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*European Organisation of Supreme Audit Institutions*



**20th anniversary of the European Court of Auditors**

**The Risk is the Determining Factor...**

**Political Party Financing and Auditing**

**Audit of the State-run Corporate Sector in Portugal**

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*Cover: 20th Anniversary ECA 13. March 97. Mr. Friedmann addresses to the Honorable guests Mr. Santer, President of the European Commission, Mr. Schleicher, Vice-President of the European Parliament, Mr. Juncker, from the Council of the European Union. Mr. Carbone, the most senior among the Presidents of the Supreme Audit Institutions of the European Union. All the 15 members of ECA at the background.*

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# Editorial

Dear EUROSAI members,

I was appointed President of the Spanish Court of Accounts recently by His Majesty, the King of Spain, following my nomination and election by the plenary meeting of this Court. This appointment also embodies the role of Secretary of EUROSAI. In the first place, I would like to take this opportunity to thank my predecessor, Mrs Garcia Crespo, for her personal commitment and professional good management during the past three years.

As Secretary of EUROSAI, I have every intention of undertaking and further developing the statutory tasks I have been assigned, and am very honoured to share that experience and the work we perform at the supreme audit institutions with you all.

Of the initiatives that EUROSAI is currently pursuing, and to which I am now fully committed, two seem to me to be of particular interest. Firstly, there is the questionnaire about the training requirements of EUROSAI members. Thanks to your good efforts, this Secretariat is already compiling the findings of that questionnaire. Soon, the final results will be available, enabling us to analyse and plan training programmes; methods and targets within the organisation more efficiently. Secondly, there is our forthcoming meeting at the EUROSAI seminar to be held in Lisbon in June. Our joint reflection on the independence of supreme audit institutions and their relationship with the legislative, executive and judicial powers highlights one of the issues that has most bearing on furthering the sound functioning of supreme audit institutions.



Ubaldo Nieto de Alba

*President of the Spanish Court of Accounts  
Secretary General of EUROSAI*

Before signing off, I would just like to say that I would welcome any suggestions you have to make and willingly provide any assistance or collaboration, as needed.

Mr Ubaldo Nieto de Alba is the president of the Spanish Court of Accounts and Secretary General of EUROSAI. He was appointed board member of the Court of Accounts in 1982 and, among other appointments, chaired the Court of Accounts Audit Department. Mr Nieto de Alba is an insurance actuary, has a doctorate in economics, and is a professor at the University Schools of Business Studies, professor of financial economics, inspector of state finances, and a chartered statistician. He was a senator from 1977 to 1982, forming part of the Constituent Assembly and First Legislature. He has been awarded the following Spanish decorations:

- Alfonso X el Sabio Commendation Plaque
- Social Security Gold-class Blue Cross
- Order of Constitutional Merit

## *Euro Sai News*

### EUROSAI GOVERNING BOARD MEETING XVI

The meeting was organised smoothly and efficiently by our Dutch colleagues, and in addition to attending to the Board's general business, it also provided an opportunity to see an interesting audiovisual documentary about how the Algemene Rekenkamer building in Holland was restored and enlarged.

The Governing Board gave its approval to the EUROSAI standard procedures document and agreed that an updated edition of the statutes of our regional group should be drafted.

The EUROSAI Secretariat has since published copies of both these publications and distributed them to all members of the organisation and to other INTOSAI regional group secretariats.



The EUROSAI Governing Board Meeting XVI was held in The Hague (the Netherlands) on April 24th-25th 1997



### PREPARATIONS FOR EUROSAI CONGRESS IV

At the EUROSAI Governing Board Meeting XVI it was agreed that the subject for discussion at the fourth Congress, to be held in Paris in 1999, would be "The Independence of Supreme Audit Institutions". This topic would be divided into four sub-themes:

1. The Relations of the SAIs with the Executive and Legislative Powers.
2. The Means of Independence.

3. Independence and Responsibility: who controls the Controller?

4. The Relations of the SAIs with the Media.

A working group consisting of members from the SAIs of France, Italy, Poland, Portugal and the United Kingdom was appointed to prepare these items for discussion.

### PREPARATIONS FOR THE NEXT EUROSAI SEMINAR

A seminar will be held in Lisbon, Portugal, from June 24th-26th 1998, to discuss one of the sub-themes for the fourth EUROSAI Congress: "The Relations of the

SAIs with the Executive and Legislative Powers." Preparations for the seminar are currently being conducted by the working party appointed to organise the Congress.

## NEWS ABOUT EUROSAI MEMBERS

- In this section, we would first like to mention Mr Maarten B. Engwirda's appointment as member of the European Court of Auditors, at the Netherlands' proposal.

- Dr Dieter Engels has been appointed vice-president of the Bundesrechnungshof by the president of Germany.

- In addition, and within the framework of the modifications to the Austrian constitution, the control and auditing powers of the Austrian Court of Audit have been given wider scope and the Court is now authorised to audit the budgetary and financial performance of statutory professional representation bodies.

## VISITS TO THE HELLENIC COURT OF AUDIT BY FOREIGN DELEGATIONS IN 1997

Our Greek colleagues have sent us information about some of the visitors they received in 1997.

### VISIT BY MR TOMA JEKOV, HEAD OF THE BULGARIAN STATE AUDIT OFFICE

From February 16th-22nd 1997, the director of the Bulgarian State Audit Office, Mr Toma Jekov, accompanied by his colleague, Mr Tzvetan Tsvetkov, paid a working visit to the Hellenic Court of Audit, and were informed about the organisation and function of the financial audit in Greece, the constitutional and legislative framework of the Court, and its relationship with the government, Parliament, the judiciary, the internal control authorities and the mass media.

From right to left: Mr. Constantinos Rizos, Judge Counsellor in the Hellenic Court of Audit, Mr. Toma Jekov, Director of the State Audit Office of Bulgaria and Mr. Apostolos Botsos, President of the Hellenic Court of Audit.



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### VISIT BY THE AUDITOR GENERAL OF THE NATIONAL AUDIT OFFICE OF THE PEOPLE'S REPUBLIC OF CHINA

From April 12th-19th 1997, a six-member delegation from the National Audit Office of the People's Republic of China, headed by its auditor general, Mr Guo Zhenqian, visited the Hellenic Court of Audit.

The auditor general's interest focused on the a priori and a posteriori audit of state, public and local entity expenditure and the results of an audit of this kind.



From right to left: Mr. Tan Shengxi, Deputy General Director at the National Audit Office of the People's Republic of China, Mr. Stilianos Christonakis, General Commissioner of the State at the Hellenic Court of Audit, Mr. Guo Zhengiam, Auditor General of the National Audit Office of the People's Republic of China, Mr. Apostolos Botsos, President of the Hellenic Court of Audit, Mrs. Zhang Qiuxia, Deputy General Director at the National Audit Office of the People's Republic of China and Mr. Yang Guangsheng, Ambassador of the People's Republic of China in Greece.

### VISIT BY MR ANTONI CASTELLS, MEMBER OF THE EUROPEAN COURT OF AUDITORS

From May 21st-23rd 1997, Mr Antoni Castells, member of the European Court of Auditors, accompanied by the auditor, Mr Gregory Leventakos, visited the Hellenic Court of Audit.

During his short stay in Greece, Mr Castells visited the minister of the Department of the Environment, Physical Planning and Public Works, the under-secretary of the Ministry of National Economy and the under-secretary of the Ministry of Development, with whom he discussed various issues concerning the First and Second Community Support Frameworks for the years 1983-93 and 1994-99, and the development of major public works such as the Athens subway, Spata airport, the Egnatia road and the other road networks. He also went to see the state of progress of the work

For more information, see European Union.



From right to left: Mr. Botsos President of the Hellenic Court of Audit and Mr. Castells, Member of the European Court of Auditors.

on the Athens subway —a project co-financed by the Regional Fund— accompanied by judge councillors from the respective department at the Hellenic Court of Audit.



## European Union

### OCTOBER 13TH 1997: 20TH ANNIVERSARY OF THE EUROPEAN COURT OF AUDITORS

The Court of Auditors celebrated its twentieth anniversary on October 13th 1997 at a ceremony attended by such dignitaries as Ursula Schleicher, vice-president of the European Parliament, Jean-Claude Juncker, president of the Council of the European Union and prime minister of the Grand Duchy of Luxembourg, Jacques Santer, president of the European Commission, Giuseppe Carbone, longest-serving head of the National Audit Institutions and president of the Italian Court of Auditors, and Bernhard Friedmann, president of the European Court of Auditors.

In his speech, Mr Bernhard Friedmann pointed out that the European Union was currently facing many challenges, in particular the fight against unemployment, the introduction of the euro and the enlargement of the Union to include new countries. In Mr Friedmann's view it was important that the European Court of Auditors should be able both to uncover shortcomings in all areas, as was expected of it by the taxpayer, and at the same time ensure that its work as external auditor was constructive, so as not to provide the Eurosceptics with further ammunition. In her speech, Mrs Ursula Schleicher drew attention to the Court's objectivity. It could be critical when necessary, while making positive comments when they were justified. In the opinion of Mr Jean-Claude Juncker, the best indicator of the European Court of Auditors' nobility was its brief to render transparent and even more efficient the management of European funds by the other European institutions in the implementation of budgetary resources and policies. Mr Jacques Santer considered that the Statement of Assurance, which has been issued by the Court since 1995, had already contributed to an awareness of the Member States' shared responsibility in the management of Community funds. Furthermore, Mr Giuseppe Carbone emphasized the very good relations that the Court has established with the national audit institutions during its twenty years'

work. In his view, the circulation and pooling of national experiences, together with the construction of a European audit system which all the Member States were destined to adopt, had created a situation of osmosis between the Community audit system and the national ones.

In addition, in order to mark this anniversary, the Court has published a study



20th Anniversary ECA -13 March 97. President of the ECA, Mr. Bernhard Friedmann giving his welcoming speech. Mr. Santer, President of the European Commission. Mrs. Schleicher, Vice-President of the European Parliament. Mrs. Nikolaou, the Greek Member of ECA, at the back.



20th Anniversary ECA -13 March 97. Mr. Carbone, the most senior President of the Supreme Audit Institutions of the EU, gives his speech.



summarising its most recent conclusions regarding sound financial management in the main areas of European Union expenditure, i. e. agriculture, the Structural Funds and development aid. This study also contains a brief analysis of the development of the Community's own resources.



20th Anniversary ECA -13 March 97. The New Hemicycle of the European Parliament was almost at full capacity.



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## THE AMSTERDAM INTERGOVERNMENTAL CONFERENCE THE TREATY OF AMSTERDAM

The Court of Auditors' powers have been strengthened by the Treaty of Amsterdam, which was negotiated at the Amsterdam European summit of the heads of state and government of the European Union on June 16th-17th 1997 and officially signed on October 2nd 1997.

The Court of Auditors was created by the Treaty of Brussels of July 22nd 1975 and officially founded on October 18th 1977. Its status was first modified by the Treaty of Maastricht of February 7th 1992, which promoted the Court to the rank of an institution. This means that it is on a par with the European Union's legislative institutions (the European Parliament and the Council of the European Union), executive institution (the European Commission) and judicial institution (the Court of Justice). The Maastricht Treaty also entrusted the Court of Auditors with the new task of providing the Parliament and the Council with a Statement of Assurance concerning the reliability of the accounts and the legality and regularity of the underlying operations.

The Treaty of Amsterdam has, once again, strengthened the position of the Eu-

ropean Court of Auditors. It provides it with several ways of making its audit of all the Community's revenue and expenditure more effective. For example, the Amsterdam Treaty broadens the Court's audit powers by explicitly adding the right of access to all necessary information held by private beneficiaries of Community funds and other intermediary bodies responsible for managing Community revenue or expenditure. Moreover, the European Court of Auditors has been explicitly given the possibility of defending its prerogatives in relation to the other institutions by appealing to the Court of Justice. The Amsterdam Treaty also stresses the role that the European Court of Auditors is required to play in the fight against fraud, by asking it to be attentive, in its audits, to any cases of irregularity and by giving it a consultative role before the adoption of anti-fraud measures.

Finally, the Treaty of Amsterdam confirms the importance of cooperation between the European Court of Auditors and the National Audit Institutions of the Member States of the European Union, in a spirit of mutual confidence and respect for the independence of all the parties involved.



## THE EUROPEAN COURT OF AUDITORS: 1997 SPECIAL REPORTS

The European Court of Auditors has adopted six Special Reports since the beginning of 1997. In July 1997, in order to make them available to the widest possible public, all the 1997 Special Reports and the relevant Information Notes were put on the Court's Internet web site in three language versions: English, French and German. Its Internet address is <http://www.eca.eu.int>. E-mail can be sent to [euraud@eca.eu.int](mailto:euraud@eca.eu.int).

