Peer Review

Concerning the State Audit Office
of the Former Yugoslavian Republic of Macedonia

General Aspects and Key Questions

I   General

The German Bundesrechnungshof will carry out a peer review of the Supreme Audit Institution of the Former Yugoslav Republic of Macedonia (subsequently referred to as 'SAO' – Supreme Audit Office). In December 2006, the SAO had requested us to carry out a short-term review designed to professionally assess its current situation and to develop proposals for its future development.

When the review team visited the SAO the first time in Skopje from 5 to 7 March 2007, both partners specified the issues on which the peer review is to focus. The main issues to be looked at the SAO's status within the country's legal and institutional framework, the SAO's internal organisational structures and procedures, its communication with third parties and the enhancement of its audit rights also regarding the use of EU funds. Agreement was reached that, for this purpose the questions set forth under item II below need to be answered. It was further agreed that the respective discussions will be structured according to the outline given in the annex. The SAO will establish the necessary contacts and plan the schedule accordingly, including talks with other institutions.

The Bundesrechnungshof has commissioned a five-member review team to carry out the peer review. The relevant peer review discussions are due to be held in Skopje in the week from 19 to 25 March 2007. The draft report is planned to be completed by the end of April. It will first be communicated to the SAO for comment. The SAO's comments will be taken into account in the final version of the report. The SAO will be free to decide about the further use of the report vis-à-vis Parliament or the public.

The Bundesrechnungshof will bear the costs of the personnel assigned to this mission and the related travel expenses. The peer review and subsequent reporting will be conducted in English. The SAO will provide the necessary interpreter services. If there is a need to translate individual documents in addition to the translation work already desired by the peer review team, this will be also arranged by the SAO. Translations from German into English will be provided by the Bundesrechnungshof.

II   Key questions

1   Is the institutional independence of the SAO adequately safeguarded in accordance with international standards?

Both the international standards (INTOSAI) and the requirements imposed by the European Union demand that the institutional independence of Supreme Audit Institutions (SAIs) be adequately safeguarded. To ensure that the performance of audits and of the SAI's other functions is permanently safeguarded against undue interference, a constitutional provision needs to be in place that guarantees the status of the SAI as an independent body of external government auditing. Such provision in favour of the SAO has so far been lacking in the Constitution of Macedonia. While Macedonia's State Audit Law includes many provisions about the SAO's mandate, internal and external procedures, there is no clear definition of the SAO as independent body of external government auditing, which would safeguard institutional independence, and especially no specific provision about its relationship with other state bodies and powers. In its development strategy, the SAO identified the lacking safeguards of its legal status. Against this background, the peer review team will evaluate as to whether the ideas developed so far for supplementing the legal provisions in the Constitution and the State Audit Law are appropriate to permanently strengthen the SAO's institutional independence. Any such evaluation must take into account the chances of any constitutional or statutory amendment proposed to this effect actually becoming law. With this in mind, discussions with the Legislature are also proposed.

2   Is the personal independence of the SAO's decision-makers adequately safeguarded in accordance with international standards?

International and European standards require that the SAO's decision-makers must be adequately protected against both direct and indirect exertion of influence. This is to ensure that they impartially discharge their functions in accordance with their statutory mandate. Since the SAO has so far not been embodied in the Constitution of Macedonia, there are no constitutional safeguards of the independence of the SAO's decision-makers. The State Audit Law protects the personal independence of the SAO's top executives

(General State Auditor und Deputy General State Auditor) by stipulating that their respective term of office is ten years. However, the conditions under which the Law permits the removal of these officers are open to interpretation, especially with respect to the quorum needed to carry a parliamentary motion for their removal. The State Audit Law does not have any specific safeguards for other top SAO staff. This also applies to the Assistant General State Auditors who have considerable decision-making powers. Against this background, the team will study whether the existing legal provisions and the ideas developed so far for supplementing them help protect the personal independence of the SAO's decision-makers.

