



**SIGMA**

**Support for Improvement in Governance and Management**

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**FORMER YUGOSLAV REPUBLIC  
OF MACEDONIA  
EXTERNAL AUDIT  
ASSESSMENT MAY 2009**

## Summary

### *Main Developments since last year*

During the past year the State Audit Office (SAO) of the former Yugoslav Republic of Macedonia<sup>1</sup> updated its Development Strategy (2008-2012) and formulated human resources and communication policies, audit quality control guidelines, and risk-based audit programming guidelines; it also undertook some structural changes. The SAO was supported in these activities by a three-year twinning project with the Dutch Court of Audit, which ended in 2008. It was decided that the co-operation would continue on a bilateral basis for another two years (2009-2010), with the objective of implementing the current Development Strategy.

The SAO has been able to increase the number of its staff and its budget, but mainly for the Audit Authority (AA) for pre-accession funds, which in Macedonia is part of the SAO, qualified as “independent” by the SAO Law. A new draft SAO Law, which should provide better operational and financial independence for the SAO and enhance communication with parliament, was supposed to be approved in 2008, but has still not been submitted to parliament. The SAO expects the new law to be in force in July 2009, but unfortunately this seems to depend on the decision of the Ministry of Finance. Proposed changes to the Constitution, under the responsibility of the Ministry of Justice, to “anchor” the SAO in the Constitution have not advanced in the past two years. The fact that ministries dictate the development of the SAO’s role might become a threat to its operational independence.

### *Main Characteristics (strengths and weaknesses)*

External audit in Macedonia needs to be improved, and there are some challenges to overcome, but it generally meets the requirements of the Lima Declaration of INTOSAI. The SAO has been operating for 11 years and, as a young organisation, it has made relevant progress in modernising its audit activities. External assistance has played a major role in this achievement. In the future the SAO needs to concentrate on achieving better financial and operational independence as well as developing its professionalism and audit capacity. The SAO has demonstrated a capacity to reach its development goals and should now concentrate on ensuring that the achieved changes are sustainable, with the contribution of ongoing assistance projects.

The ability and motivation of the SAO to absorb foreign assistance shows a clear willingness for further development. Areas that need improvement are well known to the Auditor General, and current development initiatives are targeted to overcome them.

The impact of audit reports on the way in which audited budget-users carry out financial management is rather limited. Audit programming and auditing routines contain strong follow-up procedures, but there is still no clear partner for dealing with audit reports in parliament.

Similarly, there is no clear link between financial audits and the budgeting-reporting cycle. No overall opinion is given on the annual budget execution report, and proper discharge procedures still need to be developed. The SAO annual report usually contains a list of findings from various audits, but without any overall conclusions. The Parliamentary Budget Committee’s ability to react to these findings is deficient.

The SAO expends major resources on financial audit. Unfortunately, audited accounts (balance sheet and income statement) are not yet consolidated at state level, and they are not reported publicly or used for other accountability purposes. As a result, the audits have limited value. In addition, in practice it is the SAO that consolidates the various sets of financial statements for each budget-user into one consolidated financial statement per budget-user. This leads to a mismatch of responsibilities between the government’s accounting obligations and the actual role of the SAO to audit those

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<sup>1</sup> In this report the former Yugoslav Republic of Macedonia will hereafter be referred to as “Macedonia”.

accounts and to express an independent opinion on these statements. The SAO does not have the capacity to audit all 178 mandatory entities annually, as required by law.

Audit practices and quality assurance procedures should be further developed, and this is addressed in the development plans. The current arrangement, whereby the Audit Authority (AA) for EU funds is within the SAO and the SAO is therefore required to report to the government, may be prejudicial to the SAO's independence.

### ***Recommendations for Reform***

Priority should be given to the following activities:

- Seek an opportunity to ensure the constitutional position of the SAO;
- Steer the current legislative process so as to finalise the new law for the SAO;
- Strengthen, as appropriate, the SAO's relations with parliament;
- Continue to develop financial audit capacity, including development of the plan for providing an opinion on the overall annual budget execution and the annual accounts (when applicable), with a clear link to the overall budgeting and reporting accountability framework in parliament;
- Based on current audit findings, propose recommendations for reforming key aspects of the Macedonian public service and public finance system, including reform of the accounting systems as well as overall management and control systems;
- Resolve the issue of the SAO as hosting the Audit Authority, which should be a provisional arrangement; discussions should begin on finding a more appropriate solution.