Special Report No 1/97 concerned Commission Decisions regarding the clearance of the accounts for expenditure financed during the financial year 1992 and also partly in 1993 by the guarantee section of the European Agricultural Guidance and Guarantee Fund (EAGGF). This Special Report was drawn up in response to a request from the European Parliament and examined decisions adopted by the Commission during 1996 leading to adjustments amounting to 895,1 MECU. It emerged that flat-rate adjustments (336 MECU in 1992) had not been applied uniformly, had not been based on losses to the budget during the financial year in question or had been applied even in cases in which it would have been possible to determine the exact loss incurred by the Fund or the exact degree of non-compliance with a given regulation. Moreover, certain individual adjustments were not fully justified and, in other cases, shortcomings in the systems in the Member States that had been detected by the Commission were not corrected. Overall, the Court estimates that the adjustments were around 134,7 MECU short of the correct figure.

In its Special Report No 2/97 concerning European Union humanitarian aid between 1992 and 1995 (2 272,5 MECU), the Court expresses the view that the Union's policies on humanitarian aid lack clarity and that the complementarity (and also coordination) between the different types falls far short of the requirements of the Treaty and the relevant Council resolutions. The Court suggests that a general policy document - a sort of humanitarian aid charter - should be adopted by the authorities and that a global agreement could

be concluded with the Secretariat General of the United Nations so as to specify financing perspectives and establish practical procedures for collaboration with the Commission's departments. Moreover, the Commission should introduce machinery for reporting on the content and impact of humanitarian aid.

Special Report No 3/97 examines the decentralised system for the implementation of the PHARE programme, which is the main financial instrument for pre-accession support for the countries of Central and Eastern Europe, with a total budget of 5,757 MECU for the period 1990-1996. According to the Court's observations, the implementation of the principle of decentralisation should be rationalised by improving the definition of the tasks incumbent on the various parties involved and by a reduction in the number of programmes. The Court also recommends that the beneficiary countries should become progressively more involved in financing the programmes. The number of programme management units should also be limited and clear rules should be drawn up for financing them.

Special Report No 4/97 concerns the audit of measures taken in the context of German reunification involving compensatory payments (113,5 MECU) and export refunds (44,5 MECU) in the context of the EAGGF. The audit showed that, at one time, the slaughter of a single animal affected by enzootic bovine leucosis could lead to the payment of export refunds as well as aid for the reduction of milk production and the eradication of epizootic disease. Although the Commission is aware of the risk of overcompensation, all the specific regulations were adopted without taking this problem into account. The consequence of this was that the amount of aid paid per animal was often higher than the value of the animal itself. Moreover, a significant share of the aid could have been saved under certain conditions and there were even cases of false slaughter lists being submitted. Following checks by the Commission, which got underway late, 11 MECU in aid was reclaimed from the German authorities.



Special Report No 5/97 examines the management of Community trade in cereals benefiting from export refunds, special import schemes and regional aid schemes, which, for the 1991-1994 period, corresponded to a total of 11,043 MECU. The Court found that, in 25 years, the Commission had never revised the processing coefficients used as the basis for refunds for first processing cereal products. This led to the payment of refunds that were higher than they would have been if they had been based on real yields (49 MECU higher). Moreover, serious shortcomings were also found in the organisation of inspections and the methods adopted for verifying the Community nature and the quantity of the goods exported. According to the Court's audit, additional budgetary costs resulting from the sale of maize imported at intervention prices on the Portuguese market could not be justified (9,3 MECU). Finally, other serious shortcomings were discovered, such as the fact that aid rates were linked to export refund rates, which amounted to a burden on the Community budget of nearly 4,7 MECU.



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Special Report No 6/97 examines TACIS subsidies (technical assistance to the independent states of the former Soviet Union and Mongolia) to the Ukraine. Between 1991 and 1995, the European Union granted an amount of 1,158 MECU of financial assistance, of which 343 MECU was in non-repayable aid and, of this amount, 164,7 MECU was for nuclear safety. The Court showed that, for essentially institutional reasons, the actual utilisation of TACIS appropriations was particularly slow in comparison with the need for reform, especially in the field of nuclear safety. The Ukrainian agency for the coordination of foreign aid did not perform its role as an intermediary between the Commission and the project beneficiaries very well and the Delegation on the spot was not able to function efficiently because administrative and financial management was concentrated excessively on the Commission's central departments. In order to rectify this situation, the Commission increased the number of project support and monitoring interventions. However, this led to duplication of effort and administrative delays, which, in the last analysis, weakened the warning systems.

## MEETINGS AND OFFICIAL VISITS IN 1997

### MEETING OF THE CONTACT COMMITTEE OF THE PRESIDENTS OF THE SUPREME AUDIT INSTITUTIONS OF THE EUROPEAN UNION

On October 29th-30th 1997, the annual meeting of the Contact Committee of the presidents of the Supreme Audit Institutions of the European Union was held in Copenhagen, hosted by the office of the auditor general of Denmark. At the meeting the presidents discussed the following topics:

Auditing of VAT in intra-Community transactions.

Application of Articles 92 and 93 of the Treaty.

General auditing standards.

Transposition of the EU directives on procurement contracts into domestic law. Current state of affairs in the Member States. Roles and auditing methods of the SAIs.



Meeting of the Contact Committee of the Presidents of SAIs of the European Union held in Copenhagen on October 29th-30th, 1997.

Cooperation between the European Court of Auditors and the National Audit Institutions in the EU Member States.

The Intergovernmental Conference (IGC) and the Amsterdam Treaty.

Information on the Statement of Assurance of the European Court of Auditors.

Assessment of the parameters of the Treaty of Maastricht.

The general tendency in the reports and topics that were discussed was that there is a need for more information and cooperation among the EU-SAIs as regards the development towards more transnational transactions within the EU.

Mr. Henrik Otbo, auditor general of the Danish SAI, raised the question as re-

gards information and cooperation among the EU-SAIs in relation to future IGCs. The presidents of the Contact Committee agreed to call for openness and to establish joint discussions between liaison officers with the intention of reaching a joint view, if possible.

A working party chaired by the European Court of Auditors presented 15 guidelines in continuation of the INTOSAI auditing standards. The guidelines will be translated into all official EU languages and will be presented in a harmonised form at the next Contact Committee meeting.

The meeting was held in an open-minded and constructive atmosphere and Mr Otbo closed the meeting, thanking all the participants.

**MEETING BETWEEN THE PRESIDENT OF THE EUROPEAN PARLIAMENT, MR GIL-ROBLES, AND THE PRESIDENT OF THE COURT IN LUXEMBOURG ON MARCH 19th 1997**



During his official visit to Luxembourg, the new president of the European Parliament, Mr Gil-Robles, paid a working visit to the European Court of Auditors, on March 19th 1997. At the meeting, both presidents confirmed their wish to continue the good cooperation between the two institutions. The president of the European Parliament stressed the importance of the Court's role in the Parliament's annual discharge debate and Mr Friedmann, the president of the Court, expressed his desire to see further developments in the Court's relations with the Parliament's specialised committees - and not only the Committee on Budgetary Control and the Committee on Budgets. Furthermore, Mr Friedmann expressed satisfaction that the European Parliament no longer hesitated to ask for the Court's assistance with regard to certain questions, such as Community transit, the clearance of the EAGGF accounts, or the implementation of expenditure in the context of the joint foreign and security policies.



Mr. Gil-Robles, President of the European Parliament, visiting the ECA for the first time since his nomination. The President of ECA, Mr. Friedmann and the Spanish member of the ECA, Mr. Castells, welcome him. (March 97)



Mr. Gil-Robles and Mr. Friedmann during the extraordinary session of the Court during the working visit before the former gave a speech. (March 97)

## MEETINGS OF THE LIAISON OFFICERS OF THE SUPREME AUDIT INSTITUTIONS (SAIs) OF THE EUROPEAN UNION IN PARIS ON MAY 6th-7th 1997 AND IN LUXEMBOURG ON SEPTEMBER 23rd-23-24th 1997

Relations between the Supreme Audit Institutions (SAIs) of the EU and the European Court of Auditors have evolved over nearly 20 years towards the creation of various working parties, which, during the course of the year, are responsible for examining the main subjects of common interest. The results of these working parties are discussed twice a year by the representatives of the SAIs ("liaison officers") prior to the annual meeting of the heads of the SAIs, which, this year, took place in Copenhagen on October 29th-30th. At the liaison officers' meeting in Paris, in May 1997, the questions discussed involved the auditing of VAT, which finances a substantial part of the budget of the European Union, the auditing of the application of aid granted to Member States under Articles 92 and 93 of the Treaty, the transposition into national law of European regulations on public contracts, and the establishment of guidelines for the harmonisation of audit methods. The agenda also included the question of cooperation and relations between the SAIs and the European Court of Auditors, the role of NAI staff on secondment to the Court, the position regarding a possible bi-



Meeting of Liaison officers held in Luxembourg on September 23rd-24th 1997.

lateral discussion procedure with the Member States, and cooperation with the national audit institutions of non-Member States. The same meeting discussed the Maastricht parameters and the move towards a single currency, and the European Court of Auditors presented the development of the work of the Intergovernmental Conference (IGC). The following meeting of liaison officers took place in Luxembourg on September 23rd-24th 1997.



## MEETING IN BUCHAREST OF LIAISON OFFICERS FROM 12 SAIs OF CENTRAL AND EASTERN EUROPEAN COUNTRIES AND THE EUROPEAN COURT OF AUDITORS, UNDER THE CO-PRESIDENCY OF THE EUROPEAN AND THE ROMANIAN COURT OF AUDITORS

In October 1996, the European Court of Auditors launched an initiative to develop a framework of cooperation with the Supreme Audit Institutions (SAIs) of Central and Eastern Europe countries (CEECs). This cooperation is now taking concrete form and can be compared with

the existing cooperation between the European Court of Auditors and the SAIs of the EU member states as foreseen in the Treaty.

In the context of the preparations of Central and Eastern European countries for future membership of the EU, the strengthening of the audit capacity of these

countries is an important element. For this reason, it was decided to enhance contacts between the respective audit institutions. In a first phase, cooperation will focus on the identification of priority areas which are of common interest and which are to be worked on together. It was also decided that this subject should first be prepared on a technical level by representatives of all SAI's (meeting of liaison officers) before a decision is taken by their presidents.

As a result, on October 7th-8th 1997, the liaison officers from 12 SAIs of Central and Eastern European countries and the European Court of Auditors met in Bucharest under the co-presidency of the European and the Romanian Court of Auditors. The European Court of Auditors has also provided the secretariat for this meeting.

In Bucharest, the next presidents' meeting was planned and is scheduled for March 1998 in Warsaw. At this meeting a common approach and orientation will be decided for the following priority areas:

1. The (institutional) preparation of SAIs of the CEECs and the active role they can play in the context of the future membership of the EU. This subject covers a wide area of subjects such as institutional strengthening, training, audit

methodology, etc. In this context, the studies prepared by SIGMA/PHARE on "The effects of European Union accession on external audit, budgeting and financial control" were welcomed by the meeting of liaison officers.

2. The second subject covers the strengthening of cooperation between the respective SAIs on specific audits. This consists of concrete cooperation in the practical audit work between the SAIs of CEECs on the one hand and between them and the European Court of Auditors on the other hand. A framework will be created within which different forms of cooperation will be developed: joint audits, parallel audits, exchange of information, etc. The organisational modalities, which are mainly related to the exchange of information, will largely correspond to those which already exist between the European Court of Auditors and the SAIs of EU Member States. This will facilitate future integration.

Although the above mentioned topics will be formalised at the presidents' meeting in Warsaw in March 1998, some practical first steps have already been taken, notably regarding cooperation on the preparation and execution of audit tasks of common interest



## VISIT OF THE PRESIDENT OF THE EUROPEAN COURT OF AUDITORS, PROFESSOR BERNHARD FRIEDMANN, TO GREECE ON JUNE 24th-25th 1997

Mr Friedmann, the president of the Court of Auditors, together with Mrs Nikolau, the Greek member of the Court and Mr Schmidt-Gerritzen, director of external relations, made an official visit to Greece, where they were received by the Greek SAI, the president of the Republic, Mr Stefanopoulos, the prime minister, Mr Simitis, the leader of the opposition party, the president of Parliament, the ministers of national economy and justice and the vice-president of the European Investment Bank. During his meetings with the representatives of the Greek government, Mr Friedmann gave an exposé of the role of

the European Court of Auditors and its work on auditing the use of public funds, as well as the results of the Treaty of Amsterdam and its consequences for the Court. He also stressed the difficulties encountered by the Greek SAI in auditing the European Union's Structural Funds, which are managed by independent management bodies. The need to continue along the road of good cooperation between the European Court of Auditors and the Greek SAI was also stressed.

