



SIGMA

**Support for Improvement in Governance and Management
in Central and Eastern European Countries**

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PEER REVIEW

OF THE

STATE CONTROL OF LITHUANIA

5 October 2000

Table of contents

Introduction and Executive summary	2
Legal framework	4
Focus and objectives	5
Organisation and management	6
Audit work, procedures, methodologies and outputs	8
Communication policy	9

1. *Introduction and Executive summary.*

1. A crucial element in the reform of the Lithuanian public administration is the need to improve public financial control, accountability and probity. This is particularly important in the perspective of the accession to the European Union in order to increase the overall efficiency and effectiveness of the Lithuanian economy and to limit the waste of public resources and the possibilities for fraud and corruption. The State Control of the Republic of Lithuania (*Valstybes Kontrole*) like all similar Supreme Audit Institutions, in particular in Central and Eastern European Countries, has a key role to play in that reform process.
2. Many challenges, both external and internal, are facing the Lithuanian State Control and this in a context of political and legal instability. Important changes are taking place in Lithuania in particular in the area of public financial control, such as the reform of the budget structure and the new definition of budget management responsibilities, as well as the general introduction of internal audit in the public sector and its consequences on the internal control system. Internally, the State Control, still a new institution, has to evolve towards a modern and performing Supreme Audit Institution (SAI).
3. In order to help the State Control to meet these challenges, the State Controller of Lithuania asked SIGMA to carry out a peer review of this institution. A peer team was established, consisting of Mr. Edward Fennessy, Head of Unit in the European Court of Auditors, Mr. Rolf Elm-Larsen, Head of Division in the National Audit Office of Denmark, Mr. Henri Paul, Conseiller Maître, French Cour des Comptes and Mr. François-Roger Cazala, Conseiller Maître, French Cour des Comptes seconded to SIGMA as Principal Administrator. This review was performed during February-March 2000 (see Appendix: Interview schedule of the Peer Review). As in other exercises of this kind, the purpose was to provide this SAI with recommendations for changes and improvements in order for it to develop in line with international standards and good practices amongst sister institutions of other democratic countries, while taking into account the country's specific circumstances. This would constitute an important contribution to the strengthening of the Lithuanian financial control system and public accountability, as well as to meeting the requirements of accession to the European Union.
4. The peer review first addressed the issue of the compliance of the State Control's institutional position with the basic prerequisites of independence as laid down in the Lima Declaration of INTOSAI¹. The assessment was generally positive except that there is a need for ensuring a better financial independence vis-à-vis the Executive branch. The most important shortcoming regarding independence is the significant interference of other public institutions or even individuals in the programming of the audit work.
5. The audit work as such is characterised by an approach closer to investigation or inspection work than to audit proper. Whereas some good results were obtained by the State Control in its short recent history, it does not seem possible in the long-term to continue with the audit approach in use for most assignments to date, i.e. a very law-driven, quasi-judicial process focussing on individual irregularities, with a view to chase all types of fraud and mismanagement.
6. There is a need for a renewed audit strategy aiming at ensuring better accountability in the Lithuanian public sector by strengthening internal control systems and procedures, and in a more medium-term perspective, assess the general cost/effectiveness of the public policies (performance auditing).
7. In order to go in that direction, the State Control can make use of a wide range of possible tools, but only of course if provided with adequate resources.
8. It is highly recommended though to group into a Strategic Development Plan the instruments needed to introduce the necessary changes, This plan should enshrine clear objectives and define the steps to achieve them. This programmatic document of e.g. 3-year duration should contain an estimate of the financial and human resources needed and could be submitted to the Seimas.
9. The main issues to address are :

¹ International Organisation of Supreme Audit Institutions

- changes to the legal framework in order to simplify the definition of the current State Control mandate, to cover all types of audits and to broaden its scope thereof ; a streamlining of the communication lines with the Seimas and of the audit follow-up should be included ;
 - changes to the audit process by adopting and implementing audit policies and standards and an audit manual in line with international good practice, while ensuring full ownership of these instruments by the institution ;
 - acquisition or development of modern auditing and management tools and techniques, including IT instruments ;
 - internal reorganisation in order to set up a more coherent and flexible structure for resources management ;
 - development of staff professionalism by reviewing the recruitment procedures, improving the training policy and the staff management ;
 - definition and development of a communication policy, both external and internal.
10. Within its mandate and resources, SIGMA is willing to assist the State Control to implement changes and help in the further development of this institution either by further direct interventions or by helping to find other assistance. SIGMA considers that there are three priority areas for action. These are:
- The State Control work on a Strategic Development Plan and a possible request for Phare funds ;
 - The review of the legal framework with the above-mentioned objectives in mind ;
 - The SAO strategies and Parliament procedures for a better follow up of audit findings and recommendations.

