

# NEWSLETTER • November 2002

For the Working Groups of the Presidents of the Supreme Audit Institutions of European Union Candidate Countries, Albania, Croatia, Turkey & the European Court of Auditors • Produced by SIGMA\*

## EU Accession on Course

The October Regular Report brought good news in confirming 2004 as the target year for EU accession for 10 of the Candidate Countries and the year 2007 for Bulgaria and Romania. Turkey was not yet given a definite time frame for accession. For all countries eventual accession was made subject to the fulfillment of a number of concrete commitments made by the respective governments.

It is our firm belief that the active support of the SAIs in this process has been of vital importance for the successful accession negotiations and in particular for the negotiations of chapter 28 on financial control. SIGMA would therefore like to congratulate all of those who have actively helped in the process of preparing a national system which forms an acceptable basis for fulfilling the requirements for EU accession in the area of financial control and other important areas of the *acquis* by 2004.

In this issue of the newsletter we have addressed the theme for the workshop in Gdansk on "Audit Quality Assurance" which is closely related to the work undertaken by the SAI expert group on "Quality in the Audit Process". This includes an article on page 2 and the fact boxes on page 7. In addition, we will bring some information and documentation about quality management in general. We are also bringing an article about Risk Management, which has become an increasingly important concept for financial managers and auditors in the public sector.

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Finally, we want to thank all the SAIs participating actively in and supporting so strongly this year's workshops. This includes the network of the SAI Presidents of Albania, Bulgaria, Croatia, Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Poland, Malta, Romania, Slovakia, Slovenia, Turkey and the European Court of Auditors, the European Commission and also many of the Member State SAIs.

*Best wishes from SIGMA*

## Meeting of the Heads of the Supreme Audit Institutions from Central and Eastern European Countries, Cyprus, Malta, Turkey and the European Court of Auditors, Bucharest 12-14 December 2002.

It was decided by the Heads of the above-mentioned SAIs at their meeting in Sofia that the annual meeting of the Heads of the SAIs will take place in Bucharest on 12-14 December 2002.

The host of the meeting will be Mr Dan Drosu Saguna, President of the [Romanian Court of Accounts](#).

In the context of European Integration, among others, the topic to be discussed at the meeting will mainly be based on the activity of the two working groups (Audit Manuals and Audit Activities) as well as on the reports prepared by Liaison Officers (Audit of Internal Control Systems and Quality control in the Audit Process).

Invited as speakers are the President of the Romanian Republic, Mr. Ion Iliescu, as well as the Prime Minister of Romania, Mr. Adrian Nastase. Other invited speakers include Dr. Michael Scheyer, Member of the European Commission, Mrs. Diemuth R. Theato, Member of the European Parliament and Chairman of the Budgetary Control Committee and the President of the European Court of Auditors Mr. Manuel Fabra Valles.

The Meeting will be organized at the [Athenee Palace Hilton Hotel](#) Conference Room and the Welcome reception is scheduled for 11<sup>th</sup> December 2002.



## Quality in the Audit Process

When considering how to ensure quality in the audit it useful first of all to distinguish between and clearly understand the terms of "Quality Control" and "Quality Assurance".

In Guideline No. 51 of the European Implementing Guidelines for the INTOSAI Auditing Standards where it is stated that *"assuring the quality of audits carried out by Supreme Audit Institutions (SAIs) and thus ensuring compliance with the INTOSAI Auditing Standards can be seen as a two-stage process. At the first level, it is necessary for SAIs to adopt policies and procedures designed to ensure that audit tasks are carried out to an acceptable level of quality. At the second level, it is recommendable that SAIs carry out higher level quality assurance (Q.A.) reviews of audit tasks to establish that these policies and procedures are adhered to within the SAI, and that they are having the desired effect of ensuring that work is carried out to an acceptable level of quality"* (For more detail on Q.A. see fact box II p. 7). With this approach audit quality is assured partly via the adoption and upholding of appropriate SAI standards & policies (e.g. via current controls in the process of auditing), partly via recurrent reviews of the quality of the audits already undertaken.