The president of the European Court of Auditors also had lengthy discussions with

the president of the Hellenic Court of Audit, Mr Apostolos Botsos, the vice-president, Mr George Kokolakis, and the judge counsellor and liaison officer, Mr Constantinos Rizos. Their discussions included various aspects concerning both the European Court of Auditors and the Hellenic Court of Audit. Professor Friedmann also participated in the Plenary Session of the Court, as guest of honour.

The president of the European Court of Auditors, during his visit to Greece, had the opportunity to point out how important it is for there to be effective cooperation between the European Union and the Hellenic Court of Audit on the audit of Community inflows in Greece.



From right to left: Mr. Ioocnnis Sarmas, Judge at the Hellenic Court of Audit, Mr. Constantinos Rizos, Judge Counsellor at the Hellenic Court of Audit, Mr. Apostolos Botsos, President of the Hellenic Court of Audit, Mrs. Kalliopi Nikolaou, Member of the European Court of Auditors, Prof. Dr. Bernhard Friedmann, President of the European Court of Auditors, Dr. Norbert Schmidt-Gerritzen, Director of External Relations of the E.C.A., Mr. Konstantinos Kostopoulos, Judge in the Hellenic Court of Audit and Mr. George Kokolakis, Vice-President of the Hellenic Court of Audit.



# The Risk is the Determining Factor...

## Application of analysis of risk method in governmental finance control

PETER PROBST

Director

and DANIEL DUBOIS

Scientific Assistant, Swiss Federal Audit Office

The Swiss Federal Audit Office (SFAO) is the supreme federal organ for the supervision of finance of the Swiss Confederation. As a service rendered to the Federal Council and the Parliament, the SFAO supervises the federal administration, services and institutions of the Confederation, the national social insurance and subsidised organisations. The volume of expenditure to be supervised amounts to a total of almost 100 milliard Swiss francs. In view of this order of magnitude, a complete and consistent audit is no longer possible. Therefore, the SFAO can only do spot-checks and often only at lengthy time intervals. Thereby it is important that the audits are not carried out in a straightforward way but are based upon consideration of risk. Precarious fields of expenditure and income should be audited within shorter time intervals, those fields with few risks at lengthier time intervals.

A systematic analysis of risk is an indispensable tool for the planning of audits. Three years ago, the SFAO developed and implemented such an analysis of risk that was tailored to the special needs of a governmental office for financial control. Thereby the following demands were made.

It should be oriented towards the organisational unit, not towards a single project, be simple and easy to use, systematised and computerised as far as possible, and related to risks in connection with the compliance with regulations and legality, as well as partially related to risk of commercial efficiency. Renunciation of the evaluation of the probability of risk occurrence, since the margin of discretion is too large. It should be current at all time and updated after each audit.

The concept and the most important elements of the analysis of risk are briefly presented as follows:

### Fields of examination

The primary criteria of classification is the organisational unit. Basically an analy-

Fields of examination	
Specific book-keeping	
Staff, Administration	
Procurem.of materials	
Building expenditures	
Expenditures f.experts	
Subsidy X	
Inventory	
Revenues	
...	

sis of risk to be carried out for each office, semi-governmental organisations or enterprise of the government. As a rule, these organisational units will be split up in different fields of examination. Both the fields of examination "Specific Book-keeping" and "Expenses for Staff and Administration" are considered standard domains and are to be analysed in any case. The evidence of risk given in the field of examination "Specific Book-keeping" es-



*A systematic analysis of risk is an indispensable tool for the planning of audits.*

pecially serves as a base for audits of compliance with regulations.

The remaining fields of examination refer to the specific tasks of an organisational unit and therefore may vary considerably. Such fields of examination may be individual divisions/sections or tasks of government offices. Often the two criteria are identical, i.e. a specific organisational unit (category of persons) is responsible for a specific task. Among other things the evidence of risk given in these special fields serves as a base for efficiency or effectiveness audits.

**Criteria for judgement**

Basically a large number of criteria for judgement are available. For practical reasons five main criteria were chosen.

<b>Criteria for judgement</b>	<i>Internal control system</i>				
	<i>Tasks/Complexity</i>				
	<i>Financial importance</i>				
	<i>Modifications</i>				
	<i>References</i>				

*The primary criteria of classification is the organisational unit.*

The main criteria are subsequently divided into subcriteria. Fixed levels of importance are attributed to these subcriteria (3 = high level of importance, 1 = average level of importance). Subcriteria with a low level of importance were not even taken into consideration.



Criteria / Subcriteria	Possible view of assessment	Importance
<b>1. Internal Control System (ICS)</b>		
Organisation, work flows, systems	Are the regulations for persons authorised to sign as well as the working instructions, organisational charts and duties record books compatible with the overriding legal basis, and are they being followed?	3
Separation of functions	Do decisions taken (considering the organisational structure as well as work flows), execution and control, remain separated from the financial transactions?	3
Control mechanism	Is there a concept for controls and, if so, is it applied? Are there neither control gaps nor overlaps present? Are the fields of reconciliation exactly defined (for instance in computer systems) etc.?	3
Staff	Are the professional qualifications as well as the number allotted for personnel sufficient considering the requirements? How is the working climate among the staff and their further education etc. to be judged?	1
Internal Inspectorate	Does an inspectorate exist and does it do a good job? If there is no inspectorate, would such a unit be appropriate considering	



Criteria / Subcriteria	Possible view of assessment	Importance
	the complexity of the task? The lack of an inspectorate may be a risk factor.	1
<b>2. Complexity of the task</b>		
Variety of tasks and complexity of the field	Examination fields comprising many different and complex tasks will fundamentally include a greater risk than smaller fields with simpler tasks comprising routine jobs.	3
Execution of the tasks	Do the people responsible have their tasks under control or is it too much for them? Are the internal official channels defined and are they followed (for instance: propositions for projects). Does the credit management comply with the requirements and are the modern tools available also implemented (for instance: information technology)?	3
Use of discretion in executing tasks	Is the delegation of competence well pronounced, i.e. do the executive staff have much free space and opportunities with interpretation or are there firm regulations?	1
<b>3. Financial importance</b>		
Expenditure / Revenue according to financial accounts	Within the fields of examination "Specific Bookkeeping" as well as "Staff and Administration", the following scale is applied: < 30 million Swiss francs = "low" (i.e. importance); 30 to 500 million Swiss francs = "medium"; > 500 million Swiss francs = "high". The other fields of examination are arranged graduated according to the percentage of total amount of expenditure/revenue: < 20 percent = "low"; 20 to 50 percent = "medium"; > 50 percent = "high"	3
Transactions through balance sheet accounts	The amount of turnover in the individual balance sheet accounts is the decisive factor within this field of examination: < 30 million Swiss francs = "low" 30 to 500 million Swiss francs = "medium"; > 500 million Swiss francs = "high"	1

*The task of the auditor consists only of judging every single field of examination and partial criteria based on his knowledge and audit experience.*



Criteria / Subcriteria	Possible view of assessment	Importance
<b>4. Modifications</b> Modifications in the duties record book of an administrative unit  Reorganisation	Modifications in the duties record book may lead to a higher risk factor, since the staff executing them might not entirely grasp their new duties or respectively have not yet mastered them. Especially the risk relevancy of modifications in law, of transfers to private ownership and of new tasks etc. is to be judged.  Reorganisation may cause uncertainty in the transitional phase and therefore lead to a higher risk in the execution of the tasks. This is also true in the case of a change in personnel holding key positions, change of residence of working units (i.e. influence on work flows) etc.	3  3
<b>5. References</b> References from the last audit  References from the media, technical journals, professional organisations etc.  Indications from private individuals	Were the findings from previous audits taken into account by the administration unit (follow-up-audits)? Such arrears may indicate a higher risk factor.  Coarse examination of the relevancy and justification of the indications with respect to their influence on the risk potential.  Coarse examination of the relevancy and justification of the indications with respect to their influence on the risk potential.	3  1  1

*The analysis of risk serves as a basis for the strategic audit planning as well as for the drawing up of the current audit programs.*



#### Assessment

As the system provides the criteria for assessments and weights, the task of the auditor consists **only** of judging every single field of examination and partial criteria based on his knowledge and audit experience. Thereby three levels are at his disposal:

**“low”** = good accomplishment (for instance: the internal control system is functioning properly, simpler tasks, very limited powers of discretion, no arrears concerning audit findings (i.e. appropriate steps were taken to solve the problems previously revealed by the auditors), insignificant changes in the duties record book, insignificant financial importance etc.)

**“medium”** = satisfactory accomplishment

(for instance: overall the internal control system is functioning properly, average tasks and average powers of discretion etc.)

**“high”** = unsatisfactory accomplishment

(for instance: separation of functions in important areas are not achieved, new tasks in duties record book, broad powers of discretion, significant arrears in resolving audit findings, significant financial importance.)

Example: Administration Unit x

Criteria for judgement	Weight	Judgement	Total
<b>ICS</b>			
– Organisation, work flows, systems	3	high	15
– Separation of functions	3	medium	9
– Control mechanism	3	high	15
– Staff	1	high	5
– Internal Inspectorate	1	low	1
		<b>Grand total</b>	<b>45</b>
		<b>Degree of risk</b>	<b>H</b>

*The analysis of risk is mainly considered as a working tool.*

Interpretation

The further calculations will be executed exclusively by the system. The weighting and judgement factors will be multiplied for each field of examination and subcriteria. The number of points resulting from this will be added in such a way as to give a grand total for each field of exami-

nation and main criteria and the **degree of risk** will be derived thereof. According to the total a degree of risk is “low” (up to 25 percent of the span between the minimum and the maximum possible points), “medium” (25 to 75 percent) or “high” (over 75 percent).

The results of these calculations are recapitulated per administrative unit in a ma-

Administration Unit: x

**H** = high risk      **M** = medium risk      **L** = low risk

Criteria for judgement Fields of exam.	Internal Control System	Tasks/Complexity	Financial Importance	Modifications	References	Audit Priority (1-3)	Latest Audit	Next Audit
Specific Book-keeping	M	L	M	M	M	2	12.96	1998
Staff/Administration	H	L	L	H	M	2	12.96	1998
Procurement of Materials	M	M	L	L	L	3	9.95	1999
Building expenditure	H	M	M	L	M	2	12.96	1998
Expenditure for experts	L	M	L	L	L	3	11.95	2000
Subsidy X	H	M	H	H	M	1	12.96	1997
Inventory Y	L	L	L	L	M	3	12.96	1999
Proceeds	M	M	M	L	L	2	11.95	1998



trix. Degrees of risk rated "high" are to be commented on explicitly on a separate sheet.

The final step is to form a conclusion from the level of risk to the **audit priority** for each field of examination, thereby applying special weight factors. The most important criteria for judgement is the "Internal Control System" to which the highest weight factor (5) is attributed. According to the number of points an "audit priority 3" (up to 25 per cent of the span between the minimum and maximum number of possible points attainable), "audit priority 2" (between 25 and 75 per cent) or "audit priority 1" (over 75 per cent).

#### Final remarks

The analysis of risk serves as a basis for the strategic audit planning as well as

for the drawing up of the current audit programs.

The audit planning of the SFAO is aligned to ensure a yearly audit of all the fields of examination with an audit priority 1, an audit every two to three years for the ones with an audit priority 2 and at least every five years for those with an audit priority 3.

Should longer audit intervals have to be accepted due to limited human resources, the differences between nominal and effective output is to be accounted for in the annual report of the SFAO to the attention of the supreme supervision authority.

The analysis of risk is mainly considered as a working tool. The auditor in charge is responsible for the updating and evaluation. However, the analysis of risk is not the only instrument for the audit planning. Other considerations have to be taken into account, too.



## Political Party Financing and Auditing

UBALDO NIETO DE ALBA,  
President of the Spanish Court of Accounts

Despite their social and political framework, political parties are private associations, intended for the purpose of pooling and defending interests, galvanizing the shaping of the people's political wishes, and serving as a medium for political involvement.

### I. THE FUNCTION OF POLITICAL PARTIES AND THEIR FUNDING

Nevertheless, the importance of these goals does not mean that political parties are a part of the framework of the state organisation. The fact that they perform functions that are in the interest of the general public, and are nuclear elements of the democratic system, raises the question of whether or not they should receive state funding.