3   Is the financial independence of the SAO adequately safeguarded in accordance with international standards?

For all practical purposes, the independence of the external audit function largely depends on the SAI having adequate financial resources to carry out all the work required for the performance of its statutory mandate. Therefore, SAIs must be provided with the resources that they need to carry out their duties within the overall government framework. In addition, they should have the right to request the funding they consider necessary directly from the Legislature and to manage the resources made available to them. The State Audit Law makes rather general provision for the SAO's funding and for the procedure prescribed to have the funds appropriated. In fact, the Ministry of Finance plays a decisive role. Furthermore, the SAO partly obtains its funding from fees charged for the audits it carries out. In its development strategy, the SAO has set forth approaches for enhancing its financial independence. The peer review helps obtain an accurate picture of the SAO's current dependence on the external provision of financial resources. To this end, discussions with the Ministry of Finance are also planned. In addition, the peer review team will assess as to whether the proposed legal provisions constitute a reasonable approach for improvement.

4   Have adequate steps been taken to develop the relationship with Parliament for mutual benefit?

The international and European standards for external government auditing provide for close mutual relations between the SAI and Parliament. Each SAI shall the right and the

duty to report at its own discretion on the results of its work to Parliament. The purpose is to guarantee thorough information and discussion of audit findings and recommendations and, at the same time to facilitate their implementation. Furthermore, Parliament may gain valuable insights for its own work by deliberating on the substance of audit findings and conclusions. The SAO's reporting duties vis-à-vis Parliament are set forth in the State Audit Law. Furthermore, Parliament has asked the SAO to communicate all audit reports to it. However, no firm routine practice has evolved where the deliberation of the SAO's reports in Parliament is concerned. Only in isolated cases has there been a feedback as to the impact of the SAO's reports in the parliamentary sphere. The reasons for this are to be studied during this peer review in discussions with representatives of the Legislature. In addition, the proposals already made for improving the communication between the SAO and Parliament must be taken into account for evaluation purposes.

5 Can the SAO effectively help establish internal controls especially with respect to the use of European funds?

Under international and European standards SAIs are required to help enhance the efficiency and effectiveness of the administration's internal control systems. This task is particularly important for those countries that wish to join the EU and with which the EU is conducting negotiations about accession. EU law requires the establishment and operation of effective internal management and control systems within the administrations of the candidate countries. This is a requirement that needs to be met by countries wishing to receive pre-accession assistance and – after accession – for allocating EU budget funds to the new member state. For the EU Commission, the development of functioning Public Internal Financial Control (PIFC) is therefore one of the central items on the agenda for the accession of Macedonia. Without prejudice to the fundamental separation of external audit and internal audit/control, the SAO should support the establishment and effective implementation of these systems. The peer review team will study whether the ideas and efforts developed so far are suitable and adequate for the SAO to support the establishment and effective operation of internal control systems (PIFC), e.g. by methodical guidance, by sharing information about major sources of error in the public administration or by means of systems audits.

6 Does the SAO have adequate tools for external and internal communication?

Effective external communication may strengthen the transparency, credibility and effectiveness of the SAIs' work; effective internal communication is the prerequisite for spreading knowledge and quality standards within the organisation. The SAO creates a high level of transparency by the electronic publication of all its audit reports. The peer review team will study whether this practice and other activities of the SAO, e.g. in the field of public relations, ensure an appropriate perception of its work and whether and to what additional efforts, if any, need to be made. First planning steps for developing internal communication have been made, one step being an intranet. In order to develop conclusions about future action needed, the team will explore whether there are any deficiencies in internal communication that may impair audit work.

7 Have the strategic and operative goals of the SAO been set in a clear, reasonable and transparent way?

The development of mission and vision statements is a typical element of the SAI's planning process. With its development strategy, the SAO has developed both a vision and a mission statement and underpinned these with strategic and operative goals. Some of the objectives set forth require a thorough change in the legal, institutional and financial framework for the SAO's work including some factors on which the SAO may have little influence. However, the 'Round Table' with representatives of other institutions has given ample proof of the momentum for change. At the same time, it is apparent that, due to the limited leeway for setting material and substantive priorities, not all the steps the SAO seeks to implement under its strategic and operative goals can actually be implemented. Against this background, the peer review team will assess the progress made by the SAO on its way to accomplishing the goals and the perspectives for achieving them in a timely manner. The team will evaluate the extent to which the SAO's objectives are sufficiently in line with its statutory mandate, as to whether they can be achieved within the scheduled timeframe and whether more can be done to successfully implement the strategy. The question arises in this context whether the SAO has effective structures and tools in place for strategic steering and for progress evaluation, etc.

