



# EXTERNAL AUDIT SYSTEMS ANALYSIS

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EUROSAI  
Task Force  
Municipality Audit



# INTRODUCTION

EUROSAI Task Force on Municipality Audit (hereinafter - TFMA) was established as an instrument for cooperation and development of more efficient municipal external audit systems, for sharing the best practice and experience in municipality audit as well as official activities, which started in 2017.

In 2019 implementing the Strategic Goal II (“Making the external municipal auditing system more efficient”) the Coordination Group consisting of the SAIs of Lithuania (team leader), Estonia, and Greece carried out an Analysis of the existing external audit systems by comparing and grouping different models, identifying strengths, weaknesses, and opportunities to improve them. The external audit systems of local governments were grouped by their common characteristics - the entities that carry out an external audit in municipalities, their competencies, the scope of audits, etc. The distinction of different external municipal audit models allowed to compare various systems and identify the strengths of models, reveal and share good practice examples.

The Analysis is based on an Overview of external municipal audit models in EUROSAI TFMA<sup>1</sup>, which was prepared in 2018 by the same Coordination Group. The analysis was preceded by a questionnaire held in 2017. The composition of the TFMA changed in 2019 - SAIs of Bulgaria and Malta joined the Task Force, while the SAI of Denmark has decided to withdraw from it. Due to these changes the research encompasses information obtained from a new TFMA member – the SAI of Bulgaria while the information obtained from the SAI of Denmark has not been included. The SAI of Finland does not audit the Finnish municipalities as this type of audit is not included in their mandate. The former Finnish government planned a major regional and municipal administration reform which was not implemented and the current government did not follow in those steps. Therefore, the

SAI of Finland will not have a new mandate which would be more linked to municipalities any time in the near future. For this reason, the SAI of Finland has decided to withdraw the membership from the Task Force starting from April 2020, but their information is incorporated in the analysis.

The research provides benchmarking information on the roles and mandates of SAIs and other audit entities in the field of local government auditing of 26 European countries. Different countries apply various models of external audit of local governments resulting from the governance, administrative and political systems, and other factors of the country. The Overview and the Analysis rely entirely on the information received and verified by TFMA members. The sources of information used by SAIs include national legislation, various statistical databases, SAIs’ reports and audit practices, other internal SAIs’ documents (e.g., strategic planning documents), and academic literature.

TFMA continues useful and interesting cooperation with the European Organisation of Regional External Public Finance Audit Institutions (hereinafter – EURORAI), which started in 2018 in the area related to external audit systems of municipalities. EURORAI contributed to the TFMA revision work of the comprehensive country reports as regards the involvement of regional public sector audit institutions in municipality audit in some member countries. The information of Switzerland, Germany and France was used in preparing this analysis of external audit systems.

In order to identify how different audit institutions operate in this system, their interrelationships, and their role in the whole municipal audit system, the Analysis is structured around the entities participating in external audit system as well as three types of audit: financial, compliance, and performance. It also includes case studies for each type identified to provide a deeper insight.

<sup>1</sup> [Overview of External Audit Systems in Local Government](#)

# DEFINITION OF TERMS

## SAI

Supreme Audit Institution

## LOCAL AUDIT INSTITUTION (AI)

A public institution established or an auditor appointed (elected) by the local authority to conduct external audits of local government and related entities (e.g., municipality, municipality-owned enterprises or other entities of local government). This term also applies to audit institutions established by counties or other regional divisions, if the country has two levels of local government (municipal and regional).

Public audit institution established by the governmental institution or regional parliament to conduct audits of local authorities (counties, municipalities, municipality-owned enterprises or other entities) in the specified region.

## PRIVATE AUDITORS

Private sector auditors, financed from the public budget and appointed to audit local authorities (counties, municipalities, municipality-owned enterprises or other entities of local government).

## OTHER PUBLIC ENTITIES

Entities or institutions conducting external audit of local government, excluding SAIs, regional and municipal external audit institutions and private auditors.

## ECONOMY, EFFICIENCY AND EFFECTIVENESS (3E)

The principle of **economy** means minimising the costs of resources. The resources used should be available in due time, of appropriate quantity and quality and at the best price.

The principle of **efficiency** means getting the most from the available resources. It is concerned with the relationship between resources employed and outputs delivered in terms of quantity, quality and timing.

The principle of **effectiveness** concerns meeting the objectives set and achieving the intended results.

# ENTITIES WHICH PARTICIPATE IN THE MUNICIPAL EXTERNAL AUDIT SYSTEM

There is no uniform practice. A variety of external audit models was determined by traditions, history, country's administrative system, mentality,, etc. The administrative division of the local governments of TFMA member countries is different and it affects the external audit system at the local government level. Various audit entities are carrying out external audits, they have different mandates and audit practices.

According to the different administrative structures of the TFMA countries and different levels of external audit entities involved, the entities of municipal external audit/control system can be divided into 4 main types/groups:

- Supreme Audit Institutions (SAIs);
- Independent regional/local audit authorities (Local AIs);
- Other entities of the public sector (Ministry of Finance, etc.);
- Private auditors.

The following table shows how these audit entities are distributed in TFMA member countries and how the national local government external audit system looks like (Table 1).

Table 1

Country	SAI	Local AI	Other institutions	Private auditors
ALBANIA	√			
AUSTRIA	√	√	√	
AZERBAIJAN	√			√
BULGARIA	√		√	√
CROATIA	√			√
ESTONIA	√			√
BOSNIA AND HERZEGOVINA		√		√
FINLAND		√		√
NORTHERN MACEDONIA	√			√
GEORGIA	√			√
GREECE	√			√
HUNGARY	√	√	√	√
ISRAEL	√		√	
ITALY	√			
LATVIA	√			√
LITHUANIA	√	√		√
MONTENEGRO	√			√
POLAND	√	√	√	
PORTUGAL	√		√	√
ROMANIA	√			
SERBIA	√			√
SLOVAKIA	√		√	√
SLOVENIA	√		√	√
SPAIN	√	√		√
TURKEY	√			
UKRAINE	√		√	

An analysis of the distribution of external audit entities among TFMA countries reveals that the involvement of SAIs and private auditors in municipal external audit system is the most common practice. SAIs participate in municipal external audit system in 24 countries and private auditors in 18 out of 26 countries (Figure 1).



Figure 1 Involvement of SAIs and private auditors in external audit system of local government

Local audit institutions operate in 7 out of 26 countries, other entities of the public sector operate in 9 out of 26 countries (Figure 2).

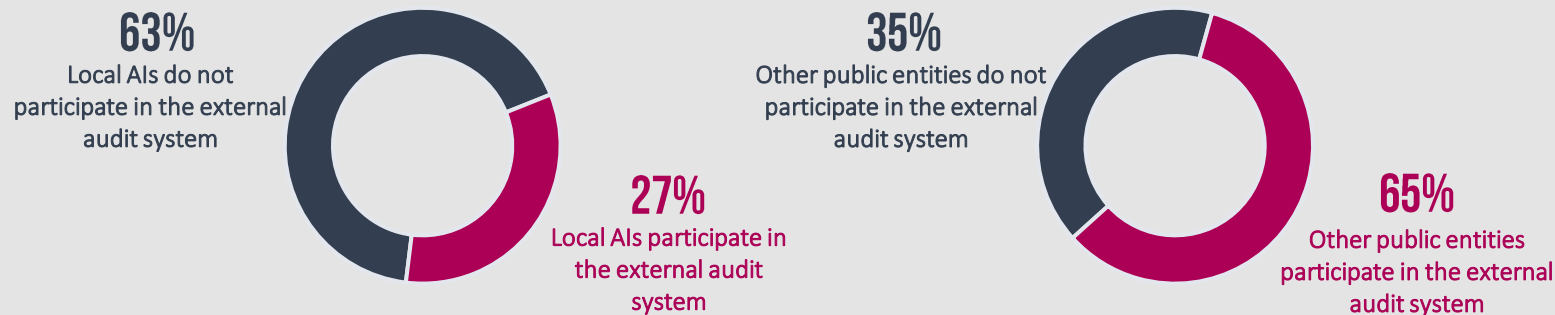


Figure 2 Involvement of local audit institutions and other entities of the public sector in external audit system of local government

The analysis has shown that the distribution of entities participating in municipal external audit system is unequal across TFMA countries. Audit entities of all types operate in 1 (4%) out of the 26 countries analysed (only Hungary) and the most common model (9 countries) is when SAIs and private auditors operate (Figure 3 on the next page).

Figure 3 Key actors in municipal external audit systems in TFMA countries

(NOTE: click on the text to go to the information)

### ALL TYPES (1)

- The role of key actors in financial audit
- The role of key actors in performance audit
- The role of key actors in compliance audit

### SAIs AND PRIVATE AUDITORS (9)

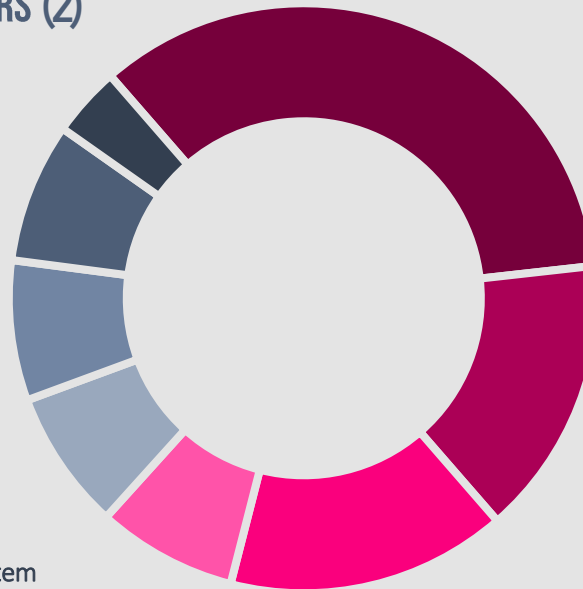
- Role in financial audit
- Role in performance audit
- Role in compliance audit

### SAIs, LOCAL AIs AND PRIVATE AUDITORS (2)

- SAIs role in financial audit
- SAIs role in performance audit
- SAIs role in compliance audit
- Local AIs role in the external audit system
- Private auditors role in the external audit system