A similar line of thinking is promoted by the IFAC International Standards on Auditing. Standard 220/02 states that *"Quality Control policies and procedures should be implemented at both the level of the audit firm [hereafter institution] and on individual audits"*. Furthermore it is said that *"the audit [institution] should implement quality control policies and procedures designed to ensure that all audits are conducted in accordance with International Standards on Auditing or relevant national standards or practices"* (Fact box I p. 7).

According to the "Government Auditing Standards" by the General Accounting Office *"Each audit organisation (...) should have an appropriate internal quality control system in place and undergo an external quality control review"*. This document distinguishes *"internal quality control system"* and *"external quality control review"*. It should be added that in the 2002 Revision Exposure Draft on this document, the term *"external quality control review"* is being revised to *"external peer review"*.

Similar concepts are seen in many well developed SAIs. For example a part of the UK NAO "Value for Money Handbook" concerns *"Securing quality in our VFM-work"*. It sets out the arrangements for promoting quality through training and guidance, and through *"quality assurance"*. Quality assurance has two aspects: continuous

quality assurance, which is an integral part of examinations, and post study completion quality reviews after the report is published.

On the basis of the above we can therefore make a distinction between actions taken during audit procedures (sometimes called "real-time" procedures) from actions taken after all audit procedures have been completed, and post-audit review). However, very often "Quality Control" and "Quality Assurance" are used synonymously and possible confusion over terminology should not prevent the very important task of ensuring that the SAI work is of the highest possible quality.

### **Workshop on Audit Quality Assurance in Gdansk, 21-24 October**

On the 21-24 October the SAI of Poland, the *Najwyższa Izba Kontroli* (NIK) hosted the workshop on Guidelines for Audit Quality Assurance for the SAI Working Group on Audit Manuals. The workshop took place in [Hotel Posejdon](#) in Gdansk. Presentations and papers from the workshop have been made available through the [EDG of the SAI Working Groups](#)

For more information, please consult the information posted at the [web site of the NIK](#), or e-mail the NIK contact persons Ms [Elzbieta\\_Grzedzinska@nik.gov.pl](mailto:Elzbieta_Grzedzinska@nik.gov.pl) and Ms [Agnieszka\\_Rucinska@nik.gov.pl](mailto:Agnieszka_Rucinska@nik.gov.pl).

### **SIGMA undertakes PIFC peer review & assistance project in Slovenia**

During November and December 2002 SIGMA will be undertaking a PIFC Peer Review & Assistance project with the Slovene authorities. The peer team will comprise the following EU Member State and SIGMA peers: Mrs Susanna Rafalzik, Head of Division at Austrian Federal Chancellery, Structural Funds Central Co-ordination; Mr Peder Blomberg, Swedish Public Procurement Expert; Mr Graham Jenkins, Former Finance Director at the UK Intervention Agency; Mr Jose Viegas Ribeiro, Deputy Inspector General of the Portuguese Inspectorate General of Finance; Lage Olofsson, Former Director at the Swedish SAI, Principal Administrator SIGMA. Mr. Francois-Roger Cazala, Conseiller maître, French Cour des Comptes, Principal Administrator SIGMA, will be project manager and team leader. The team will be supported by Project Assistant Ms Annes McGoogan. For more information you can e-mail or call [Annes.Mcgoogan@oecd.org](mailto:Annes.Mcgoogan@oecd.org), + 33 1 45 24 13 04.

## Types of Control

In the context of EU enlargement negotiations and understanding the Public Internal Financial Control (PIFC) concept, the terms ex-ante controls, on-going controls, and ex-post controls are often used to characterise the types of practical control found in an internal audit system.

Controls may also be divided into the following different types:

- a) *Preventive*: designed to prevent the occurrence of inefficiencies, errors or irregularities. These cannot guarantee that the controlled factor will not occur but reduce the chance of it occurring. Examples include division of duties and authorisation controls.
- b) *Detective*: designed to detect and correct errors, inefficiencies or irregularities. They may not give absolute assurance since they operate after an event has occurred or an output has been produced but they should reduce the risk of undesirable consequences as they enable remedial action to be taken. Detective controls are most effective when they form part of a feedback loop in which their results are monitored and used to improve procedures or preventive controls. Examples include post payment check, stock verification and bank reconciliations.
- c) *Directive*: designed to cause or encourage events necessary to the achievement of objectives. Examples include clear definition of policies, the setting of targets and adequate training and staffing.