## 1. Introduction

The State Audit Office (SAO) of Macedonia was established by the State Audit Law of 1997, and the first Auditor General was appointed in May 1998. However, operations only started in 1999, following the transfer to the SAO of employees from the audit department of the former Agency for Payments (ZPP).

The SAO is headed by an Auditor General (AG). The current AG was appointed in December 2007, and the Deputy Auditor General in 2000. Both were appointed by parliament for a ten-year term. The SAO has a clear SAI (supreme audit institution) “office” type of structure. The SAO is clearly the SAI of Macedonia with regard to its role, organisation and the basic features of its supporting law. However, it has no constitutional anchorage and thus lacks one of the most essential means of securing and protecting the establishment and independence of such an institution.

Seven departments and four individual units comprise the structure of the SAO. Each department is led by an assistant auditor general. Five of these departments conduct the financial audit work, one department is specialised in performance audit, and one is responsible for the development of the SAO (strategic planning and professional training, planning and analysis, international co-operation). The four units are: internal audit, IT, legal and human resources affairs, finance and accounting. The assistant auditors general, together with the Auditor General, his/her deputy and some other key SAO persons, form the “collegium” (regulated in the internal SAO rulebook). The collegium plays an important advisory role on certain issues, such as programming or approval of the annual report.

The number of SAO staff has grown from the initial 11 to 110, of whom 89 are directly involved in audit tasks. Of the 110 staff positions, 19 are currently allocated to the Audit Authority (AA) for EU funds. The target staff figure for 2012 is now 170, including 39 staff for the AA unit.

The SAO has been engaged since September 2005 in a partnership with the Dutch Court of Audit; originally the twinning was for three years, but this co-operation has been extended on a bilateral basis for another two years. The German Court of Audit carried out a peer review of the SAO in the first half of 2007.

As a result of various inputs, in particular provided by foreign assistance, the SAO produced in 2007 a draft law intended to strengthen its independence and remedy some of the shortcomings that had appeared during its first decade of operations. It was hoped to have adopted this law by the end of June 2008; it is now expected in June 2009.

## 2. Baseline Questions

### 2.1 *Does the SAI have clear authority to satisfactorily audit all public and statutory funds and resources, bodies and entities, including EU resources?*

The SAO has clear authority to audit all public institutions but clearly lacks capacity to cover the broad mandate. According to article 1 of the State Audit Law, the SAO can audit the financial statements and financial transactions of state entities, including entities that are completely or partially financed by the budget of the Republic, as well as local entities, state-owned enterprises and the Central Bank of Macedonia. This covers namely the state budget (Budget of the Republic of Macedonia), local government units, extra-budgetary funds, budget fund-users, legal entities in which the state is a major shareholder, political parties financed by budget funds, and electoral campaigns. In accordance with the law, the SAO can also audit the beneficiaries of EU funds, as well as projects funded by foreign and international institutions.

This means that the SAO has the mandate to perform “state audit“ (meaning regularity audit and performance audit) of 1,277 institutions. Of these, 178 are the subject of mandatory state audit at least once a year: budgets (state and local government units, funds), users of the state budget, and state-owned enterprises. Political parties constitute an additional category. The actual number of annual audits has always been fewer than that figure: 131 audits in 2006, 89 in 2007 and 84 in 2008 (81 financial audits, theme audits and follow-up audits as well as three performance audits). This

number has decreased significantly due to changes in audit methodology, with improved audit planning and reporting procedures, to which more time is devoted now than previously, which contributes to improved quality in both the audits and the reports.

The lack of a consolidated set of financial statements for each budget-user has led the SAO to voluntarily compile the financial statements and notes. Thus the SAO has taken on board a significant amount of work to first compile what is deemed to show the correct underlying financial accounts before it starts its financial audit work. This requires a significant effort, and the SAO should not be substituting for the auditees by carrying out this task. The SAO is strongly encouraged to concentrate on working with the Ministry of Finance to improve generally accepted accounting principles for these entities.