### SAIs ONLY (4)

- Role in financial audit
- Role in performance audit
- Role in compliance audit



### SAIs, OTHER PUBLIC ENTITIES AND PRIVATE AUDITORS (4)

- SAIs role in financial audit
- SAIs role in performance audit
- SAIs role in compliance audit
- Private auditors roles in the external audit system
- Other entites roles in the external audit system

### SAIs AND OTHER PUBLIC ENTITIES (2)

- SAIs role in financial audit
- SAIs role in performance audit
- SAIs role in compliance audit
- Other entites roles in the external audit system

### LOCAL AIs AND PRIVATE AUDITORS (2)

- Local AIs role in financial audit
- Local AIs role in performance audit
- Local AIs role in compliance audit
- Private auditors role in the external audit system

### SAIs, LOCAL AIs AND OTHER PUBLIC ENTITIES (2)

- SAIs role in financial audit
- SAIs role in performance audit
- SAIs role in compliance audit
- Local AIs role in the external audit system
- Other public entites role in the external audit system

# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING SAIs AND PRIVATE AUDITORS

Municipal external audit system consisting of SAIs and private auditors is the most common practice among the TFMA countries - it is applicable in 9 out of 26 countries. The results of the survey showed that such practice is applied in **Azerbaijan, Croatia, Estonia, North Macedonia, Georgia, Greece, Latvia, Montenegro, and Serbia.**

Although both types of audit authorities operate in each of these countries, their mandate and scope are different:

- in some countries SAIs are the key players in the system and private auditors act as complementary elements of it<sup>2</sup>;
- in other countries, private auditors are the key players in external audit system and SAIs act as an additional element of it, providing methodological assistance, monitoring and/or evaluating the audits of private auditors and their results<sup>3</sup>;

In order to identify how audit institutions operate in external audit system, their interrelationships and role in the whole municipal audit system, the role of various audit institutions in financial, compliance, and performance audits was singled out.



<sup>2</sup> Azerbaijan, Georgia, Greece, North Macedonia, Montenegro, Serbia

<sup>3</sup> Estonia, Latvia

## The role of SAIs and private auditors in financial audit

Financial audit deals with determining whether financial information is presented in accordance with the applicable financial reporting and regulatory framework.

It is a common practice that municipalities prepare annual financial statements (accounts), which include information on budget execution. In TFMA countries, municipal financial statements are subject to an annual audit by at least one of the audit authorities<sup>4</sup>. The common statutory mandate of the SAIs involves assurance of the national sets of financial statements, which also include the consolidated data of local government accounts<sup>5</sup>.

In most of the TFMA counties (67%) SAIs and private auditors are involved in carrying out financial audits in municipalities. In 22% of TFMA countries only SAIs carry out financial audits of municipalities and in other 11% only private auditors are involved in them (Figure 4).

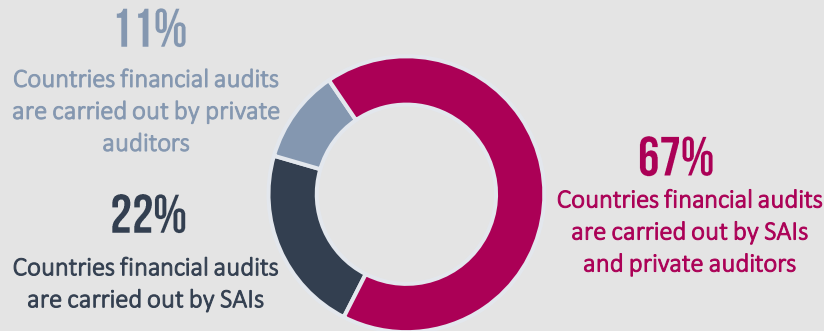


Figure 4 Conducting financial audits in municipalities



SAIs and private auditors are the most common elements of the system involved in financial audits. The role of SAIs and private auditors in conducting financial audits of municipalities varies between countries<sup>6</sup>. In some of them, the role of SAIs depends on the subject matter of the audit<sup>7</sup>.

Those who conduct financial audit along with private auditors/local auditing authorities report the inefficiency of the system due to excessive work. Proper coordination of audit engagements in local government remains a challenge. Sometimes the audit areas overlap and audits are conducted in one local government unit by several audit institutions simultaneously. As a result, much more resources are spent on ensuring an effective audit.

<sup>4</sup> SAI of North Macedonia has no legal obligation to audit the financial statements of the municipalities annually. The selection of municipalities to be audited is carried out in line with SAI Annual Program considering the scope of public expenditure at local level.

<sup>5</sup> The municipal financial statements in North Macedonia are not consolidated at national level, i.e. audited.

<sup>6</sup> For example, in the Republic of Serbia, municipalities must acquire consent from SAI before hiring private auditor. Number of municipalities to be audited by SAI is not prescribed, but rather it is determined each year by the Annual Audit Program of SAI. If financial statement audit of municipality is planned in the Annual Audit Program of SAI, SAI will not give consent for hiring private auditor. This is how SAI of Serbia avoids overlapping of audit and achieve savings. The SAI of Croatia carries out financial audit annually in selected local authorities, too. Municipalities in Croatia are obliged to prepare annual financial statements and annual reports on budget execution. They are obliged to submit them to The Ministry of Finance and the State Audit Office (SAO) according to the legislation. There are 576 local authorities in 82 out of which financial audits for the fiscal year 2016 were conducted. Financial statements of municipalities are prepared on a modified cash basis, consolidated at the national level, but the consolidated set is not audited by the SAO. Municipality audits are carried out accordingly to the annual working plan (no mandatory obligation), and then annual financial statements and annual reports on budget execution are subject to audit.

<sup>7</sup> SAIs of Azerbaijan and Montenegro can audit only government budget execution, while municipal budgets are audited by private independent auditors employed by municipalities. SAI of Latvia can audit selected municipalities based on the results of financial audits conducted by private auditors. SAI of North Macedonia has a different audit system, where municipal financial audits can only be performed by the SAI, while private auditors have the mandate to audit municipal companies.





## The role of SAIs and private auditors in performance audit

Performance audit is an examination of whether undertakings, systems, operations, programmes, activities, or organisations are operating in accordance with the principles of 3E (effectiveness, efficiency and economy) and whether there is a room for improvement in municipalities.

The analysis of performance audits shows that in the majority of the TFMA countries (56%) performance audits are conducted only by SAIs. In 22% cases – both SAIs and private auditors; in 11% - performance audits are carried out only by private auditors. In other 11 %, performance audits are not carried out in the framework of SAIs and private auditors. In this case, performance audits are carried out by local AIs (Figure 5).

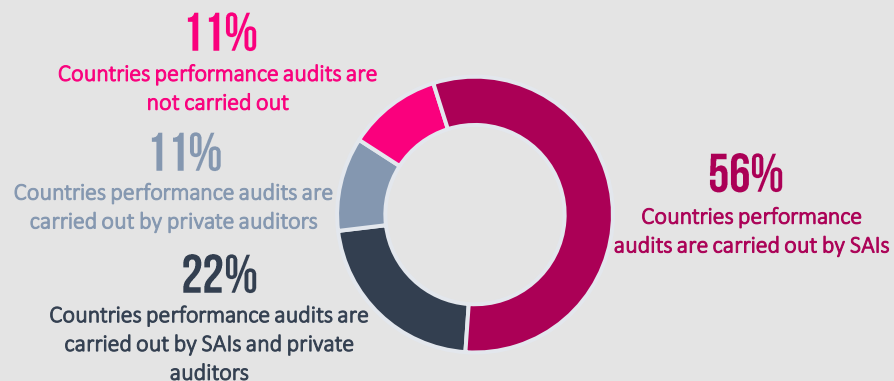


Figure 5 Conducting performance audits in municipalities

The figure shows that a greater amount of performance audits are carried out by SAIs. It is important to note that in most cases, performance audits carried out by SAIs are systemic, usually covering one or more areas, which are usually assessed in several municipalities. Meanwhile, in 1 country<sup>8</sup>, the SAI can carry out audits involving municipalities (including systemic performance audits), usually in the form of a mixture of performance and compliance audit components. It is worth mentioning that municipalities are not prohibited from hiring private auditors to carry out performance audits, but unlike financial audit, this type of audit is not mandatory for municipalities. Therefore, in practice, performance audits are not carried out by private auditors in municipalities.

Summarizing how audit entities in municipal external audit system operate in performance audits, it should be noted that performance audits are much less regulated compared to financial or compliance audits. Besides, not all states use their mandate to conduct performance audits in municipalities<sup>9</sup>.

<sup>8</sup> Estonia

<sup>9</sup> Azerbaijan, Greece, Montenegro

## The role of SAIs and private auditors in compliance audits

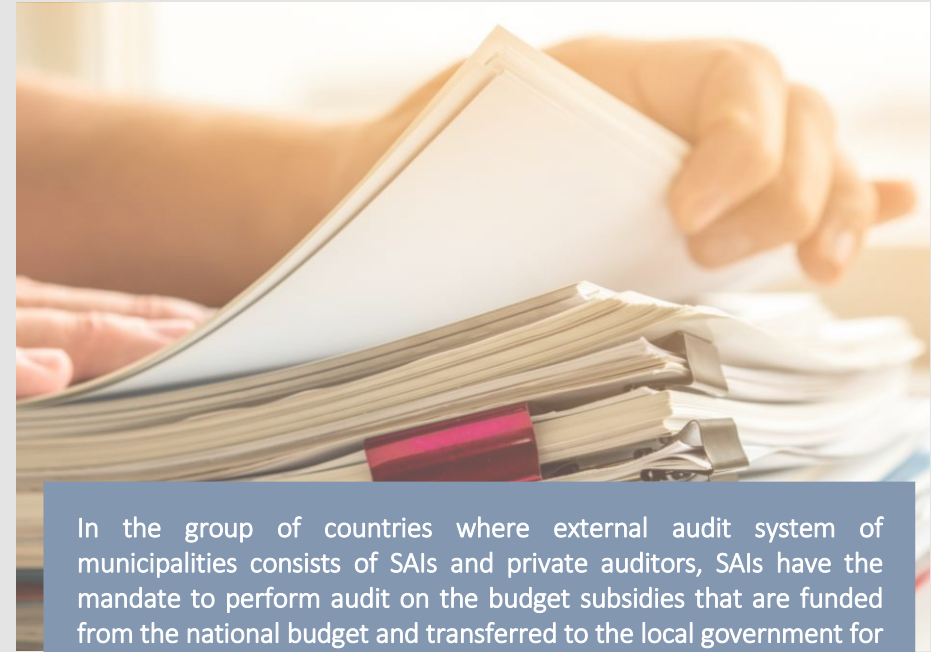
Compliance audits are performed by assessing whether activities and financial transactions are in all material respect, in compliance with the authorities which govern the audited entity.