After the Second World War, a period of political consolidation ensued when party or-

ganisations were granted legal status and their role as the backbone of the democratic system was reflected in the constitutions of each country: Italy (1947), Germany (1949), France (1958), Greece (1975), Portugal (1976), and Spain (1978). As a result, public financing was introduced without any major political and legal debate. Instead, the slant of the debate focused on whether public financing should replace private financing altogether, or merely be used to supplement it, and whether that would help solve problems such as dependency on lobby groups, lack of equality in terms of opportunities, and lack of

*State financing was one of the most striking features of party law after the Second World War.*

transparency. Thus, state financing was one of the most striking features of party law after the Second World War.

As regards how it is put to use, this form of financing can be earmarked for election campaigns, day-to-day party business, or both, as is the case in Spain. The system in America differs from its European counterpart in that, given the protagonism of the candidate rather than the party, taxpayers can assign part of their taxes for funding presidential campaigns and party conventions.

It was not long before the system plunged into crisis. An international analysis of political organisations confirmed that in most countries public financing ended up supplementing rather than replacing private financing, and not only did this fail to stave off the problems mentioned above, but other political and pathological phenomena, such as political corruption, had crept in too, even in countries such as the United Kingdom, which has no state financing, or Japan, which has a different political culture.

The debate on public versus private financing is an important issue, since it has bearing on: (a) party organisation and running, i.e. their degree of de-centralisation, participation and information, which is tantamount to their internal democracy; and (b) the mechanics of the government administration, its ethical behaviour and the scale of corruption prevalent there.

**Forms of public financing.** A differentiation has to be made between (a) direct financing for ordinary business, election expenses and parliamentary groups, and (b) indirect financing: the use of state-owned news media, special tariffs for election propaganda mailings, and free broadcasting time on radio, television and other media.

**Forms of private financing.** Membership quotas, contributions (from private individuals and companies), donations and income on assets.

Ruling out countries that have no state subsidies, changes in the public funding trends of the 1960s and 1970s are beginning to take place, in favour of the impulse of private financing.

## II. REGULATION, TRANSPARENCY AND AUDITING

Each EU country has its own set of regulations governing public financing, private financing restrictions and transparency controls. As regards transparency, it should be borne in mind that (a) it is consubstantial with democracy, in coherence with what political, social and financial life should stand for; and (b) it should apply to all types of public and private funds. There are different attitudes towards the publication of private contributions and the identification of donors. In Great Britain, it is considered as a form of participation. In Norway and Sweden, it is associated with voting secrecy: loss of anonymity leads to a loss in contributions. In Germany, contributions in excess of a certain number of marks are identified. Likewise, in the U.S., identification is a requirement for contributions in excess of a certain sum of dollars.

The enforcement of this transparency is carried out by means of public registers, and also by controls and penalty systems, which are applied in the event of non-observance. These control methods should be both internal, in keeping with the structure and democratic functioning of the parties (allowing members to claim and be furnished with information), and external. Moreover, these two types of control inevitably complement each other. As for those who question whether private contributions to political parties — which enjoy private legal identity — can be controlled, it can be argued that, given the relevance afforded them in constitutional regulations, the transparency of both public and private funding is a legitimate requirement. As far as domestic control systems are concerned, these range from the drafting of an annual balance sheet, to audit inspections, parliamentary commissions and law court control. In Portugal, control of legality is entrusted to the Constitutional Court, while in Spain, supervision is performed by the Court of Accounts.

## III. FINANCING IN SPAIN AND ITS SUPERVISION

**Financing.** Spain uses the mixed system, whereby state financing provides

*In most countries public financing ended up supplementing rather than replacing private financing.*



subsidies for election spending, for parliamentary groups in the chambers of the Cortes Generales (the Spanish parliament) and for the autonomous regional assemblies, as well as non-specific subsidies for general party business. There are restrictions on private financing, affecting both the private funding of election campaigns and funds for spending on day-to-day business. The regulations governing political parties' ordinary or election activities contain a reference to transparency as a standard requirement in each party's financial actions, together with the requirement to be duly informed of a party's financial and asset position. In this context, certain requirements have to be complied with and an adequate internal auditing system has to be set up, and external control by the Court of Accounts is included as a means of guaranteeing the degree of public transparency required. Thus, political party submission to the Court of Accounts resides in an express and differentiated legal remission in the election rules and in the rules governing regular funding.

#### **Supervision of election activity.**

Election regulations vary according to the type of election campaign concerned. As regards the financial activity currently under analysis, they cover all the items of election spending that a political party is faced with during the election period, from the date it is announced until the campaign winner is elected, and establish a maximum spending limit, according to the number of inhabitants in the election constituency, along with other restrictions on particular items of spending, such as external advertising expenditure (25%) or press and radio (20%). Likewise, details of possible sources of public or private financing and the requirements for how this funding can be used are provided.

In addition to the concomitant supervision performed by the election committee boards, the Court of Accounts has the final say in auditing the election accounts and awarding the subsidies. As a result, each political party that meets the requirements for the award of state subsidies or has had access to advance subsidies, is obliged to submit documented accounting information on its respective election income and spending to the

Court of Accounts within 125 days of the elections. Banks are required to supply the Court of Accounts with information, within the same time period, on any credit or loan transaction arrangements they may have made with the political parties, as well as companies that have invoiced parties for sums of over one million pesetas. After requesting additional information, when necessary, and making any pertinent inspection verifications, the Court of Accounts then issues an audit report within 125 days of the elections, and gives its opinion on whether or not the election accounts comply with the regulations, declaring how much regular spending has been accounted for by each party and listing, where necessary, any accounting irregularities and infringements of the law, particularly those involving election income and spending limits. When irregularities are detected, the Court of Accounts may make a recommendation for a reduction or even the non-adjudication of the subsidy to which the political party committing the infringements would have been entitled. If any evidence of misconduct amounting to an offence is identified, the Court of Accounts is obliged to inform the Public Prosecutor.

When analysing the action to be taken by the Court of Accounts in the light of the laws in force, mention should be made of the scope of coverage of the audit and the limits within which it has to be performed. The analysis focuses on the balance sheets and on their documentary explanation. Since political parties and their regular suppliers do not belong to the state sector, the system contained in the Court's own rules concerning the obligation to collaborate fails to apply to them, except in an analogue application. Collaboration is restricted to a request for information applying normal auditing techniques and, particularly, sending out memoranda, but the consequences of failing to respond to this request are not legally envisaged, nor has the appropriate penalty procedure been drawn up.

**Control of day-to-day business.** The law places the task of the external auditing of a party's ordinary financial business exclusively on the Court of Accounts. The scope of this authority covers all political parties, irrespective of

*Each EU country has its own set of regulations governing public financing, private financing restrictions and transparency controls.*



whether or not they are under the obligation to hand over their accounts to it — an obligation restricted to political parties that are awarded state subsidies for their ordinary business expenditure, as a result of having secured representation in Parliament.

The auditing task performed by the Court of Accounts, leaving aside the general, subjective framework contemplated by the law, has been directed at parties that are under the obligation to submit their accounting documents. Just as in election campaign auditing, the Court of Accounts performs a twofold action. In the first place, and solely for the purpose of providing guidance and assistance, a number of technical guidelines have been drafted and distributed to each party, setting out a particular accounting structure of the books and registers to be filled in. Parties are requested to reflect the financial activity of the whole of their territorial and institutional organisation, and to include election activities as well. They are given a reminder of their responsibility to keep safe custody of the accounts books and supporting documents, and details are provided of the balance sheets that are to be sent to the Court. This doctrinal activity is reinforced by monitoring the accounts drafted and communicating the results obtained. The Court of Accounts' audit focuses on analysing the balance sheet and the results' account submitted, examining its area of reference and its internal consistency, and making the appropriate classification and quantification of the transactions recorded. That action is based on common auditing techniques, ranging from drafting a work schedule, making an appraisal of internal control, taking any evidence required, and asking for the collaboration of third parties, by sending out memoranda, chiefly to financial institutions, and confirming data with other public bodies, in order to compare them with the results obtained from the analysis of the accounts of the party being audited.

The results of all the inspections performed are compiled in a provisional report which, irrespective of any prior comparisons that may have been made with the individuals responsible for running the party subject to inspection, is

then formally forwarded to the party so that any allegations considered opportune may be made and pertinent supplementary documents submitted. When the Court receives the allegations, they are analysed, and any modifications arising from them are included in the results' proposal. It should be emphasized that from this time on and irrespective of the degree of acceptance they may have received, the allegations are included at all times in the Court of Auditor's report, as a means of comparison or confirmation of its findings, and despite its capacity as Supreme Auditing Authority. The provisional report and the modifications from the treatment of the allegations are distributed to all the members of the Court's Full Session — 12 board members and a counsel for the prosecution —, and to the State Legal Department, for their information and to enable them to make any comments and suggestions that they wish, and request further information or documents, if necessary. After they are adopted by the Full Session, they are sent to Parliament. In the case of election reports, they are forwarded to the corresponding legislative chamber — Cortes Generales or Regional Assemblies — and to the respective department at the corresponding central or regional government authority.

Once the report has been received in Parliament, it is analysed by the Mixed Congress-Senate Committee for relations with the Court of Accounts. In a first session, which the president of the Court of Accounts is usually called upon to attend, the Committee gives a brief summary of the report and then attends to any formal requests for explanations and additional information made by the parliamentary representatives. After this parliamentary procedure is over, the Court of Auditor's report is published in the Official State Gazette with the decisions adopted in Parliament. Although news media reporting is not always accurate, the media usually give the Court of Auditor's Report ample coverage. This helps to broadcast its content, taking it beyond the context of the political parties themselves and enabling it to achieve a degree of social significance.

*Spanish law places the task of the external auditing of a party's ordinary financial business exclusively on the Court of Accounts.*



# *The establishment of the State Audit Office of Croatia*

SIMA KRASIC  
Auditor General of Croatia

One of the basic factors of the success of democratic state organisation is that the state carries out the legal and hopefully efficient management of public resources. State auditing promotes that principle considerably.

## **Beginning of the Work**

The Croatian State Audit Office began its operation in the year 1994. There was a gap of approximately 85 years (from 1918 to 1993) in the audit history, and during that period Croatia did not have its own audit organisation.

The first modern Croatian Sabor (Parliament) was constituted on May 30th 1990, after free pluralist elections. On December 22nd 1990, Sabor adopted the constitution, which created grounds for the proclamation of the Republic of Croatia as an independent state. The proclamation of re-establishment of the sovereign and independent Republic of Croatia was adopted by Sabor on June 25th 1991.

Regarding its political and social structure, the Republic of Croatia is organised as a parliamentary multi-party state with the developed institutions of a modern, democratic and social state. The Republic of Croatia has 20 counties (županija) which are local, self-governed units with local administration. The capital city of Zagreb, has its own administrative entity. Local self-government is organised through cities, municipalities and communes in which citizens decide upon local interests and needs.

## **The Organisation**

The State Audit Office is a new institution of the free, independent and democratic Republic of Croatia. It was established by the State Audit Act adopted by Sabor in July 1993. The act created the basic conditions for beginning the auditing work. Like the majority of other Supreme Audit Institutions, the State Audit Office is head-

ed by an auditor general. The auditor general was appointed by Sabor on April 8th 1994, when auditing activities in Croatia started.

Notions and experiences concerning the structure and authorities of similar institutions in other states, especially European, were also used. However, the start was not easy at all. The Republic of Croatia was under military attack and was forced to defend itself, in a war situation which was aggravating for the start of work in the State Audit Office.

The State Audit Office was a completely new institution and, therefore, its first task was aimed at finding, equipping and making functional needed work space, preparing legal acts, recruiting staff, defining the internal structure, organising field offices, and other necessary duties.

The selection of the right, highly-qualified and reliable employees was among its priorities. Employment of the candidates without any prior experience in conducting state audit duties was accompanied by difficulties, but at same time had its advantages. The candidates were free of heredity from the former system.

By organizing seminars and other forms of training, learning from other SAIs with a century-old tradition, organising exams for licensed state auditors, and other activities, we have succeeded in solving the biggest problems in a proper manner, through our own work but also with considerable support from Sabor and its bodies. Thanks to our employees, we have succeeded, in only two years, in establishing an institution of state audit and in providing a high level of performance.