2. *Legal framework.*

11. The Lithuanian Constitution and the 1995 law on State Control provide a good basis for the independence of the State Controller. But some crucial elements of independence for an SAI are lacking. For example there is no specific provision to protect the independence of the deputies, of the head of divisions or of officials.
12. The current law provides that the funding level of State Control shall be determined by the Seimas on the proposal of the Committee on Budget and Finance. This provision may look in complete accordance with the most demanding standards in this area but has not in fact been fully complied with, since the budget of State Control was actually until now always determined by the Ministry of Finance.
13. But the main problem related to the independence of the State Control consists in the decisive role played by external partners in its programming of audit work, since many institutions, including individual Seimas members or law enforcement bodies, are entitled to request the State Control to perform specific audits.
14. The Law of 1995 is both precise and exhaustive, but sometimes at the expense of clarity. It assigns a great number of missions to the State Control or to the State Controller. These extra or non-audit tasks, such as the participation of the State Controller in the cabinet's sittings or the Parliament's sessions are time- and resource-consuming, and can run the risk of impinging on independence.
15. The current law describes the audit mandate in a quite detailed manner. It is currently unclear to what extent the long list of various entities likely to be subject to audits from State Control and the different wording used to define the type of work are relevant to the actual work performed by State Control. This type of definition appears to be rigid and paves the way for legal disputes. The draft law does not improve matters in that regard since the same list is mentioned with some additions (draft article 15) and defines the exact competence of State Control with different wording, depending on the type of institution. It would be more practical and useful to use a broad and flexible definition of the audit remit so as to be able to face new situations. A specific definition or mention is normally only requested for "marginal" or sensitive areas (e.g. Central Bank, local entities, state-owned enterprises, NGOs).

Recommendations:

- Adequate provisions securing the independence of State Control officials other than the State Controller should be introduced into the audit act.
- The State Control budget should be discussed with and voted by the Seimas without any interference from the Executive, in particular from the Ministry of Finance.
- Any external interference in the programming and planning and planning of the audit work by the State Control should be eliminated, or at least significantly controlled by the State Control.
- The audit coverage of the State Control should be defined in more general but more extensive terms.

3. *Focus and objectives.*

16. *The current audit vision of the State Control is still restricted to legality and regularity aspects, with a strong intention to “check, find and punish” all cases of mismanagement - whether intentional or not - economic crime, fraud and corruption. This conception is understandable in the “control culture” still prevailing in Lithuania and also taking into account today’s Lithuanian context. It is less defensible in the medium term perspective, where the Lithuanian public sector needs a different type of audit, focussing more on the ability of the internal control systems and procedures to prevent irregularities, and on the general cost/effectiveness of the public policies. This reorientation of audit conception, which has to be defined in, and endorsed by, an audit strategy, would also help the Lithuanian authorities to meet the general EU-requirements in the field of financial control.*

17. *Whereas the focus of the audit work tends to be restricted, the number of "stakeholders" and "clients" of the State Control is more important than in similar institutions. The State Control is accountable to the Lithuanian Parliament, the Seimas. But at least three bodies of the Seimas are entitled either to order or to receive audit reports from State Control (commission on economic crime investigation, State Control Parliamentary supervision commission, Budget and Finance committee); and yet there are no clearly defined procedures when it comes to the follow-up on the reports. The most specialised body, the supervision commission, is not a proper audit committee and appears to be more oriented towards monitoring the activity of the State Control rather than to take action on audit reports and ensuring effective follow-up*

18. *Of the other stakeholders, the State Prosecutor's Office is the most important. The peers questioned the continuation of a strong linkage between the Prosecutor's Office and the State Control. This situation, which to a certain extent justifies the existence of a specific enquiry division within the State Control, is a strong contributory factor maintaining the focus of the audit work on legal violations of various kind, including those of a criminal nature like fraud and corruption.*

Recommendations:

- *The mandate of the State Control should be reviewed and should be expressed in a more simple and flexible way so to encompass all relevant cases and to make sure that both financial audit and performance audit are appropriately covered.*
- *An audit strategy has to be defined, mainly focussed on ensuring and strengthening the accountability of the Lithuanian public administration, on improving its internal control systems and procedures and on assessing its performance in the different areas of activity. Recommendations of a specific as well as general nature should become more prominent as a result of the newly defined audit strategy.*
- *The main stakeholder should be clearly identified. The State Control should be active in helping the Seimas to redefine the mandate of the Supervision Commission in order for this body to act as a public account or audit committee. The working relationship with the commission on economic crime investigation should be limited to an information exchange function. The relationship with*

the Budget and Finance committee should also be improved in the framework of the audit work of the State Control on the execution of the State budget.