Analysis of how SAIs and private auditors act in compliance audits shows that in more than a half (in 6 out of 9 countries, or 67%) of the countries belonging to this type of external audit system compliance audits in municipalities are conducted only by SAIs. In the other 3 countries (33%) compliance audits in municipalities can be conducted by both— SAIs and private auditors (Figure 6).



Figure 6 Conducting compliance audits in municipalities

Besides, not all SAIs use their mandate to perform compliance audits in municipalities<sup>10</sup>.



In the group of countries where external audit system of municipalities consists of SAIs and private auditors, SAIs have the mandate to perform audit on the budget subsidies that are funded from the national budget and transferred to the local government for specific purposes but this does not entail the SAIs' power to audit local government revenues and expenditures<sup>11</sup>.

SAIs are usually not involved in selecting private auditors, but they may review their work and identify weaknesses in the audit practice, exchange the information and perform joint learning activities.

Some SAIs from the countries where private auditors audit municipalities report the lack of the effectiveness of the system<sup>12</sup>.

<sup>10</sup> Austria, Azerbaijan

<sup>11</sup> For instance, in the Republic of Serbia, SAI conducts audit in accordance with annual program which it adopts independently and which determines auditees, subject, scope and type of auditing, outset and duration of compliance audits. SAI Serbia has mandate to audit public enterprises founded by local authorities, and other legal entities related to auditee. SAI of Serbia is obliged to, if it detects material activity pointing to elements of misdemeanor, and/or criminal offense, submit request for initiating misdemeanor, and/or criminal charge to competent authority. Also in case there is a damage to public property, SAI should inform public prosecutor of that fact.

<sup>12</sup> For instance, Estonian SAI notes that private auditors work is not effective enough as repetitive deficiencies of financial statements appear. This could be due to the fact that financial report of municipality is often issued with a clean opinion, yet there are some significant deficiencies from the public sector point of view, but auditors do not focus on it because the deficiencies identified are smaller than the materiality. For this reason, auditors do not emphasize it.



# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING ONLY SAIs

External audit system where audits are performed only by SAIs is applicable in 4 out of 26 TFMA member countries. This group of countries includes **Albania, Italy, Romania, and Turkey**.

## The role of SAIs in financial audits

The SAIs of these countries have a mandate to carry out financial audits of local governments and companies controlled by them.

The SAI of Albania carries out financial audit annually in selected local authorities.

The SAI of Romania audits annually a number of municipalities, following the rule that counties and big towns are audited yearly and small local administrative units like communes are audited at least once every 3 years.

Turkey has one particular feature - financial audits are part of regularity audits. The SAI of Turkey regularly (annually) reviews whether municipal revenues and expenditures comply with laws and whether municipal assets are protected. If an audit shows that the public resources incurred a loss, a recovery decision is returned. The recovery decision of the Court of Accounts has the effect of a court order and is not subject to appeal<sup>13</sup>.

Financial audits on selected local government units according to the annual audit plan are carried out in 50% of the group (Albania and Romania). Financial audits in all local government units are carried out in 50% of the group (Turkey and Italy) (Figure 7), but there are some differences between Turkey and Italy. Financial audits in Italy are carried out in municipalities having more than 15,000 citizens while in Turkey financial audits are carried out in all local government units without exception.



Figure 7 SAIs conducting financial audits in municipalities

Financial statements and budget execution are the objects of financial audit for all countries in the group. Grants are the objects of financial audit too, except for Turkey. Grants are not the object of the audit during the regularity audit of the Turkish SAI.

<sup>13</sup> Judicial reports concerning the public losses detected in the course of audits are decided on by the chambers of trial, each of which is a court of accounts. There are 8 chambers in the SAI of Turkey. The final decision body of the writs issued by the chambers is the Board of Appeals of the SAI of Turkey. Appeal is possible against the decisions of the chambers. Office of the Chief Prosecutor of the SAI of Turkey takes part in the trial process, as well.

## The role of SAIs in performance audits

All SAIs of the group have a mandate to carry out performance audit in local governments. In all countries of the group, subjects of performance audits vary. Albania, Romania, and Italy have a mandate to assess the use of local government funds and assets 3E. In the case of the Turkish SAI performance audit (3E) is called thematic audit. Turkish SAI carries out performance audits in local governments and municipality affiliated entities.

The SAIs of the countries belonging to the group have a right to audit local authorities, bodies set up by them, and other public and private legal entities to which the public authority has provided funds or transferred assets in the context of performance audits. Performance audits carried out by the SAI of Italy involves the entire activity of public administrations including acts, operations, behaviour to verify the compliance of the results with the objectives established by the law. The audit takes into consideration and evaluates costs, methods and time of the implementation of the administrative action. It concerns both legitimacy aspects and the efficiency, effectiveness, and economic parameters of the administrative action. By conducting performance audits, the SAI of Italy also ascertains the functioning of the internal controls. All SAIs in the group prepare performance audit reports which are submitted to the local authorities.



## The role of SAIs in compliance audits

All SAIs of the group have a mandate to perform compliance audit of local governments and their controlled companies, but Romania and Turkey have specific characteristics. The SAI of Romania carries out compliance audits involving examining and overseeing the observance of the law on the establishment, management, and use of public funds. The Turkish SAI's compliance audit is part of regularity audit. The subject matter of compliance audits of SAIs in this group is different. Compliance audits performed by the SAI of Albania cover budget execution, procurement, local government revenue and expenditure, and asset management. Compliance audits of the SAI of Romania focus on the allocation, management, and use of financial resources. The Turkish SAI carries out compliance audit through determining whether revenues, expenditures, and assets of public administrations, as well as accounts and transactions pertaining to those are following laws and other legal arrangements. If audit shows that the public resources incurred a loss, a recovery decision is returned which has the effect of a court order and is not subject to appeal<sup>14</sup>. If public loss is identified during the audit of the accounts and transactions of local governments, a judicial report is prepared for the trial of the account which means taking final decision by judicial procedure on whether the accounts and transactions of those responsible specified in laws are following the legislation, and the legal remedies related to this.

In all cases, the SAIs do not have sufficient resources to cover all municipalities on an annual basis, therefore,



apply a sample approach to the selection of municipalities. Due to resource constraints and a large number of municipalities, some SAIs perform an audit in municipalities on a sample-based covering which accounts for a certain percentage of local authorities audited annually. The systematic information on the scope and results of the audit in municipalities is unknown. As a matter of accountability, financial statements should be audited annually. Leaving financial statements unaudited for a year significantly complicates subsequent audit procedures and does not contribute to consistent accountability. Therefore, the model leads to an irregular financial audit of municipal accounts where coordinated and effective control of public financial management in municipalities might not be ensured. In contrast, the advantage of the model is that SAIs which are highly qualified in public sector auditing maintain the responsibility on local government auditing and can evaluate the emerging risks from local to global (at the level of the entire state).

<sup>14</sup> The final decision body of the writs issued by the chambers is the Board of Appeals of the Turkey SAI. Appeal is possible against the decisions of the chambers.

# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING SAIs, OTHER ENTITIES OF THE PUBLIC SECTOR, AND PRIVATE AUDITORS

Municipal external audit system involving SAIs, other entities of the public sector, and private auditors is applicable in 4 out of the 26 countries. The results of the study showed that such system exists in **Bulgaria, Portugal, Slovakia** and **Slovenia**.

## The role of SAIs in financial audits

All SAIs in this group have mandates to conduct financial audits. They can be performed in the local government, their controlled companies, and other legal entities that provide public services and are controlled by the local government. Financial audit of these SAIs aims at assessing the use of own funds, state budget funds, budget execution, local indebtedness level, financial liabilities, and financial statements. However, some differences appear among countries of this group. For instance, the SAI of Bulgaria carries out financial audits of the annual financial reports of budgetary organizations, which covers the previous year. Also, the SAI of Bulgaria carries out financial audits of the annual financial statements of municipalities, in which the total amount of reported budget expenditure, accounts for European Union funds, and accounts for non-treasury funds for the previous year exceeds 10 million levs. The SAI of Bulgaria carries out financial audits of annual financial statements of municipalities in which the total amount of reported budget expenditure, accounts for EU funds, and accounts for non-treasury funds for the previous year do not exceed 10 million levs as often as the SAI of Bulgaria determines or on the basis of risk assessments.

The SAI of Portugal can audit all local public entities (municipalities, civil parishes, municipal enterprises, local public associations or other state-controlled public bodies) or private entities that manage or use public money. The SAI of Portugal carries out financial audits only in selected local authorities. Due to the financial and economic crisis in the last few years, the SAI of Portugal has conducted financial audits mainly in the scope of local indebtedness level, total debt, budget execution, public procurement, and financial liabilities.

Financial audits of the SAI of Slovakia are usually performed as combined audits: financial and compliance audits. Financial audits are carried out according to annual audit plan and only in selected local authorities.

The SAI of Slovenia has the mandate, but in practice such audits, as separate ones, with an issued opinion on financial statements of the municipality, have not been performed for quite some time now - since 2006. Financial statements can be examined within performance or compliance audits but no separate opinion on financial statements is given.



## The role of SAIs in performance audits

SAIs in all countries of this group have a mandate to execute performance audits in local authorities, their controlled companies and other legal entities (public or private) to which the local authorities have allocated funds or has entrusted property to the administration. The similarity between the countries of this group is that all SAIs have a mandate to audit 3E of the use of local governments' funds and assets.

The SAI of Bulgaria carries out performance audits on designated topics appointed in accordance with the strategic targets and annual audit programme. Performance audit examines the activities related to the planning, implementation, and control at all levels of the auditee's management taking into account the principles of 3E. SAI of Portugal in accordance with the annual working plan conducts performance audits to assess whether budget and asset management or specific programs are in line with the principles of 3E.