The audit task is made onerous by the fact that in many cases each audited entity might have more than one, usually two or three, different sets of financial statements. The number of annual financial statements depends on the number of revenue sources – state budget, own resources, etc. Each set of financial statements is separately audited. Thus, in 2008, 81 entities were audited and 184 audit reports were issued. This is not reasonable in view of the government's efforts to strive for improved accountability and financial control mechanisms. Each entity should have one consolidated annual report covering all revenue, expenditure, assets and liabilities, for which the entity's management should be responsible for providing.

Changes in the approach may improve the general productivity of audit work, expand audit coverage and improve the impact of financial audit. Concentration on the development of the whole accounting system in the country should be a high priority for the government so as to better control budget execution.

Given the rather broad audit mandate of the SAO, the office has to work efficiently and make the best use of its human resources by improving the financial audit practice. Since the demanding function of the AA for EU funds occupies almost one fifth of the SAO staff, efficiency in the financial audit work becomes even more important if the SAO is striving to meet its legal mandate. Performance audit is a separate department in the SAO; with only seven employees it constitutes a minor part of the SAO.

To allow more flexibility in the allocation of resources and possible redeployment, the number of entities that must be audited every year by the SAO should be reduced. Firstly, when the overall public sector accounting and reporting arrangements are reviewed and further developed, the total overall number of reporting entities should be reduced. Secondly, in the case of the audit of state-owned enterprises and/or local government annual accounts, consideration could be given to leaving the audit to private audit enterprises.

Thirdly, other arrangements should be found to host the AA, since its presence has a negative impact on the availability of staff to perform the central functions of the SAO. With a higher amount of EU funds coming in, there is an increased risk that additional capacity will need to be available for the AA, thereby withdrawing staff resources from auditing the national budget. This situation would create an unhealthy balance between the audit of the national budget compared with the audit of EU funds.

**The SAO has a very broad audit remit and the authority to audit all public and statutory funds and resources, bodies and entities, including EU resources. However, the resources of the SAO and its current financial audit practices, which aim to overcome the insufficient accounting arrangements, do not permit the SAO to fulfil its annual audit mandate. The SAO needs to review its financial audit practices. In addition, the regular audit of the audit portfolio should be considered both in an annual work plan and in a more strategic perspective (three to five years), ensuring at least that all budget-users are audited regularly. This can also be facilitated through the new SAO and PIFC laws, currently under development, and through improved accounting and reporting arrangements in the public sector.**

## **2.2 Does the type of audit work carried out cover the full range of regularity and performance audit set out in INTOSAI auditing standards (1.0.38-1.0.44)?**

The State Audit Law provides in articles 2 and 3 a definition of “state audit”, which generally fits the INTOSAI definition of financial audit: “examination of documents (...) accounting and financial procedures and other records from the point of view of whether the financial reports present truthfully and fairly the financial positions and the results of the financial activities”. State audit also includes an assessment of the extent to which “funds are spent economically, efficiently and effectively”. This definition gives to the SAO a clear mandate to carry out performance audit.

### **Regularity, including Financial Audit**

In reality, as stated above, the SAO covers each year with financial audit only a fraction of the entities that it has the mandate to audit. The SAO provides an opinion on the individual financial statements. In 2006, 31% of the audit reports produced gave a negative opinion, compared to more than 40% in 2005. In 2007 the proportion was almost the same, with 30% negative opinions, and in 2008 a slight increase to 32% was recorded, but overall negative opinions remain at around 30%. This development could attest to the progress made by the SAO in working out its financial audit and in using more objective criteria to justify its opinions, taking into account risks and materiality. New guidance material to assist audit staff in their assessment of materiality and risk, prepared with the Dutch Court of Audit, as well as risk-based selection of audited entities have certainly contributed to this development.

The annual audit report on the final accounts of the previous year’s budget is presented to parliament together with the final accounts of the budget. However, since the final accounts are not a consolidated set of accounts (see Sigma’s 2009 assessment report on Public Expenditure Management in the former Yugoslav Republic of Macedonia), their usefulness is limited. The results of the separate audits performed on individual auditees during the year are presented to parliament in separate audit reports and are summarised in the SAO Annual Report, which does not conclude with an opinion on the execution of the budget. The SAO therefore still does not perform a specific audit of the consolidated state accounts, not even of the execution of the state budget as a whole.

