reviews and discussions with peers. After an audit is completed, the audit team, managers, the auditee, and external advisors evaluate the audit report. They also evaluate communication between the auditors and the auditee, contributions from external advisors, and the audit process.

56. The NAOD seeks external advice in an effort to improve its audit reports and to gain an outside perspective about whether its processes meet international standards.

### Good practice

57. **Encouraging the auditor's sense of responsibility.** The NAOD has succeeded in promoting openness and mutual trust among staff members, in stimulating quality development and delegation, and has encouraged auditors to be guided by their own sense of responsibility. The NAOD's auditors trust the quality control and assurance activities, and do not find the procedures and systems too cumbersome.

58. **Ensuring the quality of the audit file.** For financial audits, senior managers review sample audit files on an annual basis, as a quality control measure. They discuss the results of these reviews with the responsible managers so that they may correct any deficiencies. In addition, if the reviews identify systemic weaknesses, auditors add



more guidance or change procedures in the electronic audit management system. The NAOD goes beyond the INTOSAI standard that requires SAs to address areas that quality assurance systems identify as needing improvement and establishes practical guidelines for their auditors – a true best practice.

**59. Ensuring that the NAOD guidelines reflect standards.** The NAOD's financial audit departments include a product coordination group that ensures new standards are reflected in the organization's guidelines and audit procedures in a timely manner. The group also ensures that the guidelines are written in a way that results in good quality audits, and that they are developed by the teams that specialize in the work.

**60. Ensuring the accuracy of audit reports.** The NAOD has developed a practice of using audit memoranda to clear the facts, analyses, and assessments with an auditee before preparing a final report. The memoranda are normally distinct pieces of audit work that present results and preliminary conclusions for each intermediate objective of a performance audit. The audit memoranda have a dual purpose – to prepare for the final report and to be part of the quality assurance process. Although the NAOD has no clear guidelines for substantiating findings, using audit memoranda is the way the organization ensures that their analyses and recommendations are accurate and fair. Audit memoranda also help make the reports more focused and shorten the follow-up process.

**61. External review of reports.** The NAOD has recently begun using academics from various backgrounds to enhance the quality and methodologies of their performance audit reports. The recommendations of the external reviewers are presented, as is the NAOD's response, in its annual report. The NAOD accepted the reviewers' recommendations and intends to improve its methods and communication as appropriate. This external review initiative is characteristic of an organization that is open and willing to learn.

## Reporting and follow up

**62. Feedback on financial audits.** The process and outcome of all financial audits are evaluated by the audited entities. After the completion of the audit, the entities are given the opportunity to comment on the planning, communication, reporting, and usefulness of recommendations.

63. The NAOD submits its reports to the Public Accounts Committee, which may add comments on areas of interest. The Committee's comments in their reports encourage the NAOD auditors.

64. The Committee publishes and presents the reports to the Folketing and to the media. The NAOD does not have an active media policy and does not monitor media coverage of their reports.

65. Legislation requires ministries to respond to the audit findings and recommendations that the NAOD presents to the Public Accounts Committee. Those responses must include actions taken or planned.

66. Performance audit reports include brief summaries of what the auditors found and link them directly to the original audit objectives.

67. The NAOD prepares letters to managers of the entities they audit. The letters include recommendations for each financial audit.

### Good practice

**68. Active follow up.** The NAOD has an active approach to follow up. Auditors follow up four months after issuing a report, and continue to monitor developments until the NAOD and the Public Accounts Committee are satisfied. The NAOD uses the implementation rate of its audit recommendations as a performance measurement tool for the organization. Internal reviews and evaluations of the completed audits also promote learning.

**69. Timeliness of management letters.** For

each financial audit, the NAOD sends a letter to the managers of the audit entity that outlines the purpose of the audit, examination results, conclusions, and any recommendations. Issuing these letters in a timely manner is a priority for the NAOD. If management letters are not issued within six weeks after audit field work is completed, senior managers are alerted and the audit team must explain why they did not send the letter. Timely reporting is a good practice among SAIs.

70. **Audit report summary.** The performance audit reports contain a short summary presenting only the main audit questions and their answers. This clarifies that the audit has met its objectives and answered major questions.

### Areas for improvement

71. **Reduce uncertainty about recommendations.** Policy documents and the performance measurement system at the NAOD emphasize the importance of rec-

ommendations. Even though the Public Accounts Committee expresses a clear wish that the NAOD share knowledge about good practices with the government administration, the Committee states that auditors should not provide ministries with solutions to solve their administrative weaknesses. Currently, there remains some uncertainty at the NAOD about the practical use of recommendations.

72. **Making the report on State Accounts more readable.** For each ministry or audited entity the organization of the State Accounts report findings are written to correspond to the individual audit products conducted by the NAOD. The resulting product structured report does not mirror the audited ministry or entity's organization. Readers in the ministries and elsewhere would find the findings easier to follow if they were presented according to the structure of the organization being audited.



# Appendix

## About the peer review

The peer review focused on both performance and financial audit practices. Since the NAOD uses external reviews to assess the quality of their State Accounts report and seven to ten performance audit reports per year, the focus for this peer review has been on audit practices. The team also made observations about culture and institutional behaviour. The team developed a review program to guide its assessment of audit design and audit implementation. The NAOD's legal provisions, internal guidelines, and procedural instructions; external reviews of reports, interviews with NAOD management and staff, financial audit and performance audit working papers; and a crosscutting review of nine performance audit reports

on methodology use, presentation of findings, and recommendations all served as sources for the review.

### Peer review team

The Office of the Auditor General of Norway (Lead reviewer)

- Ms. Kristin Amundsen - Team Leader
- Mr. Stig J. Sunde.

The Office of the Auditor General of Canada

- Ms. Gibby Armstrong.

The Polish Supreme Chamber of Control

- Mr. Lech Marcinkowski.

The Swedish National Audit Office

- Mr. Tony Angleryd.