The scope of performance audits carried out by the SAI of Slovenia is not limited and includes 3E principles of using local governments' funds and assets.

The SAI of Slovakia has one special feature: it mostly carries out performance audits as combined performance and compliance audits. Depending on the audit topic, one or more of 3E components are examined.

There is one more similarity - all SAIs perform horizontal audits that cover one topic in several chosen municipalities.

The SAIs of Bulgaria, Slovenia, and Portugal can also carry out performance audits the scope of which is limited to one local authority. The SAI of Slovenia may conduct audits that cover both local authorities and central government institutions, which are forming policies in certain areas (e. g., ministries, the government).

## The role of SAIs in compliance audits

SAIs in all countries of this group have a mandate to conduct compliance audits in local authorities. The scope of compliance audit performed by the SAI of Portugal involves budget execution, public procurement, and programs established by the law.

The scope of compliance audits performed by the SAI of Slovakia depends on the audited topic - compliance with the applicable law on the subject. The scope in audited local authorities is budget execution, financial statements, use of local governments' funds, and assets.

The scope of compliance audits performed by the SAI of Slovenia is not limited. It also audits financial statements in parallel to ensure that important findings are addressed in audit reports, if irregularities in data recording are noticed, and, where appropriate, referred to the ministry as a systemic issue.

Compliance audits carried out by the SAI of Bulgaria are set in accordance with the annual programme for audit activity. Compliance audits examine the systems of financial management and control, internal audit, and management decisions of local governments related to planning, organization, management, reporting, and control of public finances, assets, and activities.





## The role of private auditors in external audit system of local government

There are some similarities between Slovakia and Portugal in hiring private auditors. In Slovakia, financial statements of all municipalities are the subject matter of private auditors' audits every year. When auditing the financial statements, private auditors also verify compliance of defined obligations of the Act on the Budgetary Rules. Private auditors may also audit municipality-owned enterprises. In Portugal, according to Local Financial Law annual accounts of municipalities, municipality-owned enterprises and municipal local associations must be audited and certified by private auditors. For this reason, municipalities and municipality-owned enterprises appoint private certified auditors to certify their financial statements.



There are some similarities between Slovenia and Portugal in hiring private auditors too. In Slovenia, private auditors are hired by municipality-owned enterprises or public institutions by public procurement procedures. They may be appointed to audit municipality-owned enterprises or institutions, public funds, and agencies. For some of these enterprises/institutions these audits are compulsory and for some they are not (depending on the size of enterprises and the type of organisation). Private auditors mostly are appointed to carry out an audit of annual financial statements of municipality-owned enterprises/public institutions. Additionally, municipalities may hire private auditors to conduct external/internal audit of its performance.

In Bulgaria, local authority-owned enterprises or with the ones where local authority participates in its capital are obliged to hire private auditors to examine their annual financial statements. The implementation of municipal projects co-financed by the EU is also subject to the verification of private auditors. In addition to audits mentioned above, municipalities may appoint private auditors to carry out an external audit of the performance of all municipal activities or if they deem it necessary for any specific purposes.

## The role of other entities of the public sector in external audit system of local government

Other entities of the public sector take part in the external audit system of local government in all countries of the group. There is a similarity between the countries of this group: Bulgarian, Portuguese and Slovenian Ministries of Finance control entities of the public sector which participate in external audit system of local government.

The Bulgarian Public Financial Inspection Agency (PFIA) controlled by the Minister of Finance participates in external audit system of local government. The agency has a mandate to carry out ex-post financial inspections of public organizations, including municipal and district administrations, on the observance of national legislation related to the budgetary, financial-economic and accounting activities. Upon ascertainment of legislative infringements, frauds and property damages within the inspected organizations, the PFIA has the legal authority to impose administrative and financial sanctions against the liable person. The agency is also authorized to impose administrative or financial sanctions related to public procurement. Financial inspections are appointed under the following circumstances: complaints and signals for infringement of budgetary, financial-economic and accounting activities initiated by the governmental bodies, individuals and private enterprises, requests by the Public Procurement Agency or National Audit Office, Council of Ministers or the minister of finance, in particular cases determined by legislation, assignments by the Prosecutor's bodies.



The Portuguese General State Inspector is a service of the Ministry of Finance integrated into the direct administration of the State, with administrative autonomy, directly accountable to the Minister of Finance, responsible for ensuring the strategic control of the state financial management, whose mandate includes performing compliance, financial, and performance audits.

Its intervention covers all entities of the public administrative and business sector, including local authorities, as well as the private and cooperative sectors, in this case, when they are subject to financial or tax relations with the State or the European Union (EU), or when it proves indispensable to the indirect control of any entities covered by its action.

The Slovenian Budget Supervision Service of the Ministry of Finance participates in external audit system of local government too. The main tasks of this office are in the field of spending of the EU funds (e.g., it performs pre-accreditation reviews, independent controls, certifies declarations of expenditures, reports to the European Commission on irregularities regarding the use of EU funds) and it is also a central body of the public internal financial control system (responsible for the development, harmonization, and supervision of the financial management and internal control as well as internal audit system of direct and indirect budget spending center's on the central and local level). An important part of its activities is also budgetary inspection, where among others, it also performs inspections of the use of state budget funds allocated to municipalities.

The Slovak public sector entities, such as respective ministries, Governmental Audit Office or Public Procurement Office are also part of the external audit system of local government. The first two institutions audit the management and use of the state budget and EU funds in municipalities according to their audit plans.

# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING SAIs, LOCAL AIs AND OTHER ENTITIES OF THE PUBLIC SECTOR

An external audit system where audits are performed by SAIs, local AIs and other entities of the public sector is place in **Austria** and **Poland**. In this model regional audit institutions are established by the government or regional legislature. These regional institutions perform financial audit of municipalities every year<sup>15</sup>. These institutions are overseeing a group of municipalities under their regional oversight.

## The role of SAIs in financial audits

The SAIs of Austria and Poland may carry out financial audits in local authorities, but there is some difference between them. The SAI of Poland may audit the activity of all local authorities including their controlled companies while the mandate of the SAI of Austria is limited to local authorities with at least 10.000 inhabitants. In Austria, municipalities have the legal obligation to prepare a financial statement annually. It includes information on the execution of the budget. Mandatorily, the Austrian SAI does only audit the financial statement at the federal level, but not those municipalities or provinces, even though it would be allowed to do so. However, so far, the SAI of Austria has not conducted financial audits in municipalities.

The SAI of Poland conducts annually a financial audit regarding the state budget execution on a selected sample of local government units, in compliance with the requirements set in the audit methodology, i.e., concerning the criteria for the selection of audited entities. The subject of financial audit of local government units encompasses the annual examination of the state budget execution, including subsidies granted to the local government from the state budget. It is also possible to examine other aspects of financial activity of particular local government units, provided that, according to the risk analysis, irregularities in this area may occur. Municipal, districts', and provinces' financial statements are consolidated at the national level and audited by the SAI of Poland.



<sup>15</sup> In Austria not all municipalities every year.

## The role of SAIs in performance audits

The SAIs of Austria and Poland may carry out performance audits in local authorities. Both SAIs have a mandate to audit 3E of the use of local governments' funds and assets.

Performance audit carried out by the SAI of Austria can affect multiple levels, e.g., "fiscal rules" or "quality of budget data" are audit topics which include the federal level, the province, and the municipal level. Generally, the task which a performance audit fulfils is to elaborate on cross-cutting issues.

The SAI of Poland conducts performance audit based on risk analysis, in the course of which entities most prone to the risk are selected. Risk analysis is conducted both in general (planned audits) as well as detailed (*ad-hoc* audits) aspects. The performance audit is based on decisions made by the legislator or on objectives they have designated and can be carried out throughout the public sector. Such audit may concern one subject in several local government units (most often in case of planned audits) as well as in one unit (in case of *ad-hoc* audits).



## The role of SAIs in compliance audits

The SAIs of Austria and Poland may carry out compliance audit in local authorities. The SAI of Poland conducts compliance audit regarding all activity areas of local government units. The SAI of Austria so far has not carried out compliance audits in municipalities. However, during performance audits, this is always a side aspect.

## The role of local audit institutions in external audit system of local government

Local AIs in Austria are Provinces' courts of audit and Provinces' supervisory authorities. The local audit institution in Poland is Regional Accounting Offices. There are some similarities and differences between these institutions. Both of them may carry out financial audits in local authorities. For Provinces' courts of audit in Austria and Regional Accounting Offices in Poland, compliance audit is a side aspect of financial/performance audits. Austrian Provinces' courts of audit may carry out audits of the provinces, municipalities, and their owned enterprises and entities. However, the mandate to audit certain institutions differs depending on the province. Austrian Provinces' courts audits are selected in an impact and risk-oriented manner. Audits performed by the Regional courts of audit must regularly look at the accuracy of figures and compliance with current regulations (legality). Also, they must ensure that financial management is carried out economically, efficiently, effectively and in accordance with constitutional provisions and the regulations of the various acts governing regional courts of audit, which are by and large identical. Regional Courts of audit controls are now focusing more and more on performance audits, with the effectiveness and efficiency of government operations increasingly coming under the spotlight as a benchmark for action and success. The determining elements for evaluating performance and assessing efficiency are the predetermined objectives, the resources employed and the result achieved. Typically, the scope of a single audit is limited to one municipality of the province. Austrian Provinces' supervisory authorities are municipality supervision units, which carry out regular audits of the budget execution of every municipality, audit of financial statements, debt management, etc. They are regionally different, but have a mandate and are obliged by the federal constitution to audit and supervise all municipalities within a province according to the regulation in provinces' law. As a supervisory authority within the administration, their mandate is not free, also they have limited mandates in terms of municipality-owned enterprises. The main audit activity of these authorities is to perform financial audit of municipalities. They carry out regular audits of the budget execution of each municipality (with some exceptions regarding statutory towns, which have their own control offices), audit financial statements, debt management, also give their approval regarding municipal budgets and taking out loans.