In addition, the current approach is almost totally disconnected from the budget process, as there is no linkage between the production of the audit report and either the submission of the annual draft budget document or the final (consolidated) state accounts. The audit report does not focus on the overall cash execution of the budget. On the income side, the SAO has carried out an audit of the tax and customs collection, as well as some other taxable and non-taxable income (Ministry of Economy, Ministry of Transport and Communications, and Ministry of Agriculture, Forestry and Water Supply), and it has evaluated the risks of these activities, as well as the efficiency of internal control procedures. However, it has not gone so far as to certify the revenue figures of the accounts or of the executed budget. On the expenditure side, it was stated that about 50% of the budget is reviewed during the audits but that no overall opinion is provided. This approach is possible, but it is certainly not in line with the good SAI practice of producing an overall report on the implementation of the consolidated state budget, which is a key output of any SAI and also provides a relevant matrix for further programming of audit work.

The new SAO draft law introduces some changes in that respect. It states that “after the end of each fiscal year prior to the adoption of the Annual Budget... (the SAO) shall prepare an audit report of the budget...and ...submit it to the review to the Assembly...”. This is a positive change, but such changes may not be sufficient. The Budget Law already contains the requirement that the SAO is to report on the budget, and the objectives and scope of audit are provided for in the Law on State Audit, but this legislation does not specify the questions that the SAO report should answer concerning the audit of the budget (scope of the opinion) and, more importantly, the parliamentary activities to be carried out during the approval process (e.g. what happens if the SAO gives a negative opinion on the budget execution).

### **Performance Audit**

As stated above, performance audit work is a relatively small part of the SAO's activities and is still in the development phase. Three performance audits were completed in 2005, three in 2007 and three in 2008. Some very positive development has been achieved in audit practices. If early audits focused more on the compliance of audited programmes, more recent examples demonstrate the SAO's capacity to audit the actual performance of programmes in terms of economy, efficiency and effectiveness. Good examples are the opinions on "food safety" and "treatment of medical waste", both of which heavily criticised the administration for poor outcomes. These performance audit results were communicated to the media and had the expected high interest and coverage. However, there are also some challenges to overcome along with some negative developments in recent years.

The performance audit department consists of seven staff. Increasing the number of performance audits and focusing these audits on topics of general and public interest are specific objectives of the Strategic Plan 2008, which envisages the organisation of training to develop the skills of auditors for audit subjects of general interest. Although it is certainly reasonable to focus on regularity audit at this stage, positive development initiatives that have already started should continue and should be adequately promoted. The new MATRA project continues activities for the conduct of pilot performance audits and for further capacity-building for this type of audit by involving auditors from other departments.

Furthermore, at this stage of development, it would be advisable for the SAO to design a performance audit policy for the coming years. The SAO could also program the performance audit activity in such a way as to focus on current shortcomings in overall financial management or on internal control procedures in sample ministries or other public bodies (e.g. procurement, human resources management issues, sound financial management of grants and subsidies, and management and protection of assets). The SAO might also consider looking at possible overlaps of Macedonian administrative structures and seek opportunities to increase productivity in the public administration and to favour the redeployment of staff across the administration. These efforts should eventually lead to an even greater reduction in the number of budget-users, thus making the audit remit of the SAO more workable.

Currently, performance audit reports are communicated to parliament only if they are of public interest. They are always included in the SAO Annual Report, which is presented to parliament. The new SAO draft law states that all of the SAO's reports should be sent to parliament, but there is not yet a clear practice for handling these reports in the committee(s). The current strategic goals and the co-operation project with the Dutch Court of Audit will concentrate on this specific issue and hopefully help to overcome this constraint.