The range of duties, methods, and how the auditing is carried out, are defined in

*The State Audit Office is a new institution of the free, independent and democratic Republic of Croatia.*





the State Audit Act 1993. The State Audit Act is based on the basic principles of the Lima declaration adopted by the 1977 INTOSAI Congress IX in Lima, Peru. By establishing a State Audit Office instead of a Court of Audit — the two largest models of state audit — Croatia chose the form which appears in the majority of states. The most important characteristics of the State Audit Act are: large auditing powers regarding state expenditure, besides financial audit, evaluation of management, i.e. performance audit (application of the 3 E's) as well.

The audit standards of INTOSAI are applied as a tool for the procedure. The State Audit Office is an independent body as defined by law. The office submits its reports of activities and findings to Sabor yearly. One of the powers and duties of the State Audit Office is to carry out the audit of all bodies financed by the state budget or by the budget of local entities, partly or completely. The auditees are all legal entities in which the state has a majority of capital. State funds (such as employment, retirement and health) and the National Bank of Croatia are also auditees.

As a consequence of legal determination, in practice, the auditees are not the only users of the budget, but a large number of enterprises as well, i.e. state-owned companies (not yet privatised) and ones with majority of state capital after privatization.

The definition of audit, according to the State Audit Act, comprises the audit of the use of state resources and the evaluation of economy, effectiveness and efficiency of management. It also gives the State Audit Office the right to audit projects financed by the government from the budget or state funds, for example, environmental projects. The ability of the State Audit Office to carry out the audit, as defined by law, includes large-scale powers, even larger than in some countries with a longer tradition.

Once a year, in accordance with the law, the State Audit Office carries out the audit of the state budget, local entities' budget, state funds and the National Bank. Other auditees are audited in accordance with the annual programme.

Besides the duties provided by the law and the annual programme, the State Audit

Office is obliged to carry out a specific audit upon request of the Lower House of Parliament only. No other institutions or bodies are entitled to ask for an audit. Such a legal situation assures the independence of the State Audit Office. This level of independence gives the Croatian state audit the attributes of a modern institution which is equal to most such institutions in developed countries, whose law gives permission only to Parliament to interfere in the programme of the Supreme Audit Institution.

By law, the duty of the Office is to carry out the audit strictly in accordance with the audit standards of the International Organization of Supreme Audit Institutions (INTOSAI). The audit standards have been translated into Croatian and published in the Official Gazette of the Republic of Croatia.

The application of audit standards in audit procedure made it possible for the State Audit Office to join INTOSAI and EUROSAI. That made cooperation with other Supreme Audit Institutions in Europe, and in the world as a whole, possible. By applying INTOSAI audit standards, the State Audit Office achieves objectiveness in the treatment of all auditees. Equality in treatment is assured by constant use of the same method and approach. Respecting the principles of objectiveness includes the auditee's right to make objection on the findings of the auditor. This right is guaranteed by law.

The State Audit Act contains provisions concerning the independence of the Office. The independence of Supreme Audit Institutions is among the principles which make up the foundations of each state that aims to be considered as democratic.

In the State Audit Act it is explicitly stated that the audit may be carried out only by a licensed state auditor as an independent person. The independence of state auditors makes the institution of state audit independent as well. The licensed state auditor prepares the report of findings independently and signs the findings. The State Audit Office is obligated to the Lower House of Parliament only, and no other authority can interfere.

The next principle of reporting to the Parliament and to the public, which is

*The audit standards of INTOSAI are applied as a tool for the procedure.*



among the most important principles of the modern audit system, is also respected by the State Audit Act. Once a year the State Audit Office submits its report of findings and the report of its work. Sessions of the Lower House of Parliament are transmitted by media, radio, TV etc. The reports of the auditor general attract considerable attention among journalists and therefore the public receives extensive information on the activities and findings of the auditor general. In that way, all interested citizens are informed of the findings, conclusions and decisions of Parliament. Citizens of Croatia are very interested in the activities of the auditor general and they often express their support to the auditor general, verbally or in writing.

Having already achieved results and earned its reputation, the State Audit Office of the Republic of Croatia has all legal and other presumptions to develop as a modern audit institution.

The legal document known as the Rules of the State Audit Office Internal Organisation foresees the employment of 291 employees, 242 state auditors and 49 administrative staff members. Currently, we have 170 auditors and 50 administrative staff. The auditor general runs the Office and is helped in that task by a deputy, six assistants and by principals of county offices. The managing staff, except those running the Office, are qualified for and are supposed to carry out most audits upon request. They can be regarded as direct executives of the audit.

#### **Powers of the State Audit Office**

According to the State Audit Act, the State Audit Office is competent for auditing public expenditure, financial statements and financial transactions of government units, local self-government and administration units, legal entities that are partially or on the whole financed from the budget, legal entities with a majority of state capital, and the National Bank of Croatia.

Government expenditures are all current and major expenditures are financed from the state budget, from appropriate funds at national level and from the budget of local self-government and administration units.

It is necessary to stress that the State Audit Office, by analyzing documents, deeds, statements, internal supervision and auditing systems, accounting and financial procedures, also includes the assessment of efficiency and profitability of certain activities, as well as the assessment of effectiveness in pursuing the objectives of projects and tasks.

#### **Auditing Procedure**

The organisation of the Office is defined by the Statute of the State Audit Office. The statute regulates running the Office, the function of the Council of Experts, the auditing procedure, reporting, keeping in secrecy all the confidential data collected during the audit, and financing the Office. The statute was adopted by the auditor general on May 5th 1994 and confirmed by the Lower House of Parliament on May 25th 1994. Both the State Audit Act and the statute stress the independence of the State Audit Office and, especially, independence from the executive which, as the user of the budget, is an auditee and is responsible for the reasonable use of financial resources.

After the statute had been confirmed by Parliament, the auditor general adopted the document known as The Rules of Internal Order, and also other legal documents. After that the process of recruiting the auditors and employees started. That was the beginning of work.

The State Audit Office has headquarters in Zagreb and 20 regional offices in county capitals. It is important to say that the State Audit Office is an undivided institution for the whole state, with one programme and the duty to report its findings to Parliament. Organization by regions is used only to allow more rational and efficient work.

#### **Training of Auditors**

The state audit is a new institution. There is no university department for training state auditors. Resources for obtaining staff are the Law School and the School of Economics, and their graduate students are potential candidates for the job of state auditors. The problem of ob-

*The State Audit Office started an apprentice employment programme.*



taining skilled staff has been solved in a satisfactory way by hiring experienced experts from different areas, especially from finance and accountancy.

According to the State Audit Act, the auditor general appointed an exam commission. Its duty was to organise the preparation of candidates for the exams, to hold the exams and to issue certificates. An appropriate syllabus for the exam was drafted and thanks to it, candidates have the opportunity to familiarize themselves with what is wanted of them.

The State Audit Office started an apprentice employment programme. Candidates with a degree in law and economics are provided with an opportunity by

means of this programme. After joining the office, young lawyers and economists attend specialized seminars and courses. The aim of these seminars and courses is to train all participants and to increase understanding of audit. Young apprentices participate in audit team work as well. Through this work they acquire necessary auditing knowledge. All auditors are involved in some form of training. The forms of training are, for example, courses, seminars, symposiums, lectures, international cooperation and the application of the knowledge and experience of other Supreme Audit Institutions with a much longer tradition. All auditors have the duty to read domestic and foreign audit literature.



## *The Audit of European Community Funds*

Dr. HEDDA VON WEDEL

President of Germany's Supreme Audit Institution

At a convention held on May 27th 1997 to commemorate the 50th anniversary of the audit institution of the German State of Rhineland-Palatinate, Dr. Hedda von Wedel, president of Germany's Supreme Audit Institution, the Bundesrechnungshof, gave a paper, which received wide attention, on the audit of European Community funds.

The paper highlights the differences in the respective mandates of the national audit bodies and the European Court of Auditors (subsequently referred to as "ECA") in this field. Furthermore, it emphasizes the independent status of the audit institutions concerned as a pre-requisite for an effective coordinated audit of EC funds. Finally, it describes the cooperation practiced between the Bundesrechnungshof and the ECA and stresses the need for enhancing such cooperation in the future. The paper reads as follows.

### **I. The tasks of the audit institutions and the bodies to whom they report**

The mandates of the ECA and of the national audit institutions vary to a large degree. I wish to highlight these differences because they result in differing audit subjects and audit objectives, thereby restrict-

ing the possibilities for meaningful cooperation between the European and the national audit institutions.

In the early stages of the European Community's history, its external audit function was fulfilled by what was known as the Audit Board, a body composed of staff from the national audit institutions

seconded for that purpose. However, since its establishment in 1977, the ECA is the sole body in charge of auditing the EC's financial management and of reporting thereon to the EC institutions. Eventually, the ECA itself was conferred the status of an EC institution by virtue of the decisions taken by the European Council at Maastricht. Furthermore, the requirement that the ECA provide a Statement of Assurance (SOA) as to the reliability of the accounts and the legality and regularity of the underlying transactions enhanced its audit mandate, and its staff resources were increased to perform this new task. The performance of audit work by national audit institutions on behalf of the ECA or the EU is not provided for by Community legislation.

While the ECA may collect audit evidence at national departments which manage EU funds, it always reports to the European Commission and Parliament, never to national bodies.

In contrast, the national audit institutions examine national financial management and report thereon to national governments and parliaments. This is why the Bundesrechnungshof, to comply with its constitutional mandate, will always first focus on risks to the German Federal Budget whenever embarking on an audit exercise connected with EU matters. In conducting such an audit, the Bundesrechnungshof will give preference to the information needs of the German Parliament, where the matter will be dealt with in various committees whose remits include European issues.

Only by way of a marginal note, I would like to explain that a large part of EU grant funds received by Germany go to its federal states (subsequently referred to as Lander) and are managed by Lander agencies, as a result of which there are also audit rights of the Lander audit institutions. This paper, however, focuses on the relationship between the Bundesrechnungshof and the ECA. Nevertheless, what I am going to say about this relationship is likely to apply similarly to the relationship between the Lander audit institutions and the ECA.

While the audit mandates of the ECA and the Bundesrechnungshof differ in principle, the two nevertheless have simi-

lar audit interests. This is obvious when one considers that Germany contributes about one third of the total of EU budget funds and that one third of any amount of expenditure saved by the EU means a corresponding relief to the German Federal Budget. Furthermore, while some Member States receive EU grant funds largely in excess of their financial contribution to the EU, the amount of such grants received by Germany is equivalent to only a minor portion of its contributions to the EU. This underlines Germany's concern with the economical management of EC funds.

Apart from areas in which the audit interests of the two audit institutions overlap, and in which cooperation therefore makes sense, the Bundesrechnungshof also has EU-related audit fields which do not come within the remit of the ECA. I am going to illustrate these differences in the scope of our respective audit mandates by giving some examples.

## II. EU-related audit fields of the Bundesrechnungshof

First I wish to mention some audit fields in which the ECA has no audit powers.

The Bundesrechnungshof examines whether the German Federal Government has adequately safeguarded the interests of the Federal Republic of Germany in connection with the decisions taken by the European Council on policies, legislation, programmes and the EU budget.

I am going to give some specific examples for such examinations:

Does the German Federal Government safeguard national interest by seeking to ensure that there is no duplication of European and national grants for the same purpose and no conflict between the objectives of European and national aid programmes?

Does the German Federal Government, acting in the European Council, seek to ensure that EU rules on the national management of EU funds are compatible with the German federal government system?

Does it press for reasonable budget estimates?

*The mandates of the ECA and of the national audit institutions vary to a large degree.*



Does it press for fixing reasonable remunerations for EU staff?

Does it press for avoiding unnecessary risks to the German Federal Budget in terms of interest, exchange rate losses or transfer cost connected with payments to and from the EU?

And finally, does the German Federal Government, acting in the European Council, press for the elimination of shortcomings found by the ECA in the European Commission's financial management?

The Bundesrechnungshof will also seek to verify whether the Federal Government takes the necessary steps to comply with the EC Treaty, e.g. to fully and timely implement EC directives in national legislation and not to grant inadmissible national aids. In case of such infringements of the EC Treaty, Germany would have to face penalties which, depending on the severity of the infringement, could currently amount to up to DM 1.5 million per day. Furthermore, private individuals or businesses that are put at a disadvantage as a result of an infringement of EC legislation may claim damages from the Federal Republic of Germany.

The Bundesrechnungshof also looks into the administrative costs to be borne by the German Federal Government for the management of EU funds. As such costs are not taken up by the EU, it is necessary to determine the amount of such costs incurred and to obtain assurance that they have been necessary and reasonable.