Regional Accounting Offices of Poland were established on the basis of the Polish Constitution as supervision bodies of local government units' financial matters. While the SAI of Poland annually performs financial audit regarding the state budget execution on a selected sample of local government units, comprehensive audit of each local government unit in a given province is conducted every four years by the Regional Accounting Offices. They have the mandate to audit financial management and public procurement. Audits are conducted in local authorities, local government organisational units, municipal companies, and other entities regarding their use of the subsidies granted from the local government budgets. According to the law, comprehensive audits of each local government unit in a given province are conducted every four years. The audit encompasses all local government units in the province. Audits are conducted on the basis of the annual plan. Regional Accounting Offices conduct financial audit, including some aspects of compliance and performance audit. The audit encompasses the entire financial management of local government units. The financial audit is mainly aimed at checking the compliance with the law and compliance of accounts with facts regarding the following activity areas of the local government units: managerial audit, external audit, accounting, preparation of financial statements and budgetary reports, stocktaking, and budget execution. Regional Accounting Offices also audit current expenditure related to public procurement and municipal investment tasks.

## The role of other entities of the public sector in external audit system of local government

The activity of the local government units in Poland is subject to the audit of other entities, such as tax services, National Labour Inspectorate and other national inspectorates/services that may also audit local government units. Empowerments of particular entities result from the regulations defining their organisation and competences.

The supervision over the local government units is exercised by the Prime Minister and province governors. The administrative audit is performed by government institutions, in particular the Province Offices (Province Governor), which represent the government administration in the province. The Province Governor audits the performance of government administration tasks performed by the local government bodies on the basis of legal acts or agreements. Supervision bodies (Province Governor) are entitled to request information on the functioning and organisation of the local government. Local government bodies have to present their decisions to the supervision bodies, which can revoke these decisions, dismiss the local government body, and establish a commissary municipal board.

The Austrian local government external audit system involves the provincial administration departments as a supervisory authority, which in some provinces cooperate with the district authorities.



# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING LOCAL AIs AND PRIVATE AUDITORS

Municipal external audit system involving local and private auditors exists only in 2 out of the 26 countries. The SAI of **Bosnia and Herzegovina** and the SAI of **Finland** do not have a mandate to carry out audits in local authorities. In both countries, audits in local authorities are carried out by local audit institutions.



## The role of local audit institutions in financial audits

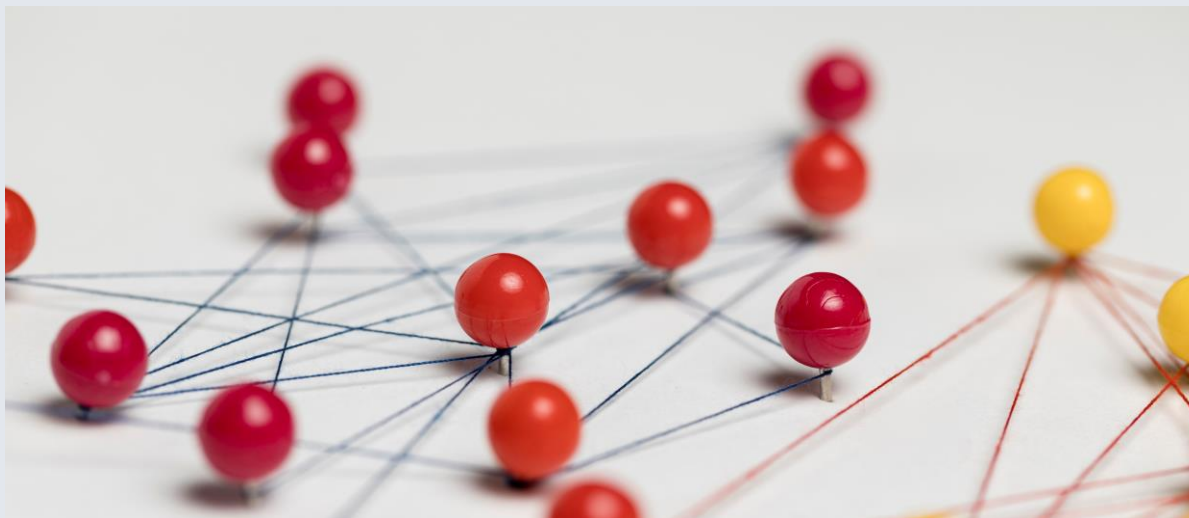
Local audit institutions in Bosnia and Herzegovina may carry out financial audit in local authorities including their controlled companies. Financial audit is carried out in selected local authorities in accordance with the annual audit plan. The subject of financial audit is financial statements, including reports on the execution of municipal budgets.

Each local authority in Finland has to have an audit committee. Local councils set up a local authority audit committee to arrange audits and assessments of the administration and finances. These committees are nominated by local councils and their members are local persons elected by the council to a position of trust, not professional auditors. The committee's chairperson and deputy chairperson are also appointed by the local council from its members. The audit committee receives funding from the local council and is accountable to it. Also, it has no mandate to carry out financial audits.

## The role of local audit institutions in performance audits

Local audit institutions in Bosnia and Herzegovina may carry out performance audit. The subject of performance audits depends on the topic and goals that are determined by the annual audit plan. Usually, such audits include activities and processes related to the use and management of resources, the provision of services, the implementation of functions, etc. Performance audits of a specific topic/area, which may include a certain number of local government units, chosen on a sample basis. Local audit institutions carry out performance audits regarding a review of the economy, efficiency, and effectiveness of the use of assets and property of municipalities.

Performance audit is one of the main audits conducted by Finnish local authority an audit committee. Audits may be performed in municipalities, municipality-owned enterprises, and joint municipalities. While conducting performance audits, the local authority audit committee assesses the extent to which the operating and financial targets set by the local council have been achieved in the municipality and the local authority corporation, and whether or not the activities are arranged in a cost-effective and appropriate manner.



## The role of local audit institutions in compliance audits

Local audit institutions may also carry out compliance audit in local authorities of Bosnia and Herzegovina. However, as compliance audit is carried out together with the audit of the financial statements, the subject of the audit is the management and use of grants from higher levels of government and the use of other funds, resources, assets, etc. The compliance audit is conducted in selected municipalities according to the annual plan. The subject of the audit is activities, transactions, and information presented in the financial statements (including a report on budget execution), the management and use of grants from higher levels of government, the use of other funds and assets. Since financial audits and compliance audits are not carried out separately, the criteria for auditing compliance are determined during audit planning.



## The role of private auditors in external audit system of local government

The role of private auditors in external system of local authorities audit in Bosnia and Herzegovina and Finland is almost identical.

In Bosnia and Herzegovina, private auditors can audit public enterprises controlled by local authorities. Financial reports and consolidated financial statements of medium and large public enterprises established by municipalities are subject to the mandatory annual audit in accordance with the law. Financial audits are performed by auditing companies from the private sector that are engaged in accordance with the law. Private financial auditors may audit local authorities. However, so far it has not been a practice for municipalities to engage a commercial auditor on their own initiative. Municipalities are audited only by local audit institutions in accordance with the annual audit plan.



In Finland, private financial auditors annually audit the municipal financial statements which include consolidated financial statements of municipalities and municipality-owned enterprises. Within financial audit, the auditor's task is also to audit whether the administration of the municipality has acted according to laws and decisions of the local council (i.e., compliance audit). For the audit of the administration and finances, the local council appoints a firm of authorised public accountants, which must be approved by the Board of Chartered Public Finance Auditing. The chartered public finance auditing corporation must appoint a chartered public finance auditor as a responsible auditor. According to law, the same audit corporation should audit the municipality-owned enterprises as well (unless there are good reasons related to carrying out audit for organising otherwise). Financial auditor is chosen according to the rules of public procurement and paid from the municipality's budget. If auditors find substantive/material irregularities already during the audit, they have to give immediate notification to the municipal executive, and additionally inform the audit committee.

After the audit, private Finnish auditors can address recommendations to any municipal entity except the council. Private auditors also conduct financial audits of regional councils.

# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING SAIs AND OTHER PUBLIC ENTITIES

Municipal external audit system with the structure consisting of SAIs and other public entities is applicable in 2 out of 26 countries. SAIs of **Ukraine** and **Israel** may carry out audits in local authorities, but there is a difference based on the mandate of SAIs.

The SAI of Israel has a mandate to perform audits in all local authorities including their controlled companies, institutions, funds or other bodies supported, directly or indirectly, by a local authority.

The SAI of Ukraine has a mandate to perform audits in all local authorities and local governments, inter alia, in those enterprises operating under their jurisdiction, entities and organizations, if they receive and use state budget funds, including transfers from the state budget to local budgets (grants and subventions), or regardless of the local governments' request of to audit specific local budgets and the activities of the requested entities.

## The role of SAIs in financial audits

Both SAIs may carry out financial audit in local authorities.

The SAI of Israel does not audit financial statements of local authorities since that specific task is performed by the Ministry of the Interior. It is important to note that various aspects of financial management are audited, such as the running of a development project's budget or the way how local authority manages its financial investments.



The SAI of Ukraine is not authorized to conduct the financial audit of local budget expenditures; therefore, it may conduct such an audit only at the request of local self-government authorities, or in terms of expenditures determined by the functions of the state and delegated to local self government. The Law on the SAI of Ukraine does not provide for an obligation to conduct annual financial audit in all local authorities.



### The role of SAIs in compliance audits

In relation to the compliance audit, there are some differences between both SAIs. The SAI of Israel may carry out compliance audit in local authorities and define compliance audit broadly, namely, as a comprehensive review of local authorities' adherence to legal and regulatory guidelines not necessarily in the budget and funding sphere. This includes, among others, legality, moral integrity, and orderly management.

The Law on the SAI of Ukraine does not envisage the compliance audit as a separate type of audit, but its elements are used when financial and performance auditing.

### The role of SAIs in performance audits

The SAI of Israel may carry out performance audit in local authorities and has a mandate to audit 3E of the use of local governments' funds and assets, while the SAI of Ukraine has a mandate to audit efficiency of the use of the funds of the state budget by the local governments and local self-government authorities, inter alia, by those enterprises operating under their jurisdiction, entities and organizations, transfers from the state budget to local budgets (grants, subventions), and the use of the funds of the local budgets in terms of expenditures determined by the functions of the state and delegated to local self-government authorities for fulfillment.

Also, the SAI of Israel has a special activity in performance audit. It may perform a short inquiry into a specific subject not included in the annual audit plan. Such an inquiry may be held where received information requires immediate response by an initial investigation. The findings may serve as a basis for future, enlarged audit tasks.