In practice the above categories may not be clearly distinguished and a single control may operate to cover two or more functions. Supervision, for example, covers all three of these categories.

Also, it is common in the framework of the so-called "COSO" model to distinguish between "hard" and "soft" controls, where soft refers to informal controls and hard refers to the more traditional, formal controls.

## The EFQM Excellence Model ®

The Excellence Model, developed by the European Foundation for Quality Management – the EFQM, is widely used by over 20,000 European organisations (in both public and private sectors) as a means of reviewing performance against internationally recognised best practise.

The EFQM Excellence Model is based on the principle that the five key enablers of excellence are about leadership, policy & strategy, people, partnerships & resources and processes. These enabling activities are the causal factors in achieving excellent performance – as demonstrated by people results, customer results and society results and then ultimately key performance results. Key performance results are the indicators of progress towards the organisation's aims and objectives, and are usually those reported in the organisation's Annual Report.

EFQM applies the principles of [Total Quality Management \(TQM\)](#) which has been applied by many public sector institutions, including some European supreme audit institutions.

Via these hyperlinks to the EFQM website you can find at lot more information about the [EFQM](#) in general and [EFQM Excellence Model ®](#) in particular, including information about the model's application in European [public sector](#) institutions.

EFQM homepage: <http://www.efqm.org/>

**Click here to get and share audit guidance and ideas via the [Audit Manuals Reference Archive](#) on the EDG of the SAI Working Groups on the SIGMA web-site.**

## Quality Management Definition

To be really effective an organisation should manage its way of doing things by systemizing it. Management systems standards provide the organization with a model for setting up and operating the management system. Standards and other solutions for quality management or total quality management (TQM) ensure that nothing is left out, and that everyone knows who's doing what, when, how, why and where.

## MANAGEMENT OF RISK

Risk management is becoming a key management and organisational tool. Risk management concepts were first developed for nuclear emergency and military uses, but auditors for a long time have used evaluations of risk in their everyday work to plan and carryout audits. It is important for the auditor to understand well what risk management means for financial and other managers and will also need to keep abreast of latest developments.

The running of any organisation is primarily concerned with achieving its objectives. Whatever the purpose of the organisation, whether it be government or private sector, it will face all manner of **risks**. The job of management is to respond to these risks so as to maximise the likelihood of the organisation doing what it is set up for.

**Risk** can be defined as *“an outcome or event, which could have a material effect on the objectives of an organisation”*. The primary **causes** of risk are closely inter-related:

- the random nature of events
- imperfect or incomplete knowledge and information
- lack of control and/or control weaknesses in the organisation

There is a continuous ‘cycle’ to the risk management process:

- **Identify** the risks and define a framework within which risk is to be identified
- **Evaluate** the risks
- **Assess** risk appetite
- **Identify** suitable responses to risks
- **Gain** assurance about the effectiveness of the responses
- **Embed** and review

A strategic approach to risk management depends on **identifying risks** against key organisational objectives. Two of the most common approaches to identifying risk are

- to commission a risk review
- risk self-assessment

An alternative but unsystematic approach is to rely on intuition. This may be the most pragmatic in getting risk management off the ground. It simply involves management identifying risks using their “gut feelings”.

**Essential to the process** is that the organisation has a **well defined hierarchy of objectives** starting with high level, strategic objectives, and working down to lower level, day to day objectives (e.g. objective for payroll, purchasing etc) against which risks can be identified. **Categories of risk** (not comprehensive) with examples are listed below. Organisations will probably be able to identify other categories of risk applicable to their work. **Issues can arise which can be an external source of risk to an organisation or can occur as an effect of an organisation’s own activity or lack of it.**

External	
Infrastructure	Infrastructure failure prevents normal functioning e.g. overload of e-mail system, computer networks, power supply systems, Transport systems for bringing staff to work may go on strike.
Economic	Interest rates, exchange rates, inflation may adversely affect plans.
Legal and regulatory	Laws and regulations may limit scope to act as desired. Inappropriate constraint through regulation may be imposed.
Environmental	Pollution, fuel consumption may have a damaging effect on the environment. The constraints of the environment in which the organisation is located may limit possible action.
Political	Change of government may require change of objectives. Organisation’s actions may attract a political response/reaction.
Market	Developments with competitors and suppliers of goods adversely affect plans.