4. *Organisation and management.*

19. *The number of staff appears to be enough to cope with the audit work if the latter is properly defined and if there is less external interference in the audit program. It is intended that a survey be carried out to assess the real needs of individual units and divisions. The peers consider that it is very important to complete this survey at an early stage.*
20. *Apart from the Vilnius headquarters, the Lithuanian State Control is composed by regional offices, some of them having been recently created or re-established. Considering the relatively small size of the country, and the fact that State Control has no direct mandate to audit the municipalities, the necessity of maintaining so many branches is questionable. The existence of a high number of regional offices, in relation to the size of the country, is perhaps adapted to the current audit work performed by State Control and to a certain level of decentralisation. But it implies a standing need for co-ordinating the programming and performing of the audits between the centre and the regional departments. The division of work between the central divisions and the regional offices is fixed, in large part, by way of negotiation at present. The number of small state-owned enterprises still operating in Lithuania may justify to some extent the existence of regional offices. However, it is likely that many such enterprises will either have to be privatised or to close down, so that the audit remit of the regional offices will consequently decrease. It is also possible that the nature of the work of regional offices concentrating on individual entities may not easily comply with the trend towards more modern forms of audit, in particular performance audits.*
21. *The State Control headquarters has recently been reorganised but the current set-up is not regarded as definitive. In the case of State Control there is a number of small units, sometimes individuals, assigned to specific horizontal tasks (personnel and international relations, public relations, accounting, maintenance etc.) reporting either directly to the State Controller or to one of the deputies. Although the State Control is still a relatively small institution, this situation creates the risk of a lack of co-ordination and difficulties of communication. It was apparent to the peers that the disparate management functions, without a clear co-ordinating structure and the combining of audit functions and support units under the responsibility of each of the three deputy State Controllers, would not prove a viable solution in the long run.*
22. *An internal audit function has been introduced in the State Control by order of 30 May 1997. The present organisational chart does not indicate the existence of this function, currently performed by the deputy head of the budget audit division. The common standard is to assign this task to a person not involved in any other operational work and who should report directly to the top management.*
23. *Improvement of the human resources management is crucial for the development of the State Control. Continuous professional training in particular is one of the most urgent issues to address by the State Control. The peers identified a series of measures that the State Control could envisage in that regard but limited progress could be envisaged as long as the funding for training will remain at a very low level.*
24. *The use of Information Technologies is still in an embryo phase, and the improvements of the recent period were introduced in a piecemeal manner. There is a need for a strategic and integrated approach, addressing both management needs and audit work issues.*

Recommendations:

- *The need for regional offices and to what extent the existence thereof is compatible with the introduction of changes in the work and methods of State Control, should be reassessed by the State Control in the near future*
- *The State Control should consider the development of a more rational organisational structure through the regrouping of the divisions along functional/geographical lines. For instance, such a restructuring could be envisaged by allocating to a Deputy acting as Secretary General all support or “horizontal” divisions. It could also be envisaged to distribute the legal functions within the audit divisions instead of having them operating independently, thereby allowing for legal considerations to be dealt with in real time, thus avoiding duplication of work*
- *In future developments, and as this is a common feature to most modern SAIs, the State Control should consider establishing a real training unit and a methodological unit, perhaps also entrusted with quality assurance functions. The library should be developed towards becoming a performing documentation centre.*
- *The internal audit function needs to be strengthened. In particular the internal auditor(s) should be freed from any involvement in other operational work and should report directly to the State Controller.*
- *As far as staff management and procedures are concerned, the State Control should take steps :*
 - *To define a recruitment plan and to revise the recruitment procedures in order to broaden the reserve of competencies needed for the audit work*
 - *To introduce a formal job rotation policy in order to help auditors to develop their knowledge and audit capabilities and to prevent unduly long assignments in the same geographic or thematic audit fields ;*
 - *To introduce a performance appraisal system adapted to the circumstances of the State Control and linked to the further development of the audit work. This could encompass the introduction of a specific certification process ;*
 - *A collective and individual training needs assessment should be carried out, with a view to identifying the gaps to be eliminated, and to developing a strategic corporate training programme to address how to remedy those gaps in a medium term perspective. Any training programme should contain elements that would improve the general understanding of the Lithuanian administrative preoccupations among the audit staff.*
- *The State Control should deal with Information Technology issues in the framework of an overall strategy, supporting the general audit objectives, improving the quality of the audit work and establishing a budget with a horizon of two or three years.*

5. *Audit work, procedures, methodologies and outputs.*

25. *The adoption and implementation of audit standards in line with international and EU standards is still at an embryo stage. Work on the development of the audit manual, which has recently commenced, is an important step in the development of a standardised audit methodology. But this progress, as well as the adoption of audit standards, will prove less profitable and effective than it ought to be in the absence of a clear audit strategy, setting the necessary priorities, is still missing.*

26. *In this regard, while it is important to build up a performance audit competence in State Control, it will be done on a more solid foundation if this body commences by improving its financial audit*

work, drawing experience and competencies from it to evolve towards audit of sound financial management and then to performance audit. The standard audit approach currently adopted for the audit of budgetary execution forms a solid basis for the development of a comprehensive methodology for financial audit that can be further developed to incorporate the essential features of performance auditing methodology.