8 Are the SAO's organisational structures adequate for fulfilling its mandate and for working efficiently and effectively?

When designing an SAI's set –up, the golden middle road must be found between the usually conflicting objectives of specifying responsibilities as clearly as possible and permitting specialisation on one hand and of preserving sufficient flexibility on the other hand. Flat hierarchies shorten the decision-making processes and help enhance efficiency and effectiveness. The peer review team will assess if the SAO has adequately implemented the organisational principles appropriate for its work. In this context, the team will study whether the organisational set-up is in line with the strategic goals and relevant legal provisions and whether it is properly designed to meet the needs of the SAO's product users. Furthermore, the team will examine whether responsibilities have been clearly defined and whether the organisation is flexible enough to refocus to meet any challenges arising. The team will also take into account the decision-making processes especially at the collegiate level and further mechanisms for ensuring close cooperation among the various organisational units.

9   Does the SAO have a consistent and coherent quality management system to ensure the high quality of processes and working results?

Compliance with the organisation's own quality objectives can be assured only by a systematic approach covering the entire SAO. Such a systematic approach may rely on several models and points of departure. The SAO took regard to quality assurance when it developed its special decision-making process for audit reports, which involves three senior executives. So far, it has not put in place an overall and coherent high quality management system covering the entire audit process. The recommendations for the improvement of quality management to be worked out under the twinning project with the Netherlands SAI will be available shortly. The team will ask what quality management system the SAO intends to implement and if the development desired is compatible with the standards and procedures laid down in the Audit Manual. At the same time, the team will look at the impact of the existing quality assurance elements and the effectiveness and transparency of their implementation.

10 Does the SAO have effective internal controls in place?

All institutions that use public funds need to comply with their responsibility for the proper use of resources by means of effective internal controls. The SAIs are particularly required to meet this requirement because they have to evaluate the bodies audited by them on the basis of the criteria for expedient internal controls and at the same time must accept the application of these criteria to themselves. Therefore they should set an example of good practice. ´Measurable yardsticks for putting in place internal control systems have been developed by the EU Commission under the "Concept of Public Internal Financial Control (PIFC)" especially for accession countries. The SAO's internal control system is still in its initial stage. While the SAO's organisation chart shows an internal audit unit subordinate to the SAO's top executive, no staff have been assigned to this unit. The peer review team will explore how internal controls may be developed more speedily at the SAO and what functions the internal audit unit is to perform. Another interesting point is how internal audit staff shall be selected, trained and deployed. Furthermore, the team will study internal regulations on the prevention of corruption, if any, and how compliance with these regulations is ensured.

11 Is the IT support adequate for ensuring smooth operations and permitting further development?

The availability of IT equipment is directly relevant for an SAI's capacity; is critical to the institution's administrative management. The SAO carried out an IT self-assessment with the support of the Netherlands SAI. An IT strategy is also in place. Accordingly, the major bases for providing adequate working conditions by equipping each workplace with hardware, standard software and internet access have been created. Still key elements e.g. internal networking and specific software solutions for audit support are need to be supplied. It might be a good idea to establish a separate organisational unit which will be in charge of both internal IT support and IT audits and that will take forward the process of improving the IT framework. The critical factor will be the availability of budget funds; with the assistance of the Netherlands SAI, a funding need in the amount of €250,000 has been identified. The peer review team will have to verify the progress made so far in the development strategy and to identify the options for

implementing further planned steps. With regard to the fact that budget funding has to be approved by the Ministry of Finance, the chances of obtaining sufficient funding need to be evaluated. The team will look at the procedure for procuring hardware and software. Other interesting issues are the use of external IT service providers, the possibilities for exchanging data with other public entities and the IT security strategy.