**The SAO is entitled to carry out both regularity (financial) audit and performance audit. However, the practice of both audits needs to be developed. Financial audit does not include at the moment the attestation of the execution of the state budget as a whole and therefore in general it has modest value. Performance audit practice has produced some first promising results.**

### **2.3 Does the SAI have the necessary operational and functional independence required to fulfil its tasks?**

The State Audit Law formally provides the Auditor General and the SAO with a good degree of independence from the legislative and the executive, as well as from the organisations that the SAO has the responsibility to audit. The Auditor General and his/her deputy are appointed for a ten-year term, which is certainly one of the longest among SAI heads with fixed-term appointments. Both officials can only be dismissed by parliament on grounds laid down by law, which are now more specific since the amendment adopted in May 2006. Otherwise, the law provides for incompatibilities concerning the Auditor General and his/her deputy aimed at preventing a possible conflict of interest in the discharge of their duties. Also the independence of state auditors, in terms of preventing conflict of interest, is regulated by the State Audit Law.

The state auditors are appointed by the Auditor General; they are not civil servants but are subject to the Labour Law and to the State Audit Law. In the future it will be useful to ensure that such a situation does not constitute an obstacle to the exchange of personnel or to mobility within the public administration, which could be an important element in terms of career development and human resources policy.

When performing audits, SAO auditors have full access to the auditee's premises, books and other records as well as the right to ask questions that are useful for the audit work. State confidentiality cannot be placed as an obstacle to the investigations of the auditors. Fines for non-compliance are foreseen by the State Audit Law. As the need may arise, the SAO can hire external professionals to carry out expert work on specific issues in the course of an audit. This contracting-out of course depends on the resources available, and so far it has not been implemented in practice.

All audit reports are published on the SAO website and can be communicated to anyone who requests them. The SAO must in any event transmit to parliament its annual report on audit activities as well as reports containing findings of major irregularities. Unlike in the current law, the new draft State Audit Law (article 33) demands that all audit reports be submitted to parliament.

In practice, with regard to independence, there are still several challenges to overcome, which are indicated by the examples that follow.

Firstly, in September 2007, the government mandated the Ministry of Justice to draft an amendment proposal to incorporate the SAO in the Constitution. Despite the efforts of the SAO, the proposal is still with the Ministry of Justice.

Secondly, the role and mandate of the SAO also depend on the adoption of the new draft SAO law. The current version has been under discussion for over a year and unfortunately is still in the Ministry of Finance. Its adoption is now envisaged for July 2009. It can be noted that the main development process of the new draft law seems to be under the control of the Ministry of Finance and not the SAO. Furthermore, current open issues (SAO budget allocation from parliament, role and independence of the Audit Authority, deadline for adaptation and consultations with the EC, etc., as explained below) seem to be for the Ministry of Finance to decide. There are also some other direct signs that the executive is trying to weaken the SAO's independence. For example, the new draft law reduces the term of the Auditor General from ten to seven years; the Ministry of Finance has overruled the SAO's requests for budget increases; and staff numbers are, in reality, under strict control of the ministry. This is far from international good practice and may have major consequences for the SAO's ability to fulfil its mandate and role. Any deliberate attempts to weaken the SAO's role or independence should be very carefully monitored. The SAO should take an active role in protecting its independence by seeking closer dialogue with parliament.

Thirdly, the current legislation provides guarantees for financial independence that do not work in practice. Since the adoption of an amendment of May 2006, the budget of the SAO is subject to a separate vote by parliament. In reality the budget that is voted is not the one proposed by the SAO, but one that has been submitted by the Ministry of Finance. An expected positive development in the new draft law is the elimination of the SAO's dependence on its own resources (audit fees); its entire budget will be allocated within the state budget. However, if the Ministry of Finance overrules the article in the draft law that provides for the SAO to submit its budget requests directly to parliament for a vote, this might have a negative effect on the SAO's financial independence.

Lastly, the SAO has also accepted to host the Audit Authority (AA) for the Instrument for Pre-accession Assistance (IPA)<sup>2</sup> funds. A special department was formally designated as such by the government in April 2007. The AA was created on 31 July 2007, and its head was appointed. While linked to the SAO, benefitting from SAO staff secondments and located in the same premises, according to the Law on State Audit, the AA is "organisationally and functionally independent from SAO structures". In 2007, the SAO and the AA signed a Memorandum of Understanding and

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<sup>2</sup> Council Regulation (EC) No1085/2006 dated 17 July 2006. For the implementation of this Regulation, a Commission Regulation (EC) No: 718/2007 is published on 12 June 2007.