Finally, the Bundesrechnungshof has to address the question of whether the Federal Government has complied with its overall responsibility vis-a-vis the EU in relation to the German Lander, e.g. does the Federal Government take adequate steps within its power to ensure uniform compliance in all Lander with the Commission's regulations on the management of EU funds in order to avoid EC sanctions?

This in turn gives rise to the question whether the allocation of burdens among Germany's territorial entities is equitable, e.g. whether penalties imposed by the EC are apportioned in accordance with the "offender pays" principle.

Apart from these audit fields which are exclusively covered by the Bundesrech-

nungshof, there are also cases where its powers to audit and to collect audit evidence overlap with those of the ECA.

Where such overlaps exist, the interests of the two audit institutions do not necessarily coincide. Certain measures taken by the EU may result in financial disadvantages to the Member States without adversely affecting the Community budget. This may be the case, e.g. where Member States incur higher interest expenditure or loose interest income because the EC Commission calls EC own resources prematurely. In such cases, national audit bodies are much more likely to look into the problem than is the ECA.

Nevertheless, there are some important audit fields in which the interests of the Bundesrechnungshof and the ECA coincide at least partly.

The first issue of this kind is whether the national departments managing EU funds comply with the EU's requirements as to the regularity and economy of financial management. Where this is not the case, there is not only the danger that EU funds are wasted but also that the EU will disallow expenditure incorrectly incurred by German authorities on behalf of the EU, placing the corresponding financial burden entirely on Germany.

Another issue that warrants auditing by both the ECA and the Bundesrechnungshof is whether Germany collects VAT in the full amount and in compliance with the relevant EC directives. This is because a certain portion of each Member State's revenue from VAT is due to the EC as own resources.

Other issues of common audit interest are structural measures in the Member States which, in the German case, are co-financed from EU, German federal and Lander funds. The ECA regularly complains that the Member States either do not call for the payment of funds by the Commission or, if they do, delay the actual use of these funds for the purposes for which they were granted. At national level, we have to find out the reason for these practices. We have learnt from Lander courts of audit that national funds appropriated for regional development were spent early and then the EU funds could not be claimed because the required matching funds were not available at national level.

*While the ECA may collect audit evidence at national departments which manage EU funds, it always reports to the European Commission and Parliament, never to national bodies.*



In such cases of a common audit interest, cooperation between the audit institutions concerned makes very much sense.

On the whole, it can be said that an allocation of audit responsibilities has emerged between the ECA on the one hand and the national audit bodies on the other.

Nevertheless there are overlaps and issues of common audit interest in certain areas. This allocation of responsibilities which, in practice, amounts to a worksharing arrangement, is a direct consequence of the different legislative mandates of the audit institutions and the different addressees of their reports. It is only this sharing of audit work which allows comprehensive monitoring of the complex financial arrangements pertaining to the European Union.

### III. Independence of audit institutions

In order to make the worksharing approach to the audit of the EU viable in practice, all the audit institutions involved have to carry out their original mandates. However, in order to do so, they must be able to decide independently and without external interference about how to carry out their mandates. The independence of audit institutions is not an end in itself but rather a means to ensure effective external audit.

However, the independent status conferred upon the Bundesrechnungshof by the German Constitution is so far-reaching that even the German Parliament may only make requests for audits. If an obligation were imposed on the national audit institutions to cooperate with the ECA, the latter's influence on external audit activities at national level would be greater than that of the national parliaments. This might considerably hamper the assistance national parliaments receive from external audit bodies in the exercise of their legislative oversight function.

Therefore the EC Treaty rightly does not impose an obligation on national audit institutions to cooperate with the ECA but only provides for voluntary cooperation. The German Parliament's Appropriations Committee took great care to emphasise this aspect in a resolution it passed in September 1996. While endorsing the European Parliament's initiative to promote cooperation between the ECA and the national audit bodies, the German Appropriations Committee stressed that, in the interest of national parliamentary oversight, the audit institutions taking part in this cooperation were to maintain their full independence and that, in this respect, the Committee's view coincided with that of the German Federal Government and the European Council.

Support for safeguarding the independence of the national audit institutions has come forward from various quarters. Among others, the heads of the supreme audit institutions of the EU Member States and the President of the ECA, at their latest meeting held in November 1996 emphasised that cooperation with the ECA would have to be voluntary.<sup>1</sup>

However, all national audit institutions involved in EC-related audit work also agree that they will in future enhance their voluntary cooperation on the basis of mutual trust.

### IV. Existing and future of cooperation with the European Court of Auditors

The following is to set forth the existing forms of cooperation and the targets we have set in this respect.

At the institutional level, there is a lively exchange of opinions on the basis of annual meetings of the president of the ECA and the heads of the national Supreme Audit Institutions of the EU Member States (known as the "Contact Committee"). When required, such meet-

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<sup>1</sup> The various efforts to safeguard the independence of national audit institutions have meanwhile led to a clarification of the EC Treaty, whose Article 188 c 3 now expressly provides that the national audit institutions and the ECA cooperate in a spirit of trust while maintaining their independence. Along with other amendments of the EC Treaty, this one was adopted by the European Council in Amsterdam in June 1997. The amendments were signed by the Member States in October 1997, while ratification by the Member States is still pending.

ings take place more frequently and are prepared by meetings of liaison officers. Special working groups have been established to deal with certain issues, e.g. the development of common auditing standards and the implementation of joint VAT audits. During the last Contact Committee meeting in November 1996, a new working group was established whose terms of reference are to explore the possibilities, prerequisites, procedures and rules for enhanced cooperation between the audit Institutions.

At the practical level, we have had considerable success with cooperative VAT audits initiated by the Bundesrechnungshof in 1994, in which, apart from the ECA, several national audit institutions take part. Experience with these audits has shown that such cooperative assignments require a vast input of preparatory and coordinating work.

Therefore, they provide good value for money only where an individual audit institution cannot conduct effective audit work on its own, e.g. because the audit involves "cross-border" issues.

In isolated cases, auditors of the Bundesrechnungshof have accompanied their colleagues from the ECA on audit visits in Germany. However, we derived little benefit from this because we were notified of the audit subjects only in general terms and at short notice.

In my opinion, closer cooperation requires above all a better exchange of information between the audit institutions. To achieve this, agreements must be reached and procedures developed. A first step has been taken by exchanging audit programmes between the ECA and the Bundesrechnungshof. Further steps must follow with a view to developing a practical system for passing on information. Many things have to be considered in this endeavour. There are, e.g. some unresolved questions in connection with expenditure disallowed by the EC. Also, any

agreement on the communication of audit findings must include provisions to safeguard the rights of third parties. Eventually, the audit institutions could enter into agreements about sharing audit work in order to make better use of the resources of the various audit institutions.

In my view, any enhancement of cooperation is at present impeded by the short reporting deadlines imposed on the ECA by Community legislation. These deadlines restrict the ECA's discretionary decision-making about time-consuming broadly-based audit exercises, e.g. systems audits. In contrast, the Bundesrechnungshof schedules larger periods of time for such audits and discusses the audit results with auditees. As to the latter, the ECA often lacks sufficient time to do so.

## V. Conclusion

I would like to summarise the foregoing as follows:

Again and again, audit institutions find that officials and entities in charge of spending public funds do not sufficiently bear in mind that it is ultimately the taxpayers, that is all of us, who have to pay for all public expenditure incurred. Where EU funds are involved, this lack of awareness appears to be even greater. This makes an effective audit even more important.

This is why I advocate any cooperation of audit institutions which contributes to a more efficient and effective audit of EU funds, provided that such cooperation is voluntary and based on a spirit of trust. The ECA and the audit institutions of the EC Member States have agreed to enhance cooperation and to work out the methods and procedures necessary to do so. The progress made so far gives me the hope that we will attain our common objective.

I wish us all every success in meeting the challenges lying ahead.

*The Bundesrechnungshof also has EU-related audit fields which do not come within the remit of the ECA.*



# *On the threshold of performance auditing*

NECDET KESMEZ

Court Member, Turkish Court of Accounts

Over the last decade accountability has gone far beyond the traditional criteria of regularity and financial propriety. SAIs have shifted emphasis from compliance and financial auditing to performance auditing, in parallel with a new concept of accountability and also with a dramatic change in the pattern of government expenditure. Audit is not being regarded as an end in itself any more, but as a means of achieving necessary improvements in the public sector management.

## **Introduction**

Performance auditing is a relatively new discipline. This new type of audit has evolved to meet the need for greater information by taxpayers and their representative, Parliament, mainly regarding efficiency and economy in the use of resources by public managers acting on behalf of the executive. These new aspects of accountability and auditing also helped performance auditing come into being. Moreover, as performance auditing is continuously developing, new ideas are emerging to extend its scope; it is suggested, for instance, that ethics, equity and equality be added to the traditional three E's.

These developments were among the most important driving forces in the realisation of the amendment to the legislation governing the Turkish Court of Accounts (TCA), which provides explicitly that the TCA shall have the power to carry out audits of economy, efficiency and effectiveness on the departments and agencies under its jurisdiction. Under the same amendment, the Budgeting and Planning Committee is entrusted with responsibility for reviewing the performance audit reports, as well as the other parliamentary reports cited in TCA Law, and for submitting them, together with its opinion, to the General Assembly of Parliament. This provision, which eliminates the ambiguity hitherto prevailing as to the addressee of the TCA's parliamentary reports, will give great impetus for embarking on new audit projects. This article is intended for the

purpose of sharing our short experience on the threshold of performance auditing with our sister institutions, especially those that resemble the TCA in terms of performance auditing and other contemporary audit approaches.

## **Organisation and Functions of the TCA**

A brief description of the organisation and functions of the TCA may help the reader to better appreciate what follows.

The TCA was established in 1862. It operates under the Constitution of 1982 and under the provisions of a law specific to the TCA. The Constitution and TCA Law state that the TCA is to audit, on behalf of the Turkish Grand National Assembly (TGNA), revenues, expenditures and properties of government departments and agencies.

While the TCA carries out its work on behalf of the legislature, it remains independent of both the legislative and executive branches of government. The president, Court members and auditors, have permanent tenure. Besides its institutional independence, the TCA enjoys its financial independence by preparing its own budget which it submits to the legislature without the intervention of the Ministry of Finance.

The following government departments and agencies are under the jurisdiction of the TCA: (i) central government organisations which are financed from within the General Budget; (ii) au-

*The main functions of the TCA can be categorised as: auditing, judicial proceedings and reporting.*





onomous or semi-autonomous government organisations financed by “Annexed Budgets” (e.g. state universities, the General Directorate of State Highways, the General Directorate of State Hydraulic Works, etc.); (iii) organisations financed by revolving funds and certain extra budgetary funds; and (iv) special budget organisations including, chiefly, municipalities and provincial administrations.

Certain government institutions and activities are outside its jurisdiction, namely state-owned enterprises, some extra budgetary funds and privatisation processes. Until the recent amendment to its law, the TCA had to stay within the confines of financial and compliance audit.

The TCA is an organisation with a dual configuration: an “Auditing Body” and a “Judicial Body”. The auditing body is comprised of auditors who are recruited and appointed by the president of the TCA upon successfully passing a competitive examination. TCA auditors enjoy a considerable latitude in exercising their duties although they are administratively attached to the secretary general and the president of the TCA.

The judicial body is structured collegiately: it comprises a General Assembly, two high boards (the Board of Appeals and the Board of Chambers) and eight Court chambers. All these colleges are staffed by (i) “Court members” elected by the Parliament from among TCA auditors of a specific seniority and standing, and also from among the bureaucrats occupying certain high governmental positions; and (ii) “rapporteurs” appointed by the TCA president from among the auditors.

The main functions of the TCA can be categorised as: auditing, judicial proceedings and reporting. The auditing function is carried out by TCA auditors and involves the preparation of (i) financial and compliance audit reports (internal reports); and (ii) reports on the financial system and on the implementation of state, departmental or agency budgets (draft external reports). Both two types of reports are signed by the auditors who actually carry out the audit work required. However, they have to be examined by one of the collegiate bodies of the Court, and a deci-

sion should be taken on them, in the first case by the chambers, and in the second usually by the General Assembly.

The judicial function is exercised mainly by the chambers and the Board of Appeals. The General Assembly also participates in this function, but only when there is a contradiction between the decisions reached by the above-mentioned bodies.

The auditors’ internal reports are “tried” by one of the eight Court chambers. At the end of this trial, the chamber issues a self-enforceable writ whereby the officers responsible for the account are either acquitted or held liable for the amount in question. The officers responsible may appeal against the writ of a chamber to the Board of Appeals, whose decision is final.