12 Do the existing conditions allow for further development of the audit spectrum in line with international standards?

According to the Declaration of Lima, the scope of the Supreme Audit Institutions' audit of public revenues needs to be as extensive as possible. The VI EUROSAI Congress emphasised the considerable significance of the audit of public revenues. For the SAO, this is a new field of audit. The same applies to the audit of public assets. Therefore, it will be necessary to ascertain whether the SAO has the fundamental prerequisites for appropriately handling a sufficiently wide audit spectrum. This implies the study and evaluation of the current and targeted future situation with respect to audit possibilities and audit rights and of the audit capacities in place in the SAO for this purpose. It will be necessary to find out whether the SAO has sufficiently specific plans for recruiting an adequate number of adequately skilled staff for the performance of this task. An evaluation of the potential significance of an extended audit spectrum of the SAO is to include assessing any potential deficiencies in tax administration which the SAO can help to remedy by strengthening its audit activities.

13 What portion of all audit work do efficiency analyses, organisational and horizontal audits account for and do their results meet international standards?

Performance audits, organisational and horizontal audits play an increasingly important part in international government audit standards. In accordance with the SAO's statutory mandate, the bulk of its audit work is accounted for by financial audits of government entities. However, the SAO also has a performance audit division, which so far has carried out some audits of the efficiency and effectiveness of government measures. The peer review team will explore to what extent of its overall work the SAO's is committed to evaluating programme efficiency or the efficiency and effectiveness of the organisational set-up of the audited bodies. The team will not only study the quality and

effectiveness of the performance audits carried out but also whether performance evaluations and studies on organisation of public entities play an adequate part in the SAO's standard work. Another aspect is the amount of horizontal studies undertaken to generate audit findings and recommendations of a cross-boundary or government-wide scope and what human resources are available for this type of work. In doing so, it will be necessary to take regard to the international standards which already have largely been translated into SAO-specific standards.

14 Are adequate procedures in place for the selection of audit themes?

The SAO is free to determine its work programme. The selection of audit themes primarily follows the SAO's statutory obligations. In addition, the selection criteria outlined in the SAO's annual programme need to be taken into account. Against this background, it will be necessary to ascertain:

- how information about suitable themes is obtained;
- on what criteria the selection of audits is based and what weight is given to them in the decision-making progress;
- how risk analyses for the various audit fields are carried out and
- as to whether auditors may supply ideas of their own for the work programme.

To evaluate the selection process, both the annual work plan and the relevant provisions in the audit manuals will be analysed. Moreover, the team will study factual decision-making progress by means of interviews with the SAO's top executive and with staff of the audit divisions.

15 May the large number of audit mandates have a negative impact on focussing audit work on specific issues and on widening the audit spectrum?

The SAO's entire audit spectrum comprises nearly 1800 bodies. The SAO has statutory obligation to carry out about 350 audit mandates each year. Given the volume of the obligatory mandates, there is little leeway for focusing on other issues or further developing performance audits, selective audits and organisational audits. The peer review team will assess whether this limitation may restricts the effectiveness of the SAO's work. For this purpose, the percentage of the SAO's audit capacities tied up by the

obligatory mandates will be quantified. Taking into account that, owing to inadequate staff resources, the SAO is not able to fulfil all its obligatory mandates, a picture of the validity of the results developed by these mandatory audits is to be obtained. With a view to future developments, it will be necessary to find out what intentions and options for action exist for deciding about the future framework of obligatory audit mandates and how these intentions and options may affect the effectiveness of the SAO's work.

16 Are methods and processes of audit work in line with international standards?

Carrying out audits is the key function of an SAI. Therefore, the peer review will focus on the analysis of the methods and processes involved in carrying out audits. Such analysis requires a study of the existing guidance for carrying out audits (especially the Audit Manual) both to verify their compliance with international standards and their relevance for practical work. Issues to be looked into are how audit missions are designed and prepared, how audit teams formed and composed as well as the fieldwork done. One question to be addressed is whether, given many formal rules, there is enough scope for a flexible approach focusing on the major problems of the audited body. The analysis of the audits will include the study of the annual report, the audit programme and individual reports. In addition, the peer review team will have discussions with the SAO's top executive and with staff from the audit divisions to obtaining an objective impression of how audits are carried out.