Co-operation. The AA has adopted its own internal acts of organisation and systematisation and it is financed by its own budget programme; the AA independently approves plans and annual reports, which are separate from the SAO plans and reports and do not influence the SAO's operation.

This separation between the two institutions looks like a very artificial construction in practice. It creates a conflict of interest for the SAO, as the SAO should also have the authority to audit all EU funds' management, which includes the AA. The SAO audits of the AA would hardly be seen as an objective analysis of AA activity, as the Auditor General (AG) would be the ultimate authority assessing one of its branches. It might become confusing when results of that audit are reported to parliament and are presented publicly.

In addition, part of the SAO is not free to decide about its auditing work, as the AA has to send its annual audit plan to the European Commission and to the National Authorising Officer (NAO), who is part of the Macedonian Government, and must accept eventual changes in the plan. The AA also reports not to the Macedonian Parliament but to this same NAO, to the Competent Accrediting Officer (CAO) and to the EC, which means that part of the SAO cannot be considered independent from external influence. This situation affects the SAO as an institution. There are serious doubts as to whether the rather artificial separation of the AA from the rest of the SAO can really overcome these concerns with regard to the independence of the SAO as such. This solution should therefore only be provisional, and more suitable arrangements should be considered.

**The standard components of SAI independence are generally in place, but achieving financial and operational independence in practice is problematic.**

#### **2.4 *Are the SAI's annual and other reports prepared in a fair, factual and timely manner?***

The fairness and factual correctness of the SAO's reports are safeguarded by provisions in the SAO Law, the experience of audit staff, as well as internal quality control measures. According to the law the draft report is submitted to the auditee, who has 15 days to provide written comments. The final report is produced, with the comments incorporated, and again submitted to the auditee, who has 30 days to lodge a complaint against the report. It is up to the AG to make the final decision, at the latest 30 days following receipt of the complaint. During the current assessment period this has not happened. In the new draft law the procedure has been slightly changed: the auditee has a longer period for the initial response (30 days), and there is no specific procedure for issuing a complaint. This arrangement seems reasonable if, as foreseen in the draft, parliament plays a more important role in discussing and deciding actions based on final audit reports.

Experienced, competent and independent staff constitute a critical factor in the production of fair, factual and timely reports. Currently the human resources development policies of the SAO are under review, and new development goals are being established. Modern audit practices along with audit manuals should be constantly developed. The law has a provision that only a chartered state auditor can sign the audit reports and to obtain the title means passing the examination, which is arranged by the SAO itself. In reality no examinations have taken place so far, and all of the current "certificates" have been issued by the Ministry of Finance. To follow the law, the SAO has now started to initiate the required examination procedures and plans to increase the number of chartered state auditors. In the long run, the examination level should also be closely monitored externally. Due to the small size of the organisation, the required level might not be guaranteed in the long run.

Quality control guidelines were also recently introduced, and it is foreseen to develop additional quality assurance procedures within the next strategy period. The current quality control procedures consist of the use of templates and checklists. However, there is no procedure in place to ensure an audit quality management system (in line with the EU Member State SAIs' recommendations of 2005). Such a system would be based on three main pillars: audit quality control (referred to as "hot reviews" as they are performed before the audit decision is taken); audit quality assurance (referred to as "cold reviews" as they are performed after the audit decision has been taken); and finally, audit quality management (the processes supporting the core audit processes).

Audits are normally carried out in accordance with the audit programme approved by the AG, and the SAO appears to have no problem meeting the target dates. The annual report is sent to parliament by the date specified in the SAO Law. However, as indicated above, this report does not have much relation to the overall budget execution process. The annual report is submitted to parliament seven months after the deadline for submission of annual financial statements, which is far too late to have a meaningful impact in terms of ensuring public oversight of budget execution.