Both SAIs carry out performance audit which covers one topic in all local authorities of the country or several of them.



## The role of other entities of the public sector in external audit system of local government

The Ministry of the Interior of Israel, State Audit Service of Ukraine and State Fiscal Service of Ukraine are involved in municipal external audit system. There are some differences based on the activity of the mentioned institutions.

The Ministry of the Interior of Israel hires private auditors, who are appointed to carry out the audit of the annual financial statements of local authorities and all other external audits required by the Ministry. Private auditors may audit all local authorities including their controlled companies. The SAI of Israel and all other entities of external municipal audit system are not required by law to coordinate strategies with each other. However, aiming at saving taxpayer's money, the SAI of Israel provides the Ministry of the Interior with its annual work plan in order to prevent overlapping audits. The SAI of Israel receives and analyses all the reports published by the Ministry of the Interior, some of which serve as a basis for the planning of the annual work plan. If a specific query arises, the SAI of Israel may refer it to the Ministry for clarification, but it never corresponds with the private auditors.



The State Audit Service of Ukraine, the State Fiscal Service of Ukraine and the State Treasury Service of Ukraine have the power and functions that are endowed to the SAI of Ukraine in terms of control over compliance with budgetary legislation. By the law they are central executive bodies whose activities are directed and coordinated by the Cabinet of Ministers of Ukraine and the Ministry of Finance.

In accordance with the mandated tasks and regulation, the State Audit Service of Ukraine exercises a public financial control by conducting a public financial audit, procurement checks, inspection (revision) and monitoring of procurements at all stages of the budget process concerning state and local budgets.

The State Fiscal Service of Ukraine implements the state tax policy, state policy in the field of state customs, administration of a single contribution to the compulsory state social insurance, in the field of combating offenses when application of tax, customs legislation and legislation on payment of a single contribution .

The State Treasury Service of Ukraine implements the state policy in the field of treasury servicing of budget funds, accounting of budget execution, in particular, controls the accounting of revenues and expenditures of state and local budgets, preparation and submission by commodity managers and beneficiaries of budget funds of financial and budgetary reporting.

SAI of Ukraine may engage the employees of these services to joint activities.

A financial audit and performance audit of the same the local authority or local self-government authorities may be conducted by the SAI of Ukraine and the State Audit Service of Ukraine. Cooperation between these institutions consists of mutual use of materials.

# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING SAIs, LOCAL AIs, AND PRIVATE AUDITORS

The SAIs of **Lithuania** and **Spain** may carry out audits in local authorities. Also, both SAIs can perform audits in all local authorities including their controlled companies and other legal entities, to which the municipal institution has allocated funds or transferred property. There is a difference between these SAIs in carrying out financial and compliance audit in local authorities.

## The role of SAIs in financial audits

The SAI of Lithuania may carry out financial audit in local authorities but it does not audit the financial statements of individual municipalities. Financial statements of all Lithuanian municipalities are consolidated into the set of national financial statements. Auditing the latter is the annual responsibility of the SAI, imposed by law.

The SAI of Spain carries out financial audits in selected local authorities the number of which depends on the annual audit programme of the SAI. Usually, the SAI of Spain carries out horizontal audits (a certain topic with local budget implications is analysed at the same time in many local entities) which have financial scope, though normally the audits are not only financial but performance and compliance as well.



## The role of SAIs in performance audits

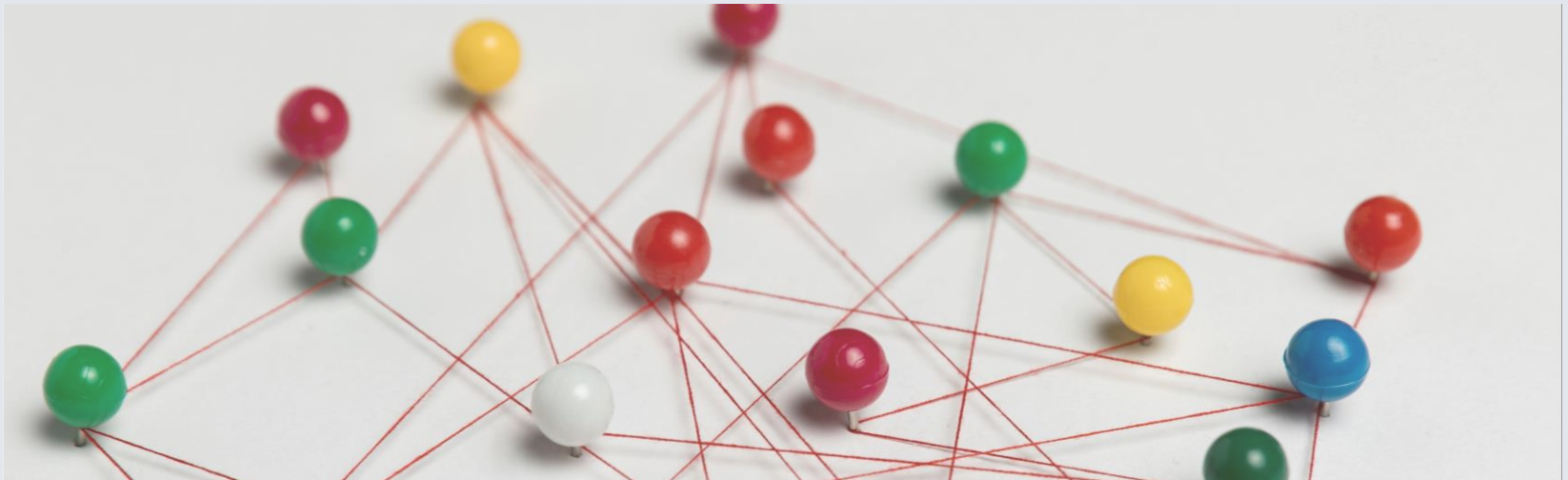
The SAIs of Lithuania and Spain may carry out performance audit in local authorities. The main similarity between them is that they have a mandate to audit 3E of the use of local governments' funds and assets. Also, both SAIs carry out performance audit which covers the same topic in all local authorities of the country or several of them.

## The role of SAIs in compliance audits

The SAIs of Lithuania and Spain may carry out compliance audit in local authorities, but the legal regulation and applicable practice in the SAIs of Lithuania and Spain differ.

The law on the SAI of Lithuania does not distinguish compliance as a separate type of audit, however, it states that the SAI supervises the lawfulness and effectiveness of the management and use of the state property and the use of state budget funds allocated to municipal budgets. The SAI of Lithuania may also audit municipal budget execution, local governments' funds and assets if this is established in the annual audit plan. In the current practice, it carries out compliance audit together with financial audit of the consolidated state budget execution statements and evaluates the use of State grants allocated to municipalities. The aspects of compliance are also evaluated in conducting performance audits.

The SAI of Spain defines compliance audit as checking the entity's management system and procedures as well as a comprehensive review of an organization's adherence to regulatory guidelines. The SAI of Spain carries out compliance audit together with financial and performance audits in selected local authorities the number of which depends on the annual audit programme of the SAI.



## The role of local audit institutions in external audit system of local government

Local audit institutions in Spain and Lithuania may also carry out audits in local authorities. In both countries, local audit institutions may carry out audits on activities of local authorities without prejudice to the exercise by the SAI in its function over the entire public sector at state, regional and local levels. Local audit institutions of Spain and Lithuania cooperate closely with the SAIs.

The SAI of Lithuania cooperates with local audit institutions mainly in the spheres of financial and compliance audits to avoid duplication of activities, to cover a wider scope simultaneously, and to exploit resources more efficiently. The SAI of Lithuania has taken the first steps in carrying out performance audits together with local audit institutions. Cooperation forms also include the use of common methodology, exchange of risks, coordination of strategies, and collaboration in a particular audit.

The SAI of Spain provides for the existence of coordination measures between the SAI and local audit institutions by establishing common criteria and audit techniques to ensure greater efficiency in the results, avoid duplication in audit activities, and sharing information. The SAI of Spain uses the information included in local audit institutions' reports if it is relevant for an audit, mentioning where the information comes from. Also, it is important to note, that the SAI of Spain and the regional audit institutions have carried out cooperative audits, such as environmental audit, land public property audit, internal control function in municipalities audit, municipal markets, and slaughterhouses audit.

## The role of private auditors in external audit system of local government

There are some similarities between Lithuania and Spain in hiring private auditors. In both countries, every single local authority has a right to hire private auditors. In Spain, the role of private auditors is restrictive. They have two different functions: to audit foundations and owned enterprises (meeting certain requirements established by law) and occasionally, the municipalities can hire their services, but it doesn't happen so often. It is mandatory for some enterprises and foundations (it depends on certain parameters established by the law such as the number of workers, business volume, etc.). In both countries, private auditors mainly are appointed to carry out audits of annual financial statements of municipality owned enterprises when it is required by law. Private auditors usually prepare an opinion on financial statements of municipality owned enterprises that are addressed to the municipality and audited entity. Additionally, in Lithuania, local authority may hire private auditors to conduct external performance audit of municipality owned enterprises, if they decide it is necessary for specific purposes.



# MUNICIPAL EXTERNAL AUDIT SYSTEM INVOLVING ALL TYPES OF AUDIT ENTITIES

External audit system that consists of all types of audit entities – State Audit Office (SAO), Government’s (territorial) offices, State Treasury, and private auditors – is quite rare among TFMA countries and such system exists only in **Hungary**.

## The role of audit entities in financial audits

The SAI of Hungary and Government’s (territorial) offices have a mandate to perform compliance audits. The scope of the compliance audits conducted by the SAI covers regularity of the internal control system, the financial management (i.e., budget execution, use and management of state grants, local governments’ funds, assets, and properties), and also regular and regulated operation (preparation of financial statements, internal regulations, processes, decision making and execution, due provision of public services, integrity, etc.). Government’s (territorial) offices are supervising and auditing the legality of operation and activities of municipalities (e.g., conformity of decision making with the law, budgeting or executive processes). While conducting financial audit, the Hungarian State Treasury assesses whether yearly financial statements on the execution of municipal budget meet legal requirements.



## The role of audit entities in performance audits

Performance audit scope, evaluation of management performance carried out by the SAI of Hungary is included in serial audits relating to municipality institutions or municipality-owned enterprises. Further performance audits are subject to individual planning on a case-by-case basis, extending to any county or municipality. The performance audits (carried out via modules) evaluate the performance categories (effectiveness, expediency, efficiency, economy) in terms of the whole organisation and certain parts thereof (including amongs others: performance of the economic area and management performance).