27. *In this respect, it has been noted that, while the narrative report, currently used by the State Control for the compulsory annual report on the execution of the budget, is the most appropriate format in the current circumstances, the State Control should consider the possibilities for evolving the audit approach towards an attestation or certification-type audit. Such an audit would provide the budgetary authorities with a better framework for granting discharge to the executors of state budgetary resources, in a context of enhanced public accountability.*
28. *The resources devoted to the planning process, in particular time budget and preliminary study, are quite inadequate at present and this is likely to have negative consequences for the efficiency and effectiveness of how the audit tasks are carried out. The supervision of the audit work, including review of working papers by hierarchical superiors, needs to be improved and properly documented.*
29. *More generally, audit outputs and decision-making take at present the form of a quasi-judicial process whose effectiveness is judged on the basis of the sanctions imposed. The peers consider that there is a need for improved dialogue with the auditees and less rigidity in the entire audit process. This implies both an on-going dialogue between auditor and auditee during the audit process as well as a more inclusive contradictory procedure before final decisions are taken; they also consider that, in the interests of openness, more time should be allowed for sanctions to be appealed;*

Recommendations:

- The State Control should first devise an audit strategy on which an audit manual can be progressively constructed, so as to allow modern audit standards to be adopted and implemented in line with international and EU standards ;
- The general perspective should be to improve the current financial audit work and to progressively build up the State Control performance audit competencies and capacities.
- In the medium term, State Control should consider the possibilities for evolving the audit approach towards an attestation or certification-type audit.
- Regarding the development and implementation of standards, the State Control should now start to give more emphasis to the audit planning mechanisms, to the documentation of the work done during an audit as well as of the audit supervision procedures.
- The State control should renounce its quasi-police approach to the audit work. To adopt modern audit practices also means to create, when it is justified, a relationship of confidence with the auditee. In particular, the State Control should :
 - *build a long-term relationship with auditees, to better understand the auditee's business but also to improve the monitoring of the audit follow-up ;*
 - *avoid surprise inspections, except for detecting a suspected fraud or in specific risk areas ;*
 - *give enough time to auditees to familiarise themselves with the audit task, and also to understand and comment on the reports ;*
 - *exercise its right of imposing sanctions in a fully fair and transparent manner in particular by, at the reporting stage, informing the persons involved about sanctions likely to be decided upon by the State Control authorities ;*

- *give more room and time for internal appeal to the Head of Division, Deputies and State Controller, in order to avoid appeals to the courts ;*
- *whenever possible, highlight existing good practices amongst auditees in order to favour their dissemination as appropriate.*

6. *Communication policy.*

30. *The State Control communication policy seems to be at the early stages of development. A first issue to address is the publication of audit reports.*

31. *There is no constitutional or legal obstacle in Lithuania to the publication of audit reports by the State Control. The annual report on the budget execution is made public. However the peers found that the current legal basis lacked specificity as far as the publication of reports is concerned. The 1995 act only states vaguely and without sufficient clarity that “the mass media shall have the right to obtain information about the activities of the State Control”. This provision does not imply per se that audit reports should be published. The draft law is somewhat more precise in that regard since it provides for the publishing of information from and about the State Control, including reports, in a special publication issued by this body.*

32. *Nevertheless, it does not provide clearly for the fact that the publication and publicity of some reports represent a major contribution of the SAIs to the enhancement of public accountability and a primary output of the audit work. To publish reports is not seen as a crucial instrument to help the effectiveness of the audit work.*

Recommendations:

- The right to publish audit reports should be clearly stated in the law in order to comply with the INTOSAI Lima declaration which establishes that the Supreme Audit Institution shall be empowered to report its findings annually and independently to Parliament or any other responsible public body.
- The Supreme Audit Institution shall also be empowered to report publicly on particularly important and significant findings during the year.
- In addition, the State Control should endeavour to report on the follow-up of its audit work and try to identify the impact of its activity, less in terms of amounts of money retrieved than in terms of implementation of former recommendations, improvement of management and control systems and procedures, and changes introduced in laws and regulations.

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