**Basic procedures are in place to produce fair and factual audit reports. Quality assurance and human resources development as well as examination schemes should be developed. Timely reports, where the fairness and factuality has a meaning, will only be achieved after major improvements in the overall financial management systems of the public sector where the attestation of the accounts are given the required importance.**

**2.5 *Is the work of the SAI effectively considered by parliament, e.g. by a designated committee that also reports on its own findings?***

In addition to the annual report, the AG submits to parliament the reports on ministries, budgets and funds, and state-owned enterprises. Reports containing a disclaimer of opinion and reports concluding that the financial statements do not give a true and fair view of the audited entity are also sent to parliament. However, so far there has been little interest, if any, in the work of the State Audit Office. The normal recipient of the reports is expected to be the Parliamentary Budget Committee, but the committee members have not familiarised themselves with the relevance of audit reports and do not discuss them. No designated committee has been established to discuss SAO reports or to develop its own findings. The SAO has tried to promote the establishment of such a committee, but so far its influence has been rather limited.

A new communications policy was approved by the AG, and external assistance is involved in developing the SAO's external relations. Also the new draft SAO Law provides that all audit reports are to be sent to parliament, which means that valuable findings of performance audits will hopefully be directly communicated to parliament in the future. However, this may not be sufficient to ensure that audit reports are properly used by parliament for scrutinising the government's use of public funds.

It is clear that the audit reports have no impact on, and no link with, the discussion of the annual state budget. This lack of impact is related, among other factors, to the contents of the SAO's annual report, which has not focused on the overall execution of the previous year's budget but on collecting the findings related to individual auditees, and also to the lack of a clear overall accountability framework, including procedures for parliamentary committee decisions based on the SAO reports. The SAO should aim to recommend changes in the Budget Law and in parliamentary work practices so as to establish relevant procedures for handling SAO reports and to develop clear meaning/relevance for SAO reports in the budgeting-reporting cycle.

The current situation does not mean, however, that there is no follow-up on audit reports. Follow-up is first of all linked to the recommendations suggesting further proceedings by means of investigations by administrative or law-enforcement bodies, such as the Ministry of Finance, Public Revenue Office, Public Procurement Office, Public Prosecutor, Anti-Corruption Committee and Financial Crime Department in the Ministry of Interior. All of these bodies are said to co-operate efficiently with the State Audit Office and to provide feedback on the work that they have undertaken in reaction to the SAO's findings. This co-operation on follow-up is normally reflected in the SAO's annual report. It is based solely on the interpretation of the current legal provisions: article 28 of the State Audit Law provides that these authorities are to inform the SAO within 90 days of any measures taken as a result of an audit report. The annual activity report of the SAO contains statistical information on the implementation of its recommendations. The SAO otherwise systematically follows up in its report on the implementation of the recommendations resulting from its previous audit work.

So far the SAO's major "audience" for audit results has been the government. A special Audit Committee was even formally established within the executive as a result of the conclusions of the

government session of 6 September 2007. This audit committee is supposed to review audit reports and propose measures and activities for the implementation of the recommendations. However, this committee cannot substitute for a parliamentary committee, with balanced representation and work procedures (e.g. public hearings, follow-up procedures, etc.) for the purpose of scrutinising the government's management of public funds.

A second initiative, derived from the same government meeting, entrusted the Ministry of Finance with the responsibility for setting up the "relevant commission in the National Assembly to review the audit reports, and propose measures and activities to the competent bodies" in order to implement the recommendations made. For the moment, the creation of this commission has remained a government intention only.

**The SAO's work is not effectively considered by parliament, as there is no designated committee that deals with audit reports and issues its own findings. Reports sent to the Assembly meet with no real reaction, but most other follow-up activities seem to be efficient.**

## **2.6     *Has the SAI adopted internationally and generally recognised auditing standards compatible with EU requirements, and how far have they been implemented?***

The INTOSAI standards have been translated into Macedonian and have been published in the *Official Gazette of Macedonia*. The State Audit Law specifies that audits are to be conducted in accordance with the applicable laws and regulations and to follow the INTOSAI auditing standards. Within the current time frame it is difficult to assess what this provision means in practice. In order to provide valuable feedback for further development, it is recommended to perform a peer review within the next two years. Such a review would also support one of the SAO's main strategic goals -- to improve audit quality.