The SAI of Hungary presents audit results in audit reports, which are published on the official website. In addition, they are sent to the Parliament and all responsible parties. Audit opinion by private auditors on the financial statements is submitted to the supreme governing body of the mandating entity (Shareholder’s meeting in case of enterprises, Body of local representatives in case of local governments). Audit opinion does not generally contain recommendations as they are summarized in a Management Letter.



## The role of audit entities in compliance audits

Hungarian SAI and Government's (territorial) offices have a mandate to perform compliance audits. The scope of the compliance audits conducted by the SAI covers regularity of the internal control system, the financial management (i.e. budget execution, use and management of state grants, local governments' funds, assets and properties) and also regular and regulated operation (preparation of financial statements, internal regulations, processes, decision making and execution, due provision of public services, integrity, etc.). Government's (territorial) offices are supervising and auditing the legality of operation and activities of the municipalities (e.g. conformity of decision making with the law, budgeting or executive processes). While conducting financial audit, the Hungarian State Treasury assesses whether yearly financial statements on the execution of municipal budget meet legal requirements.



# REGIONAL AND LOCAL AUDIT INSTITUTIONS IN EURORAI COUNTRIES

The group of EURORAI countries where a regional audit entity conducts audits in municipalities includes countries with a federal structure. Cases of **France**, **Germany**, and **Switzerland** provide a deeper insight.

The nature of the political system of the country makes a difference in the regional audit institutions. In federal countries<sup>16</sup>, they are organized in accordance with the specific legislation of each land or canton and their activities are dictated by this legislation. Also, regional audit institutions are organized in accordance with the unified law throughout the country<sup>17</sup>. In all these countries regional audit institutions inspect the bodies under their jurisdiction. As a rule, in all cases, the scope of regional audit institutions extends to budgetary control of local authorities, the examination of the annual financial statements, auditing of public accounts, checking compliance with the law, the examination of the management activities, checking of the efficiency, and economy of the use of asset.

Regional audit institutions plan audits of local authorities in a different manner.

In France, audits may be initiated in response to a reasoned request by the prefect, the local authority or on the initiative of the regional audit chamber as part of its annual verification programme.

The Swiss regional audit institutions are entitled to determine their working and auditing programmes freely.

In Germany, auditing of local authorities is divided into local audits and supra-local audits. The latter is carried out by the German regional audit institutions and local audits are the responsibility of the local audit office. It means that regional audit institutions carry out supra-local audit according to the population of the local authorities and the annual audit plan<sup>18</sup>.

Regional audit institutions apply different practices announcing about the audit.

In France, the auditing of the accounts and management is announced by a letter from the president of the chamber.

The Swiss regional audit institutions decide whether they will carry out an audit with the provision of advance notice or without it (surprise audit). Generally, unannounced audits take place in connection with the cash-desk and asset audits or in the event of received indications of irregularities (illicit activities).



<sup>16</sup> Switzerland and Germany

<sup>17</sup> in France

<sup>18</sup> e.g. Schleswig-Holstein State Court of Auditors is responsible for the supra-local audit of the districts and cities of more than 20,000 inhabitants

German and Swiss regional audit institutions carry out audit following regularity, legality, efficiency, appropriateness, economy, and effectiveness auditing criteria. French and German regional audit institutions may carry out audit related to all communities and local public institutions situated in the geographical area of the regional audit institutions' competence.

French and Swiss regional audit institutions do not carry out audit thorough all areas on an annual basis. In France, it depends on referral to the prefect, while in Switzerland, the various areas for auditing (audit fields) being audited periodically, through a specifically-focused in-depth audit.

German regional audit institutions may audit the financial statements and the management reports produced by the stand-alone municipal enterprises and special-purpose associations by itself or engage private auditing firms. French and Swiss regional audit institutions do not have a mandate to audit municipal enterprises but French regional audit institution may audit social and medical-social institutions as well as private-sector health institutions if they are funded by the state.

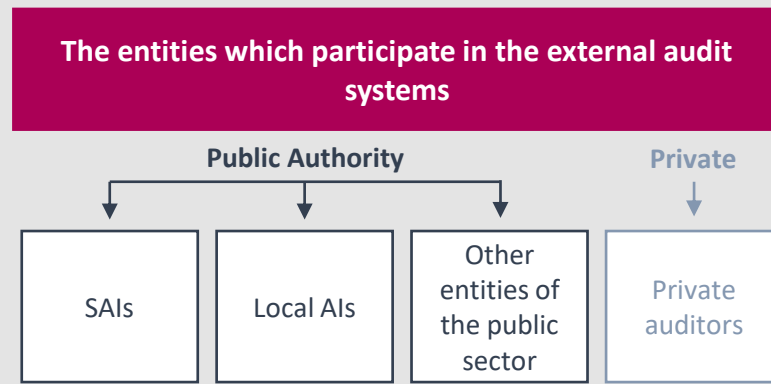
In all analysed countries regional audit institutions provide support for parliament and government of the state. This mutual supportiveness is particularly demanding. Furthermore, regional audit institutions may have special auditing tasks. In France, regional and territorial audit chambers participate in the evaluation of public policies implemented locally within the framework of thematic investigations conducted in close cooperation with the National Court of Audit. In Switzerland, audit offices may have tasks entrusted to them by the legislature and the executive and they may be called on to act in an advisory capacity.



# CONCLUSIONS

As the results of the Analysis show, external audit structures vary significantly across TFMA countries and there is no single model to audit municipalities.

External audit systems at municipal level in TFMA countries can be separated into private and public audit models. The entities participating in the system have different mandate and approaches to audit municipalities.



The private audit model entails that auditors from the private sector are invited to audit municipal accounts in a financial audit or combined with compliance issues. They are rarely mandated to carry out performance audit.

The public authority model includes SAIs, local/regional audit authorities, and other entities of the public sector.

External audit structure depends on the extent of decentralization of each country, the administrative breakdown, and the interaction mechanisms between audit entities at different levels (private and public audit authority), as well as the powers and role of the SAI.

In some external audit systems, external audit entities act as advisers and independent assessors to central and local governments, while in other countries they act as judicial authorities with significantly more stringent powers and impact. Also, there are differences in responsibilities and mandates. Despite the different structures, roles, and work focused on the SAIs and the regional external audit bodies, these institutions have a collective common purpose of promoting accountability and good governance.

The local audit authorities play a significant role in the system. The powers are delegated to local audit authorities and the activities they carry out complement and make the system coherent. The mandate of local audit authority to audit certain institutions differs depending on the country. All of them are orientated to perform financial audit including some aspects of compliance audit. However, now a greater emphasis gradually being placed on performance audits, with the effectiveness and efficiency of government operations increasingly coming under the spotlight as a benchmark for action and success. Local audit authorities usually carry out audit in the selected local authorities in accordance with the annual audit plan. However, some of them, in accordance with their mandate, carry out a single audit which is limited to one local authority. The audits are mostly carried out in an impact and risk-oriented manner. The local audit authorities significantly contribute to the improvement of external audit system of the local government in cooperation with SAIs.

Regional audit institutions may achieve better efficiency since their audit mandate covers geographically grouped municipalities. This simplifies the SAI's ability to cooperate with a smaller number of regional audit institutions. These institutions can perform annual financial audit of the municipal accounts. One of the shortcomings

is the fact that these institutions exist at the regional authority. Therefore, countries' regional arrangements inform the structure and if there is no regional self-governance, these institutions are formed as a representation of the central government (executive). Auditing local government through the representative institution of the executive may threaten the independence of the local self-governance.

In this model, separate audit authorities are established at the municipal level. Building and maintaining professional capacity in municipal auditing is a challenging task. This weakness can be partially addressed by assigning the role to the SAI in providing guidance materials and capacity development opportunities to municipal external auditors. However, effective cooperation and coordination between the SAI and a large number of municipal external auditors must be ensured.

In smaller municipalities, the independence of these external auditors may also appear a challenge given the personal and political circumstances.

As the most important advantage, this model ensures that the financial statements of municipalities are annually audited and form part of the accountability chain at the local level. This does not affect the SAIs authority to perform horizontal compliance and performance audits (and some of the financial audit procedures) at the local level.

Private auditors play a limited role in the system. They usually are hired to perform financial audit in local authorities-controlled companies and other legal entities (public or private) to which the local authorities have allocated funds or has entrusted property to the administration. Additionally, local authorities may hire private auditors to conduct performance or compliance audit. Private auditors are mandated by the law to carry out financial audit of local authorities in certain countries. There are some examples of successful cooperation between private auditors and SAIs. If there are large numbers of municipalities, in the systems



where local governments are audited by private auditors, inefficiency is also a challenge due to substantial aggregate audit fees.

Other entities of the public sector have a limited role in the system. Usually, they perform audit under their mandate. Their main duty is to carry out internal audit, ex-post financial, budgetary inspections, and control the use of the state budget and EU funds, verify compliance of public procurement. Due to the differences in responsibilities and mandates between other entities of public sector and various participants of the external control system, their cooperation in sharing methodology and results of the audit is limited.

In the course of analysis when comparing models, identifying strengths, weaknesses, and good practice examples that would strengthen the municipal external audit systems, cooperation and collaboration between different audit bodies, collection and use of municipalities data were noticed.

## The role of SAIs in external audit system goes beyond audit activities

In many EUROSAI TFMA countries, SAIs act in their audit mandate as participants of external audit system. However, as the analysis has shown, the audit system can be more robust and effective when SAIs act not only as audit entities but also as coordinators, methodological support and good practice partners, especially concerning external audit systems with local AIs. In some countries, SAIs role in the system is already being expanded beyond audit activities<sup>19</sup>.

Among others, in some countries, the role of SAIs in external audit system as a methodological and quality assurance body is clearly defined<sup>20</sup>.