The third function of the TCA, reporting, is based mainly on the auditors’ above-mentioned “draft external reports”. TCA Law stipulates circumstances or occasions when the TCA is allowed or required to report to Parliament. The most important of these is related to the draft Final Account Laws pertaining to the General and Annexed Budgets. After discussing the report of the Final Accounts Audit Group, the General Assembly adopts a Statement of General Conformity for every draft Final Account Law, whereby the TCA assures Parliament that the figures and other disclosures shown in the draft Final Accounts Law fairly present the actual results of budgetary implementation. Although it cites several circumstances and occasions to be reported to Parliament, TCA Law does not stipulate a general purpose report. Nonetheless, in recent years the General Assembly has started to add “Annexes” to the Statement of General Conformity which, in coming years, it is hoped will acquire a format that will serve as a general purpose annual report.

### Aspirations to Reform

It is not always possible to indicate the exact point of time at which a new current of thought within an organisation came into being. Likewise, we cannot indicate the precise time when the idea for the TCA to embark on performance auditing crystallised. Roughly, it can be said to

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date back to the 1970s. Looking back, one sees many rejected proposals, aborted initiatives and unsuccessful attempts. Narration of this depressive adventure may make for interesting reading. However, some time ago, coinciding with the election of the current president, we suddenly reached a turning point. Cooperation with two esteemed SAIs, namely the United Kingdom National Audit Office (NAO) and the Office of the Auditor General of Pakistan, was instrumental in this happy event.

### External Factors

The upshot of the long story of undertakings mentioned in the previous paragraph was that in 1995 the TCA management, considering performance audit as an important instrument in realising the TCA's aim to promote improved public sector accountability, control and good governance, decided to make necessary preparations to launch a performance audit. In inaugurating the pioneering work on performance auditing, the kind support of the Auditor General of NAO and his distinguished staff must earnestly be acknowledged here.

Cooperation with the NAO was the most important favourable factor in this endeavour. Of course, many other external factors, as well as the internal ones, affected the reform movement favourably or unfavourably, and they are still prevailing to some extent.

By giving a clear mandate to the TCA, the Turkish Parliament has shown its interest in the matter, and this alone is sufficient reason for enthusiasm on the part of those who are doing pioneering work.

But there is still a common understanding in the public administration that "performance" is an internal activity of the individual organisations, and that the TCA's involvement in this activity is an intervention in the executive decision-making process. Since Turkish internal audit units are mostly concerned with compliance, and a typical internal auditor is not "improvement" but "investigation-minded", there is not much benefit to be had from the experience of the internal audit function.

On the other hand, the fact that most government departments and agencies are operating without a modern management information system poses another difficulty for the performance auditors. Fundamental concepts such as "performance management" "performance accountability", "performance measures, indicators and standards" are still alien to most public sector managers.

Usually, agencies do not provide measurable outputs in their budget requests. The broad objectives stated in the legislation and other relevant documents remain untranslated into clear policies and measurable annual targets. It seems almost impossible to establish an input-output relationship between agency objectives and the appropriations they receive.

Nevertheless, the project started by the Ministry of Finance for ameliorating budgetary and accounting procedures and streamlining financial implementations (the Public Financial Management Project) has stimulated discussions on and aroused interest in performance measurement and performance auditing. Particularly, implementation of new budgetary codes and accounting systems and improvements in the budget preparation process may lead to a deeper understanding of performance issues.

### Assets and Drawbacks

Public confidence in the work of the TCA and the high standard of competence of its staff are the main assets for achieving the result expected from performance auditing. The great enthusiasm created by the adoption of the long-awaited amendment to TCA Law may be regarded as another favourable factor for success. Yet it should be taken into consideration that the time-consuming nature of this type of audit and expectations among most of the TCA's professional staff of harvesting its fruits in a short time, may cause some disappointment at the outset.

Another point of caution is the apprehensions of some auditors about being left out of the new and promising activity.

Actually, setting out for new audit approaches will, of course, necessitate a substantial redeployment of resources and

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tremendous effort in retraining the staff. One cannot deny that this reshuffling and relearning process is apt to create results comparable to those of a forced immigration. That is why the management is planning gradual development, to spread out the consequences of the reform over a longer time span.

As was mentioned above, until the recent amendment to its law, the TCA had to stay within the confines of financial and compliance audit, in which all observations, findings and decisions were geared to strict adherence to the provisions of the law. As a result, both the auditors and the Court members were accustomed to the comfort of issuing self-enforceable writs, whereas in the realm of performance auditing the rules of the game are entirely different.

Although TCA auditors may be attached to audit teams, especially in assignments outside TCA headquarters, they are not required to work under the supervision of a team leader. Moreover, supervision and peer review are considered to conflict with the "principle of the independence of auditors". Up to the present, this feature was not considered particularly harmful, since in traditional audit assignments there was no compelling need for team work. As team work is one of the essential requirements in performance auditing, TCA auditors should undergo a process of unlearning, to get used to the new culture of team work and the collective nature of modern audit approaches.

Another drawback relates to the process of decision-making in reporting to Parliament. According to TCA practice before the recent amendment, all the parliamentary reports were to be discussed and adopted by the General Assembly. Though the wording of the law makes it very clear that the performance audit reports shall not be subject to judicial procedure, the amendment did not bring in any explicit change in this respect and left the issue of finalising these reports open. Now, it is up to the president to decide whether to submit them to Parliament just with his signature, or to send them to the General Assembly to be discussed and finalised. Here the question is not related to legality but to quality. Which course of action will assure better quality, higher credibility and greater effectiveness? In

fact, none of these two courses of action could be used off the shelf. Both need tailoring to fit the performance audit environment where, instead of concepts such as provisions of law, legal evidences, and methods for interpreting the wording of the law, the concepts of standards, criteria and techniques for analysis and evaluation prevail.

### Preparation of the Environment

Difficulty in determining the exact time of conception of an idea was mentioned above. After conception, of course, the brooding period starts. It is again difficult to estimate the time needed before hatching. It depends on factors affecting the propagative capacity of the parent as well as on the attributes and features of expected offspring.

Admittedly, for the birth of the Performance Audit Project a long time had to pass before the actual delivery. But brooding over performance auditing subjects for such a long time led to the conception of new reform ideas. These new ideas further flourished into a full-fledged reform initiative covering all aspects of auditing, including parliamentary reporting with special emphasis on management and planning of the audit function. It is hoped that before the end of this year this initiative will become a comprehensive reform project to be financed partly by the World Bank.

The most important component of the project will be training. Actually, training programs on modern audit approaches and techniques started several years ago. The TCA benefited from opportunities created by sister SAIs, particularly the General Accounting Office (GAO) of the USA, the Office of the Auditor General of Pakistan and the NAO of the United Kingdom.

The "Intensive Training Program in Performance Auditing" courses organised by the Office of the Auditor General of Pakistan, held in Lahore in 1991, 1993, 1994 and 1995, and were attended by 10 TCA auditors, were the first breakthrough on the way towards creating a knowledge base at the TCA.

Finally, it was cooperation with the National Audit Office (NAO) of the Unit-

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ed Kingdom that encouraged the management to start work on performance auditing. In the framework of this cooperation, the TCA received technical assistance under three different headings. The first gave four TCA auditors an opportunity to attend the "Audit Training Course(s) for Staff from Overseas Supreme Audit Institutions" held at the NAO annually. Under the second heading, a joint project for a training course at the TCA's Training Centre in Manavgat, Antalya, took place. Four distinguished members of the NAO participated as lecturers and 20 English-speaking TCA auditors as trainees in this four-week course.

The third item in NAO-TCA cooperation, which is still underway, involves two collaborative audit projects: (i) a risk audit study on acquisition, storage, display, recording and inventory of collections of Turkish National Museums; and (ii) a performance study on maintenance and repair activities of the General Directorate of Highways. In this context, two audit managers from NAO (one for each project) are providing advice and guidance on the planning, execution and reporting phases of the audit tasks. The following is a brief account of what has been accomplished so far in the second study.

### Launching the First Performance Audit Assignment

In February 1996 a performance audit team, comprising seven auditors, was formed. The auditors had received their preliminary training in the field of performance auditing at one of the aforementioned courses.

It should be mentioned here that in this first performance audit undertaking the TCA could do very little planning because there was little entity knowledge available, and there was time constraint. We did not have general surveys to enable our SAI to prepare a proper Strategic Performance Audit Plan. But the performance audit had to start from somewhere. So, to expedite the process it was decided that the subject of the first performance audit should be selected from among the topics or areas for which a performance audit had been carried out at the NAO previously. First, a list comprising 10 likely

subjects was chosen, after a joint study of a very long list of NAO reports. Out of these 10, three were selected by the Performance Audit Team at the TCA and for each of them the team prepared a study proposal.

The team began work in March 1996, following the president's approval of the proposal concerning "Maintenance and Repair Activities carried out by the General Directorate of Highways on State and Provincial Roads". The team completed its preliminary study in October 1996. Having obtained the senior management's approval, it started the full investigation in January 1997.

According to the preliminary study, the full study is scheduled to be completed by June 1997. The work is running to schedule. Judging from the results obtained so far, it is strongly believed that the TCA's first performance report will be worth submitting to Parliament. Furthermore, the work will also produce an important by-product: a collection of "What-to-do" and "How-to-do-it" instructions which will later grow into a "Guideline on Performance Audit Tasks".

### Concluding Remarks

We are aware that introducing changes and innovations is a challenge and that adaptation is a lengthy process, especially in an environment where tradition is important. To overcome the difficulty we have chosen an evolutionary approach. In this context we updated our earlier Modernisation Plan, which was developed in 1995. The new Modernisation Plan has been drawn up in a manner which will ensure a gradual transformation. We believe that the growth in number and quality of the TCA's performance audit reports, and their growing credibility in the eyes of Parliament, public, governmental agencies as well as the mass media, will create a "synergy".

The TCA appreciates the importance of exchanging knowledge and experience with sister institutions, and values them as a significant source for acquiring knowledge and experience.

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## *External control in Mercosur*

MR HOMERO SANTOS

President of the Brazilian Supreme Audit Institution

The economic integration process resulting from the creation of Mercosur (Southern Common Market) has important repercussions on activities concerning governmental auditing, for which the Tribunal de Contas da Uniao (the Brazilian Supreme Audit Institution) is responsible. The increase in trade between Argentina, Brazil, Paraguay and Uruguay makes it necessary to evaluate the performance of the public administration bodies and entities in a new context. Environmental issues, international banking operations, customs, public bidding and the tax expenditure resulting from the exemption of import taxes are all directly related to regional integration. Moreover, the destination of budgetary resources for Mercosur requires the control of its application.

The normative power of the organs of Mercosur has been introducing alterations in the internal legislation, with the objective of harmonizing it. With the progress of integration, laws, decrees and regulations need to be modified in all the Party States in a way that permits the creation of a common market, with the elimination of customs, tariff and non-tariff barriers, or any other type of equivalent measures, in which there is no form of discrimination to international competition. In this new context, one of the most relevant themes is that which refers to government procurement. To confirm its importance in the international agenda, the meeting in Cartagena of the Organisation of American States, the OAS, which took place in March 1996, created a working group dedicated to studying and suggesting changes in legislation in OAS member countries to eliminate restrictions to international competition in government contracting of the American countries before the year 2005, with the objective of creating a free hemispheric trade zone, to conform with the agreement made during the Summit of Americas of December 1994 in Miami.

All those reasons have caused the TCU to establish contact with the Supreme Audit Institutions (SAI) of the Party States of Mercosur, with the objective of evaluating the repercussions regarding the audit mission of those institutions caused by regional economic

integration. In July 1996, a multilateral agreement was signed in Asuncion, Paraguay, and a working group was created to study the legal competence of each Supreme Audit Institution, in order to identify themes of common interest. The Treaty of Asuncion, which created Mercosur, is only six years old, but there has been a very rapid advance in integration. Today, Mercosur is a customs union that has two free trade agreements signed with Bolivia and Chile. This causes us always to look at the model of the European Union, which is in a more advanced stage of integration. Naturally the paths to be taken by Mercosur will not necessarily be the same as those of the European Union. Mercosur still does not have any supranational organ, like that which has been created on the European continent. However, 20 years of experience by the European Court of Auditors, which is responsible for the external control of the European Union Budget, is valuable material for the Supreme Audit Institutions of Mercosur Party States. The approximation between these institutions is founded on the clauses of the Madrid Agreement signed in December 1995, which has as its objective the strengthening of the existing relations between the parts and the preparation of the conditions for the creation of an inter-regional association.