The SAO has produced a financial audit manual and a performance audit manual as well as quality control principles, guidelines for follow-up audits, planning guidelines and a manual for the format of audit reports. In addition, previous and current co-operation projects with the Dutch Court of Audit have introduced many valuable pilot audits for developing financial audit and performance audit. Also new policies for human resources management, IT and communication, and quality assurance practices (currently under development), as well as co-operative and joint audits with sister organisations will serve the same purpose.

**The SAO has adopted the INTOSAI auditing standards, and framework and development goals have been established. Practical implementation is underway but will be a major challenge.**

## **2.7     *Is the SAI appropriately aware of the requirements of the EU accession process?***

Since December 2005 Macedonia has been an official candidate for EU accession. The SAO's awareness of EU requirements has considerably increased since that date. The SAO has indeed taken action on certain points, such as the right to access end-users of funds and suggestions for amending the State Audit Law accordingly. Current developments are also supported by the fact that the SAO has employed staff who had previously been involved with the EU-required PIFC development process as well as with building the financial management framework for EU funds with the Audit Authority unit.

More generally, in spite of its recent establishment and limited resources, the SAO already plays an active role in various international forums. A member of INTOSAI since March 2001, the SAO has also been a member of EUROSAI since May 2002 and in particular a member of its working groups on environmental audit and IT audit. Furthermore, the SAO is represented in various training activities, and staff have been trained and certified as IDI (INTOSAI Development Initiative) trainers. The SAO is also a member of the network of SAIs of EU candidate and potential candidate countries supported by the European Court of Auditors, and it is taking part in parallel audits with other SAIs of the network. The SAO has sent five interns to the European Court of Auditors.

**The SAO is appropriately aware of the EU accession process.**

### **3. Reform Dynamics - Capacity to Further Develop the System**

The legal framework is in place and is generally in line with INTOSAI principles, but several changes are urgently required in order to guarantee the independence of the institution and to ensure that it has a meaningful role. Many of these changes were recommended in previous Sigma assessments, but have not yet been implemented. Changes in the Constitution, adoption of the new SAO Law, overcoming financial and staff restrictions, establishing a separate committee in parliament, etc. all seem to be depend on the executive, and the SAO has little influence or opportunity to establish its position. The Auditor General should mobilise his entrusted power to achieve that goal, as otherwise the required criteria (following international standards) for becoming an EU Member State may not be met.

This does not mean that nothing has changed. The SAO internally has achieved many developments with the help of external assistance. The SAO has constantly renewed its Development Strategy, which is a good indicator of the commitment of the SAO to constant improvement. Current strategic documents concern the period 2008-2012; they now list five strategic goals: functional, organisational and financial independence; ensuring optimal human resources; improving the quality of audits and monitoring the impact and development of new types of audit; IT system development and using IT in audit; and communication policies. Strategic objectives are also supported by human resources and communication policies. Generally the Development Strategy incorporates the main conclusions of the peer review carried out by the German Court of Audit in 2007, the results of the twinning project with the Dutch Court of Audit, and the SAO's own needs assessment.

The progress of the SAO, including implementation of the Strategic Development Plan, is still supported by a two-year bilateral assistance project provided by the Dutch Court of Audit. This project is the follow-up to a previous three-year "twinning" project, and it has four components that address the key challenges of the SAO: capacity-building (quality assurance, follow-up system, performance assessment and training policy); auditors' skill enhancement (pilot audits, training and update of manuals); IT and IT audit; external communication (including with parliament). Additionally, the assistance project should focus on actual implementation of the developed principles and sustainability of the changes introduced. As mentioned above, it is also recommended to undertake a peer review within the next two years so as to conduct an in-depth evaluation against INTOSAI standards.

**The State Audit Office of Macedonia has demonstrated in recent years a determination to develop and improve its internal capacities and operations in order to become an efficient SAI. There is still much to be done to meet the standards, and the new AG has a major challenge, not only to impose the required changes in the SAO legal framework but also to ensure their implementation. The SAO should start to play a leading role in reforming financial management and accountability in the public sector.**

#### **Recommendations for Assistance**

The last peer review took place in 2007. In order to evaluate sustainability and the depth of the changes, it is recommended to undertake a new peer review within the next two years.