As external audit bodies in municipality level, SAIs are highly qualified in public sector auditing. They maintain the responsibility on local government auditing and are able to evaluate the emerging risks at the level of the entire state including the local

government. Even though in some countries SAIs do not have either a mandate or practice of audit at the local government level, they have a statutory mandate to audit consolidated municipal data as a part of the audit of a consolidated set of the national financial statements. It is a common practice that SAIs have the mandate to perform compliance audits in local governments. Such audits are mostly combined either with financial or performance audits. It is also a widely accepted practice that SAIs conduct performance audit in municipalities. In all the cases where performance audits are performed by SAIs, these are implemented as a horizontal engagement involving a few municipalities.

In terms of the role of SAIs according to the mandated audits at the municipal level, SAIs significantly contribute to the improvement of external audit system not only by conducting audits but also by taking the leading role and supporting beneficial changes in audit of the public sector.



<sup>19</sup> For example, the SAI of Italy released guidelines for local governments advising local authorities on accounting matters, the SAI of Spain implements coordination with the regional audit institutions for the performance of the audits, the SAI of Lithuania took its first steps in carrying out performance audit together with local audit institutions, meanwhile the SAI of Hungary organises seminars and conferences for municipalities on good practice, and the SAI of Serbia organises annual lectures for the municipal and city administration, heads of finances and budgets, internal auditors and managers of financial units. During the lectures, the SAI shares current experiences gathered in the process of auditing local government units.

<sup>20</sup> The SAI of Lithuania annually carries out the external review of audits conducted by local audit bodies to ensure audit quality. The obligation to perform external review is stipulated in the law. This review includes an assessment of the quality control system developed by the local audit and the quality of the audits. The results of the external review and suggested recommendations are presented in the review report, which is submitted to the local audit institution.

## SAIs provides information on audits in municipalities

One of the most important components of the external audit system is the handling of information obtained from audits and communication of the results to the various levels of the government and society. The analysis of external audit systems in EUROSAI TFMA countries has shown that in a great number of them, SAIs provide summary information on municipal audits, their findings, and results<sup>21</sup>.

In other EUROSAI TFMA countries, information is systematized not only with the aim of providing a common picture at the local level, but also of knowing and analysing the most common and sensitive issues<sup>22</sup>.

## Collection and use of municipal data as a component of external audit system

In recent decades, with the rapid technological progress and increased demand of society and various levels of government to manage information of local government and the general situation in municipalities, the need for municipality data collection and use has grown. Data management is essential when it comes to the external audit system and its efficient functioning<sup>23</sup>. Disclosure and publicity of the municipalities' data act as one of the components of the municipal external audit system, promoting greater transparency and accountability.



<sup>21</sup> For example, in Georgia, the SAI reports the results through several types of reports. Every year SAI reports about its activity and a chapter of the Annual Report consists of the audit results conducted in the municipalities. Also, once in every 2 years, the SAI presents a report on the audits conducted with respect to the spending and execution of the budgets of municipalities. Whereas the SAI of Estonia submits each year an overview of the use and preservation of the state assets including local governments. Also SAI of Estonia prepares a summary of its activities including municipal audits and its findings. This is a part of the annual report.

<sup>22</sup> A great example would be SAI of Latvia which prepares proposals for discussion by summarising audit results in the areas where systematic and continuous shortcomings are prevalent. The document is addressed to the legislator, executive power, NGOs, academia, business, society, etc. Other example is the practice of the SAI of Slovakia which uses briefings. Though the preparation of such documents is not mandatory, briefings were used in several audits in a large number of municipalities to provide complex information to the representatives of audited municipalities, professional public, and interest groups. Among others, the SAI of Slovakia is preparing publications on the municipal audit field, which purpose is to enable the lay and professional public to know the process of the audit activities and its findings, recommendations, and proposals for improvement in municipalities.

<sup>23</sup> A great initiative has been introduced in Georgia, where the SAI has developed an innovative web-platform – Budget Monitor ([www.budgetmonitor.ge](http://www.budgetmonitor.ge)), which is an entirely unique product. The website works as an interactive tool which enables all users to access comprehensive information about public resource management in an easy-to-interpret manner. All the interested parties can receive information in an editable format and make comparisons. A similar initiative was implemented in Lithuania by the Ministry of Finance which created a website ([www.lietuvosfinansai.lt](http://www.lietuvosfinansai.lt)) that shows up-to-date data on municipal revenues and expenditures related to the state budget and grants. In Serbia Ministry in charge of local government ensured analytical servis for local government which ensures set of open data on local government that may be used for analyses and comparison <https://rsjp.gov.rs/sr/analiticki-servis/>

On the other hand, municipal data management is also important due to the possibility to ensure that external audit mechanisms function properly. Contributing to TFMA activities<sup>24</sup>, the SAI of Slovakia developed a database on the main municipal data and updates it annually to facilitate its comparison and use. In implementing Activity 1.7.1<sup>25</sup> under the TFMA Strategic Goal I<sup>26</sup> to ensure that the municipality data are as accurate as possible and to encourage the secondary use of the data, the SAI of Austria analyzed the information collected from the EUROSAI TFMA members in the field of quality assurance and data collection. It developed a monitoring tool which provides short, standardised reports or tailor-made analyses of municipalities' data. The SAI of Spain has developed a computer system that helps to transfer data on the accountability of municipalities General Account directly to the SAI of Spain or through the regional audit institutions. Hence, this system a great tool which ensures and strengthens accountability.

## Strengthening cooperation between different audit authorities

Because external audit is seen as a system of different entities with different powers, and roles, talking about enhancing collaboration is inevitable. In other words, the system is creating added value as long as it is clearly defined and all participating parties are interested in monitoring, analysing, and improving external audit of municipalities.

The cooperation between different levels of audit system participants is not specific to all TFMA countries for many reasons, such as a large number of audit entities, separated competences, etc. However, some of the TFMA countries are using good practices to build collaborative relationships among external audit system participants, thereby strengthening the overall system and ensuring high quality and professional external audit of municipalities.

When there are external audit systems at local levels there is a coordination between the SAI and these entities during the financial and performance audit. In financial audit, it implies the assurance that the audit work performed by the local external auditors is reliable and in performance audit, it may imply the coordinated audit procedures. Horizontal compliance and performance practice would mean a greater presence of the external audit in local public sector.

Some examples of good practice to avoid duplication of audit themes or fields between different entities in the audit system were revealed<sup>27</sup>.

<sup>24</sup> EUROSAI TFMA Activity Plan 1.9.2 To update database about the main municipal data/expenses annually

<sup>25</sup> EUROSAI TFMA Activity Plan for 2019

<sup>26</sup> "Exchanging the best practice and experience to reach audit results that have a substantial impact on improving public financial management"

<sup>27</sup> In Austria (cooperation in the audit planning procedure and in case of overlapping local AIs own the right of preference), Israel (cooperation is implemented through the Ministry of the Interior - SAI provides its annual work plan, also, in exceptional cases, audit plans are coordinated to prevent the waste of public funds on similar audits), Lithuania (exchange of risks, coordination of strategies and cooperation in particular audit, especially in carrying out annual audit of a set of National financial statements, where SAI and local audit services coordinate group audit strategy, determine the type of work that will be performed, etc.), Slovakia (signed Cooperation Agreement between the SAI and the Chamber of auditors (private auditors) concerning the exchange of information and passing common learning activities).



Other practices that exist in some countries are the use of information collected or held by various external audit system entities in conducting audit procedures, evaluations, formulation of audit findings or recommendations. This not only saves time, reduces audit costs and minimizes the administrative burden for audited entities but also allows to use the already made insights, to measure progress in some cases, etc.<sup>28</sup>

Another important aspect of the cooperation between entities in the external audit system is the operation of different audit institutions following the same principles and common audit methodologies<sup>29</sup>.

It is important to note that all the above mentioned practices were identified as the most common and applicable in different audit systems of the countries. However, the survey revealed a great number of different practices. As a matter of principle, good practices, such as external audit systems are not easily adaptable and are highly dependent on the context of the country in which they operate, power sharing of the participants in the system, etc. However, it is important that the competences and powers of

the external audit system and its entities would be sufficiently clearly defined and its functioning analyzed and continually improved to maximize the effectiveness and efficiency of external audit of municipalities.

All external audit system bodies in the municipality level should cooperate and coordinate activities to avoid duplication of audits and to ensure a sufficient audit coverage of the entire municipal system, rather than its individual components. SAIs should engage in coordinated efforts with other bodies of external audit system at the local government level to improve local auditing practices and support beneficial changes in this area.

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<sup>28</sup> For example, in Italy, the SAI has access to data of other institutions including municipalities and internal auditors. In Latvia, the SAI acts as the auditor for group financial statement, coordinates its audit approach with sworn auditors and for the report uses the work of sworn auditors (if the SAI does not agree with a sworn auditor's audit approach or does not find it sufficient, it implements certain detailed audit procedures in the municipality and publishes a separate report about the municipality). Meanwhile in Montenegro, during audit process, the report of external private audit firm is available to the state auditors of the SAI (the SAI gets acquainted with the content of this report but the practice has shown that the SAI cannot rely on their reports). The SAI uses the findings of internal audit in cases when it is determined that the internal audit is relevant for conducting audit procedures and when it comes to the audit planning, it uses the reports of internal and external private audit on prior conducted audits with the aim to understand the audited entity and its environment. In Lithuania's case, the Internal Audit Service, which has drawn up a draft work plan for the Internal Audit Service of the following year by 1 November of the current year, submits it to the Municipal Control and Audit Office for the purpose of coordination between them. The draft plan of the Internal Audit Service shall be submitted to the SAI by November 15 of the current year (this document serves the SAI as one of the sources for risk analysis). In Lithuania, the Internal Audit Service in municipalities does not deal with the external audit issues. The purpose of the internal audit is to contribute to the achievement of the objectives of the public legal entity, its subordinates and public entities, through a systematic and comprehensive evaluation of risk management and internal control. In Poland, the SAI may conduct audits with other institutions as the leading partner. It may also negotiate control plans with other entities and exchange complaints. The SAI cooperates with internal audit teams and external auditors, using the results of audits carried out by these entities in local government. Audit results are used only for cognitive purposes.

<sup>29</sup> This practice is typical in Lithuania where local audit apply the same audit methodology that is prepared and used by the SAI. Also, such practice is common in Spain where each regional audit institution audits the municipalities of their autonomous community but the SAI has a mandate to audit these entities as well, so the information is exchanged with the SAI and the common criteria, as well as audit techniques are established to ensure greater efficiency in the results



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