17 Does the form of reporting ensure optimum benefit and effectiveness?

Asserting audit results is an essential foundation for the successful work of SAIs. It largely depends on the way in which audit results are communicated. The reports to auditees are the primary factor for this. Last but not least, their quality has to be measured by the yardstick of whether they present the essential findings, their factual bases and the evaluations derived therefrom in an accurate, clear and reasonable way. The summarised information presented in the annual report is also of major importance. The SAO's annual report includes a large amount of statistical information on the SAO's work. In addition, the SAO publishes quarterly reports. All of the SAO's report types are largely standardised. The peer review team is to explore whether this guarantees optimum benefit for the users and the largest possible degree of effectiveness in terms of the SAO's

objectives. For this purpose, the information content of the annual report and quarterly reports will be evaluated. It will also be necessary to analyse the substantive weight of the audit findings addressed in the reports and of the objections raised by the audited bodies. Where appropriate, approaches for enhancing the effectiveness of reporting, e.g. management letters, need to be considered.

18 Is there an effective procedure for following-up on the implementation of the SAO's recommendations?

The assertion of the audit findings also depend on consequent follow-up on recommendations made. The peer review team will verify the weight which the SAO places on the implementation of its recommendations and the extent to which it succeeds in following up on implementation. A major factor is whether the recommendations are specific and are worded in a way facilitating implementation. The SAO has a statistics-based system of following-up on recommendations. The team needs to verify whether this system effectively contributes to the systematic highlighting or prevention of backlogs and omissions on the part of the auditees. Furthermore, we need to ascertain what key recommendations have been implemented in recent years and what efforts, if any, the SAO has made to assert its recommendations.

19 Does the recruitment procedure make sure that the SAO's demand for adequately skilled staff is met in the long term?

Currently the SAO does not have the human resources it thinks it needs for ensuring an adequate quantity and scope of audit activities.

The SAO intends to design a strategy for the recruitment of suitable staff by 2007. Based on the current status of planning, the team needs to assess of how the SAO justifies its establishment authorised and how total audit capacities considered necessary are to be employed. In doing so, we need to find out to what extent the procedure for making budget funds available permits the allocation of adequate human resources. Another focus is the question whether appropriate means (e.g. media) are used for recruitment and whether the criteria for employment and assignment to posts are in line with technical requirements (competence, analytical abilities, creativity, good manners, oral and written expression). Finally an impression is to be gained of the stages of the final decision-making process for hiring a particular candidate. In this context, it will also be necessary

to find out whether the induction phase for newly hired staff is adequately used for imparting knowledge but also for terminating the employment of unsuitable persons.

20 Are the training measures in line with technical requirements?

Intensive and well-targeted training measures are indispensable for an audit institution in the process of speedy development such as the SAO. It will be necessary to check whether the training measures are in line with technical needs. The SAO's development strategy calls for drawing up training plans that especially address audit methodology, foreign language skills and computer skills. An issue of special interest is the procedure for identifying training needs, taking into account both the skills required and the status of training staff already have. The team will study whether there are any quantitative or time-related restrictions for the participation in training. Furthermore, the team will analyse whether external and international training accounts for an appropriate proportion of total training. Concerning the quality and effectiveness of training measures, the question is to be explored whether any evaluation has taken place and to what extent the transfer of knowledge within the organisation is facilitated and sped up. Special regard is to be taken to the training measures necessary for achieving the status of an "Authorised State Auditor".

21 Are measures for staff management adequate?

The team will study whether the staff is supported to enable them to perform the functions entrusted to them by law fully and effectively. One aspect focuses on the procedures called for in the development strategy for ensuring the protection of the property and health of the staff and, in general, the implementation of service and employment regulations. Finally, item 2.1 of the development strategy calls for the introduction of an ethics code, which will also be of interest for the peer review. Another issue to be checked is whether the SAO has transparent and plausible procedures in place for evaluating staff performance.