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'Act of God'	Ability to act as desired affected by fire, flood etc. Contingency plans against disasters prove inadequate
<b>Financial</b>	
Budgetary	Availability of resources insufficient to carry out desirable actions. Inability to control or direct resources
Fraud or theft	Loss of assets. Resources not available to carry out desirable preventive actions.
Insurable	Insurance not obtainable at acceptable cost. Failure to insure.
Capital investment	Inappropriate investment decisions being made.
Liability	The organisation is adversely affected by others' actions, leading to the organisation gaining a right to seek damages. The reverse can apply.
<b>Activity</b>	
Policy	Inappropriate policies being pursued. Policies based on inadequate or inaccurate information.
Operational	Unachievable/impractical objectives. Objectives inadequately achieved.
Information	Inadequacy of information for decision making leads to decisions being made without sufficient knowledge.
Reputation	Development of poor public reputation and consequent effects. Ethical reputation, for example, may limit scope to act as desired.
Transferable	Risks which could be transferred are retained or are transferred at the wrong price
Technological	Need to improve/replace technology to remain effective. Failure of technology disables the organisation's operations.
Project	Projects developed without the risks being properly assessed. Projects failing to deliver in time budget or functionality.
Innovation	Exploitation of opportunities for innovation missed. Using new approaches without properly assessing risks.
<b>Human Resources</b>	
Personnel	Lack of sufficient staff with appropriate skills limits ability to operate effectively, or at all! Poor morale affects staff.
Health and safety	People unable to perform their responsibilities due to neglect of well being of employees.

**Assign ownership of risks**

Risk management is most effective when a senior official is allocated ownership. The risk owners can be formed into a Risk Management Committee. Risk management is most effective when a senior official is allocated ownership of particular risks, normally those within his area of responsibility. The risk owners can be formed into a Risk Management Committee, which would identify the areas of greatest risk to the organisation, and decide how to respond to those risks. A re-evaluation of risk would take place at regular intervals and the Committee would also have a monitoring role to determine how risks are being managed.

**Evaluate**

Some types of risk lend themselves to a numerical *diagnosis*, particularly financial risk. For other risks –for example reputation risk- a much more subjective view is all that is possible. It will be necessary however to develop some framework for categorising risks into, for example, high/medium/low.

**Assess risk appetite**

Decisions about response to risk have to be taken in conjunction with the identification of the amount of risk that can be tolerated.

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## Response to risk

Mitigation/control strategies:

- avoid the risk by suggesting alternative strategies
- eliminate the cause(s) of the risk
- reduce the likelihood of the risk occurring
- reduce the direct consequences of the risk
- minimise its impact in business terms
- transfer the risk (insurance)
- instigate further investigation to gather more information before a final decision is made
- accept the risk as unavoidable

Flowing from this the organisation should draw up a **corporate risk register**. The register should contain details of the risks. For each risk the register will show:

- importance
- proposed action to deal with the risk
- responsible officer
- whether there are controls in place to achieve the organisation's objectives
- if the controls are inadequate, what the organisation is doing about it.

## Gain assurance that risk is being properly managed

It is vital that assurance is obtained as to the effectiveness of management actions. This can be provided by management periodically reporting on the work they have done to keep risk and control procedures appropriate and up to date. Internal Audit can also provide assurances about management's risk and control mechanisms.

## Embed and review

The risk environment doesn't stand still and it is important that the risk process is regularly re-visited to have an assurance that the risk profile for the organisation continues to be valid.

Useful steps for **implementing the risk management process**:

- a memo from the 'boss' to all members of management and staff to 'kick off' the process
- circulation of a risk management policy document
- workshops at different levels on risk management
- re-allocation of some of the training budget specifically to risk training
- dissemination of key business objectives and significant risks
- clear policy communicated on how significant risks are to be managed

Rather than developing separate risk reporting systems it is better if possible to build early warning mechanisms into existing management information systems. Cumbersome databases can be a major distraction from the key point which is that each person in the organisation becomes more focussed on meeting the business objectives and in managing the significant risks which relate to the task which he or she performs.