That is the reason why the Supreme Audit Institutions of Mercosur can and shall advance in the cooperation and ex-

*Today,  
Mercosur is  
a customs  
union that  
has two free  
trade  
agreements  
signed with  
Bolivia and  
Chile.*



change of experiences with the European Court of Auditors. That is why the TCU had the honour of receiving delegations from the SAIs of Argentina, Bolivia, Paraguay and the European Court of Auditors in Brasilia to discuss themes related to governmental auditing in the Party States of Mercosur and to the beginning of cooperative activities with organs of the European Union. It was the third meeting between the presidents of the institutions in charge of Public Administration Audit in their respective countries. During the meeting a joint declaration was approved to promote cooperation between the SAIs, to admit Bolivia into the group made up of the SAIs that signed the multilateral agreement in Asuncion, to carry out a coordinated performance audit in the area of customs, and

to evaluate its efficiency and effectiveness, focusing on the control procedures and the required formalities for the transit of goods and merchandise at border points between the Party States of Mercosur. Moreover, a working group has been created to prepare an audit manual with harmonized control procedures and a common data base in the Internet. An evaluation of the efficiency in the flow of information between the Party States and the administrative agency of Mercosur, as well as a seminar in Buenos Aires to discuss the experience of the SAIs of the European Union, will also be carried out. The results reached so far make me feel honoured to preside over a Court focused on one of the most important contemporary questions, as is the case with regional economic integration.

*The paths to be taken by Mercosur will not necessarily be the same as those of the European Union.*



## *Audit of the State-run Corporate Sector in Portugal*

ALFREDO JOSÉ DE SOUSA

President of the Tribunal de Contas, Portugal

By unanimous decision of its council, the next EUROSAI seminar is to be held in Lisbon in 1998, at the same time as the World Exhibition (EXPO'98). A public company — Parque Expo'98, S.A. — was specifically set up several years ago to organise the event. In 1996, the Court of Auditors was given powers to carry out the auditing of public companies. The coming together of these two events merits the inclusion of several considerations on the subject in the EUROSAI magazine.

### I. EXPO'98 CASE STUDY

#### 1. General Considerations

1.1 EXPO'98 is a fine example of companies in the state-run corporate sector in Portugal. EXPO'98 will be the last world exhibition to be held this century, and its theme is: "The Oceans, a Heritage for the Future". The aim of the exhibition is twofold: "to highlight the physical and cultural assets of the oceans, and to reflect

on their conservation and the responsibility of future generations."

1.2 The theme of EXPO'98 is based on the fact that Portuguese history and culture have always been closely linked to the sea. Not only does Portugal, and in particular Lisbon, have a historic relationship with the sea, but by deliberation of the General Assembly of the United Nations, 1998 is the International Year of the Oceans. This makes the theme chosen for the exhibition

even more fitting, both in its timing and in its geographical setting, as it will be staged in Lisbon, the birthplace of maritime discoveries. Fitting, too, is the fact that at the same time Portugal will also be celebrating the 500th centenary of the Portuguese voyages of discovery. The oceans have done much to serve humanity and, despite the fact that they have been exploited on such a large scale, they still hold great potential for the economic and social development of mankind. Not only states, but also national and international public and private institutions, the United Nations and regional intergovernmental organisations (EU, Council of Europe, OEA, OUA, Pacific Forum, etc.) will, therefore, be participating in Expo'98.

**2. The EXPO group: Parque Expo 98 S.A.**

2.1 By its very nature, an undertaking of this size can only be truly successful if it includes cultural, artistic, technological and scientific activities. The size and complexity of the urban redevelopment project for the Expo'98 site, together with the financial management of the activities needed for staging the exhibition, are such that these activities need to be entrusted to an institution that has a corporate structure. The state is left with the task of globally coordinating all the actions and projects involved in the organisation of Expo'98 and its associated urban redevelopment project, through the creation of a commissariat, directly answerable to the prime minister.

2.2 Thus, the parent company of the EXPO group, Parque Expo'98 S.A., came into being — a joint stock company with a share capital of PTE 8,550,000,000, held exclusively by the state, through the General Directorate of the Treasury, with 91 per cent of the capital, the rest being held by Lisbon City Council. The company's objective is to plan, implement, construct, operate and dismantle the Lisbon 1998 World Exhibition, and to oversee the urban redevelopment of the area surrounding the EXPO site. The company had a starting capital of PTE 500 million, which was later increased to PTE 8,050 million through the alienation of land belonging to the state.

With regard to the financial size of the undertaking, as at December 31st 1995, the guarantees and warranties given by the state for bank loans and obtained by the company totalled PTE 80,650,908. The EXPO group has continued to grow and today comprises approximately nine different yet complementary companies. Parque Expo, S.A. is part of the group, holding all the capital in some of its companies and overseeing the participation of private companies in others. The EXPO group is responsible for the execution of the exhibition's infrastructures and transport elements, its urbanisation and landscaping, permanent buildings and temporary structures, and the installations and buildings for shows and other events. The budget forecast in the master plan should thus be seen as an estimate of costs, which will vary with time.

**II. CONTROL OF THE CORPORATE SECTOR OF THE STATE IN PORTUGAL: ORIGINS AND EVOLUTION**

**1. The situation prior to 1975: traditional public companies**

1.1 Prior to the revolution of April 25th 1974, the involvement of the state in the activities of corporate-type businesses centred mainly on either the actual public administrative sector, on so-called traditional public companies, or on private and public joint stock companies.

1.2 At the end of the 1970s, so-called modern public companies began to emerge, such as the C.T.T., Correios e Telecomunicações de Portugal and the T.L.P., Telefones de Lisboa e Porto (the Post and Telegraph Office and the Telephone Company), and so on, as a result of the transformation of services that were traditionally part of the public administration.

**2. The situation after the revolution: nationalised companies**

2.1 The 1974 revolution led to a widespread process of nationalisation in Portu-

*The size and complexity of the urban redevelopment project for the Expo'98 site, together with the financial management of the activities needed for staging the exhibition, are such that these activities need to be entrusted to an institution that has a corporate structure.*



gal, which began on September 13th 1974 with the nationalisation of the three central banks that existed at the time: Banco de Portugal, Banco de Angola, and Banco Nacional Ultramarino. The process, which intensified from March 11th of the following year, spread to practically all sectors of the economy: the whole of the banking and insurance sector, transports, energy and basic industries and/or those considered lucrative.

2.2 In a second phase, following approval of Decree-Law 260/76 of 8 April, the new public companies were created as a result of nationalisation.

2.3 Decree-Law 260/76 defines a public company as a legal person created by the state with its own capital or with capital supplied by other public entities, for the exercise of activities that are of an economic or social nature, in accordance with national economic planning, with a view to constructing and developing a democratic society and socialist economy. The following key ideas lie behind this legal definition. The exercise of economic activities on the part of the state and other public bodies must be carried out through suitable institutions, specifically created for the purpose, that are not part of the central, regional or local administrative public sector; ownership of all productive factors is public, as is the management and auditing of these entities; public companies must also comply with government directives.

2.4 Another phenomenon worthy of note during this period vis-à-vis the organisation of the corporate public sector was the concentration of most of the participating interests acquired by the state through indirect nationalisation in a single organization: the I.P.E., E.P., Institute of State Participations, Public Corporation (Decree-Law 496/76 of 26 June).

### 3. The current situation

3.1 In the latter half of the 1980s, for reasons that had more to do with pragmatism than politics or ideology, there was a gradual international trend — and Portugal was no exception — towards taking the control of economic activity away from

the state. In Portugal, this was marked by the occurrence of two phenomena. The first was reflected in the privatisation and reprivatisation process; the second, in the near total abolition of the public company as defined by Decree-Law 260/76 of 8 April, through the progressive transformation of existing public companies into joint stock companies (in some cases with a view to later privatisation or reprivatisation) or through the constitution of new public capital enterprises regulated by commercial law.

### III. THE FINANCIAL CONTROL OF THE COURT OF AUDITORS OVER THE CORPORATE PUBLIC SECTOR

#### 1. Legislation prior to the coming into force of Law 14/96 of 20 April

1.1 Article 113 of Decree 1831 of 17 August, 1915, subjected the financial administration and book-keeping of all government offices, public enterprises or services, with or without autonomy (to use the actual wording of the statute), to inspection, examination and verification by the High Council of Financial Administration.

1.2 With the coming into force of Decree-Law 260/76 of 8 April, a new cycle in the history of the external auditing of the accounts of the corporate public sector began, one which has only just come to an end with the coming into force of Law 14/96 of 20 April.

During this period, which lasted for around 20 years, the Court of Auditors' auditing of public companies was fundamentally indirect in nature. The day-to-day financial affairs of public companies were only made known to the Court through the dissemination of the financial affairs of its governing public body, and only then in cases in which this body was subject by law to this jurisdictional control.

However, the fact that public companies were not subject to audit by the Court of Auditors (Article 29 of Decree-Law 260/76) meant that their accounts were not rendered annually, thus preventing the

*In the latter half of the 1980s there was a gradual international trend towards taking the control of economic activity away from the state.*





Court from assessing the efficiency or profitability of the public monies invested in them and, as a result, from detecting any irregularities in the application of public funds and from devising sanctions.

1.3 Indirect control of the accounts and assets of public companies during this period occurred in three situations.

(i) A priori audit by the Court of Auditors of all contracts concluded by companies subject to the jurisdiction of the Court, in particular those contracts relating to the realisation of or increases in capital, including any additional loans or payments which constitute charges for the companies, given that these obviously have repercussions on the State Budget or that of any other public body or part of its capital;

(ii) As part of its auditing of the accounts of public companies, the Court of Auditors also carries out a posteriori control, evaluating the legality of each item of revenue or expenditure. This control is carried out in two ways: automatically, whereby certain public bodies must submit their management accounts and related documentation to the Court by May 31st of each year, or through the realisation of audits or inspections of these bodies, on their own initiative or at the request of Parliament or the government;

(iii) Finally, the issue of the annual report on the General State Account and the accounts of the autonomous regions, as required by the constitution and the law, implies a thorough and complete knowledge of the financial standing of the whole central and regional public sector. In drawing up its report, the Court must assess the assets of the state and autonomous regions, and their income and expenses, etc. during the period to which the Account refers.

## 2. Legislation regarding financial control of the corporate public sector as defined by Law 14/96 of 20 April

2.1 Law 14/96 of 20 April, created a special regime for the external financial control of the corporate sector of state and other public bodies in Portugal, to be carried out by the Court of Auditors in its ca-

capacity as the supreme body for the external auditing of public accounts in this country.

This statute introduced direct auditing of the accounts and assets of the corporate public sector, and operated simultaneously with the indirect auditing system outlined in the previous paragraph.

2.2 Auditing of the corporate public sector is based on a posteriori control, which is in turn split into two sub-regimes: (a) an a posteriori examination system similar to that governing other public bodies, in which, as we saw earlier, the bodies must submit their accounts and related documentation in respect of the previous year to the Court by May 31st each year, as required by law; (b) a concomitant examination system, which allows the Court of Auditors to audit, examine and inspect bodies subject by law to its control at any time, either at its own behest or, in certain cases, if so requested by a tenth of all Members of Parliament or the government. The purpose of the audits carried out by the Court is not only to examine the legality of the financial actions and contracts carried out and concluded by the bodies subject to its inspection, but also to examine the soundness of the financial management of these bodies. In other words, verification by the court that these acts and contracts — taking into account the prevailing circumstances at the time they were carried out or concluded — obeyed the criteria of economy, efficiency and effectiveness in the application of public monies.

Of the contracts concluded by these bodies, the legislator has paid particular attention to those regarding the alienation of participating interests held by them. The Court is thus empowered to examine the general terms and conditions — especially the financial conditions — of such contracts and to ensure that they obey sound financial management criteria.

Note that this statute provides an autonomous inspection regime especially catering for reprivatisation processes, which empowers the Court to examine the legality, regularity and obedience of the process with sound financial management criteria. This applies fundamentally to an evaluation of the company to be reprivatised.

*The Portuguese Court of Auditors set up a project team on March 20th 1996 specifically geared towards carrying out examinations of both the corporate public sector and reprivatisation processes.*



In order for it to carry out its duties more effectively, the Portuguese Court of Auditors set up a project team on March 20th 1996 specifically geared towards carrying out examinations of both the corporate public sector (including the alienation of its participating interests) and reprivatisation processes.

Given that this is a new area of financial control, audits for 1997 have been carefully planned to ensure the credibility of the Court, concentrating first on studying the whole of the corporate sector of the state and on training auditors.



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