The **message** for financial managers is that risk management is not simply a process to be gone through to satisfy external parties. It is a highly practical management tool and should be a fundamental part of planning and decision making. Therefore top management should work to embed risk management within every process and to ensure all staff understand the value of risk management.

BOX I

**DEFINITIONS OF “QUALITY CONTROL” AND “QUALITY ASSURANCE”**

*Quality Control* consists of all measures taken and procedures carried out within the audit process that seek to guarantee the quality of the audit work and of the resulting report.

*Quality Assurance* involves a review process, after the audit has been completed (i.e. where the resulting report has been adopted by the responsible audit body) the purpose of which is i) to ascertain if the Quality Controls are working properly, and ii) to suggest improvements.

*Adapted from the Audit Manual of the European Court of Auditors.*

BOX II

**COMMONLY FOUND ELEMENTS IN THE EX POST QUALITY ASSURANCE FUNCTION**

The following are some commonly found as elements of internal quality assurance:

- \* staff carrying out QA reviews are suitably qualified and experienced (they may be either employed full-time in quality assurance, or on short-term secondments from other parts of the SAI);
- \* staff carrying out QA reviews are independent of the audits being reviewed;
- \* staff carrying out QA reviews have the power to select audit tasks for review;
- \* procedures are established for the selection of all audits to be reviewed, which will ensure an appropriate coverage of all the activities of the SAI over a set period of time; all tasks of the SAI must potentially be subject to review (re. the reviewer must have full knowledge of the activities of the SAI);
- \* procedures are established to determine the nature, extent, frequency and timing of the QA reviews;
- \* procedures are established to resolve disagreements which may arise between QA reviewers and audit staff;
- \* staff carrying out reviews have right of access to all relevant internal documents and to the staff who prepared them or managed the task;
- \* staff carrying out reviews normally have the duty to report and make recommendations in a timely manner to the SAI's senior management, and senior management normally has the duty to respond to these;
- \* audit staff can request that a QA review is carried out at any stage of an audit task;
- \* publication of an Annual Report - (normally) made available to all audit staff.

In certain cases, and particularly when the SAI uses temporary secondments to carry out internal quality assurance reviews, the SAI may decide to develop and use standard checklists of objectives that the reviewer must achieve to ensure the consistency and completeness of the reviews carried out.

Source: Annex I of Guideline No. 51 of the [European Implementing Guidelines for the INTOSAI Auditing Standards](#)

Agenda of events in 2002/2003

Week	Date	Event
42	15 October	Meeting of the INTOSAI Governing Board in Vienna
43	21 – 23 October	Fourth workshop of the working group “Audit Manuals” in Gdansk, Poland. Hosted by the NIK Topic: Audit Quality
44	28-29 October	Meeting of European Financial Control Organisations in Malta
	November	IDI Programme for SAIs of Phase II: Strategic Planning workshop in Zagreb
48	26 November	“Verstehen” Conference organised by the EC Internal Audit Service, Brussels
48	27 November	Commemoration of the 25 <sup>th</sup> anniversary of the ECA, Luxembourg
48	27 – 28 November	Meeting of the Heads of SAIs from EU Member States and the ECA in Luxembourg; part of the meeting will include the Heads of SAIs from candidate countries
50	12 – 13 December	European Council meeting in Copenhagen
50	12 – 13 December	Meeting of the Heads of SAIs from Central and Eastern European Countries, Cyprus, Malta, Turkey and the ECA in Bucharest
1	1 January 2003	Start of the new SIGMA programme for the EU candidate countries 2003-04
	January 2003	Meeting of the ETC Board in Lisbon
	February 2003	IDI Programme for SAIs of Phase I & II: Regional Audit Workshop for candidate countries SAIs, Cyprus,
	26-28 May 2003	EUROSAI Training event: Evaluation of Internal Control, Prague

Contributions to upcoming issues of the Newsletter are most welcome and should be send to [nicolasjohn.treen@oecd.org](mailto:nicolasjohn.treen@oecd.org) or [johannes.stenbaek-madsen@oecd.org](mailto:johannes.stenbaek-madsen@oecd.org).