



SIGMA

Support for Improvement in Governance and Management

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BOSNIA AND HERZEGOVINA

EXTERNAL AUDIT

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1. Legal Framework

External audit in Bosnia and Herzegovina was initially based on three distinct laws passed between 1998 and 2000: the *Law on Audit of Financial Operations of Institutions of Bosnia and Herzegovina* (BiH), the *Law on Budget Audit of the Federation of Bosnia and Herzegovina* (FBiH) and the *Law on Public Sector Audit of Republika Srpska* (RS). All three laws were drafted with World Bank assistance, and the drafts had identical provisions. However, some changes occurred during parliamentary deliberations, with the result that the adopted laws differ to a certain degree in terms of structure and content.

By mid-2000, the three Supreme Audit Institutions (SAIs) for BiH, FBiH and RS, each headed by an Auditor General, had been established with assistance from the Swedish National Audit Office (SNAO). The first audits of accounts were carried out in 2000 and since then the number of audits has gradually increased.

The general view on how to secure the independence of a Supreme Audit Institution is that the existence of such a body should be “enshrined” in the Constitution. This is not the case in BiH at either state or entity level and can be seen as a significant shortcoming. A new legal framework was created and adopted nearly at the same time for the three levels of government in 2005-2006. Three new laws now govern the activities of the SAIs of Bosnia and Herzegovina (adopted respectively on 6 October 2005 for RS, 31 January 2006 for the state level, and 22 March 2006 for the Federation). The intention was to rationalise the supporting legal texts of the three institutions and to bring improvements to the procedural framework following five years of operation. The main target, however, was to change the terms of the management (now seven years, not renewable) and to make it possible for the management currently in place to apply again (as a transitory arrangement) for re-appointment. This would have been impossible under the previous legislation.

In accordance with the three initial Audit Laws, a Co-ordination Board of the Supreme Audit Institutions was formed, consisting of a committee and a secretariat. This set-up has been kept entirely by the new legal framework. The Board consists of the three Auditors General and their deputies. The Auditor General of the SAIBiH acts as chairperson. The permanent secretariat of the Board is now operational, since staff members of the SAIBiH are now entrusted with the related functions, although on a part-time basis. One person, a senior auditor, has also been appointed on a full-time basis, but as he is ill he has not yet taken up duty.

The main functions of the Board are to:

- establish consistent auditing standards;
- ensure consistent audit quality;
- assign responsibility for joint audit activities;
- determine representation in international bodies.

The Co-ordination Board agreed on secondary legislation, which was subsequently passed in the three jurisdictions, and adopted a series of common practical documents and guidelines – in particular, the INTOSAI Code of Ethics for Public Sector Auditors in April 2001 and a Joint Audit Manual in 2003. It has

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recently adopted a set of guidelines for quality control of the audit work, a common communications policy and a communications plan, and a common human resources management policy.

The SAIs became members of EUROSAI in 2002, represented by the SAI/BiH. All three SAIs are engaged in INTOSAI's technical assistance activities (the INTOSAI International Development Initiative). They also have started to participate in the activities of the group of SAIs of candidate countries and potential candidate countries to the EU organised by the European Court of Auditors.

The special Advisory Group, which had been established to support the process of strengthening the legal framework of the three SAIs and which comprised representatives of the SAIs, World Bank, the international community and donor organisations, has been dissolved.

Also, the Special International Auditors for RS and FBiH, established in the early 2000s by the OHR, have ceased to exist. The role of these institutions was to focus on possible cases of fraud and mismanagement in the BiH administration.

The new law would normally have enabled the SAIBiH to become the external auditor of the Brcko district, which has so far lacked a specific public external audit function. However, district authorities took the initiative of creating a specific body, called the Brcko SAI and modelled on the SAIBiH structure and legal framework. This decision, of a very formal character, does not move in the right direction in terms of cost-effectiveness and efficiency. There is little case, if any, for establishing a "supreme", or any other, audit institution at the level of Brcko. It is now difficult, once the body has been established and an Auditor General appointed, to reconsider the interest and relevance of such a decision, which in addition is said to have been prompted or supported by international organisations.

2. Institutional Framework

State level

The SAIBiH is headed by the Auditor General, who has two deputies and 34 staff. An additional five persons should be recruited, so that the SAIBiH would reach the level of 42 by the end of 2009. This SAI aims to establish the middle-level of management necessary for the future functioning of the SAI, supporting the Coordination Board, and improving the quality control and assurance functions in the SAI.

The appointment of the SAIBiH management still poses a serious problem. Contrary to what happened in the two other SAIs after the adoption of the new legal framework, the senior management of the SAIBiH has still not been officially appointed, more than two years after the adoption of the new legal framework and three years after the expiration of the former management's term of office. The current management, composed of the Auditor General and one of the two deputies, still fulfils a "technical mandate". In addition, the former parliament had added further criteria for recruitment to the legal provisions, which can only be seen as impairing the independence of an institution that should be regulated only by the law (and the Constitution). This situation has demonstrated, at the very least, a disturbing level of misunderstanding by the BiH Parliament of the status and functions of an SAI. In practice, it is clear that there is still a strong political element in the designation process of members of the SAIBiH management board. This is not surprising, as the designation procedure is, by law, entirely controlled by the Parliament of Bosnia and Herzegovina. For the time being, the procedure has resumed and been implemented by the selection committee, which has submitted to parliament merit lists for the three posts to be filled. The final decision should have been made by the end of May 2008.

A recent example of the risks still threatening the independence of the SAIBiH is the result to be obtained from the expected adoption of the new Law on Salaries of the Civil Service. Contrary to existing practice, characterised by a fair balance between the financial managerial independence of the SAI, the public finance constraints and the unity of the BiH civil service, this new law could place the functioning of the SAI completely under the rule of the Ministry of Finance, thereby decreasing the salaries within the institution and consequently breaking the equilibrium prevailing between the three SAIs of Bosnia and Herzegovina.

The auditees are in principle split between the two deputies who are responsible for co-ordination of the audits carried out by the office (which in practice has not been the case for the last two years). The SAI uses job rotation between the members of audit teams in order to support training and broaden experience. The auditing process is regulated by means of management instructions and templates; findings and conclusions are discussed with the audit team and the management group before the audit report is drafted.

The SAIBiH has more than 60 state institutions to audit and endeavours to audit them all on a yearly basis, in accordance with its mandate. The scope of potential activities of the SAIBiH is constantly expanding with the extension of the competences at the state level of Bosnia and Herzegovina and the creation of new institutions. The SAIBiH has thus already produced two audit reports on the recently established Indirect Tax Authority. The SAIBiH also audited the state-owned broadcasting company, and the report is said to have triggered many comments in the media and in political circles, as the management of this organisation was severely criticised.

The audit scope includes financial and systems-based audits, i.e. audits of internal control systems are included. The SAI identifies the main problems within the actual public administration as being related to the weak internal control systems and to non-compliance of the administration with the rules in place.

A first pilot performance audit will be finalised in the framework of the current technical assistance project with Sweden. Its topic is the effectiveness of the staff recruitment and management procedures, with a special focus on the activities of the Civil Service Agency. A specific performance audit department has been set up.

Federation of BiH

In 2007 the SAIFed had 54 staff (as compared to 28 in 2001).

The SAIFed has three regional offices: Bihac, Mostar and Tuzla. It has four audit branches, responsible for the Federation, cantons, municipalities and public funds/institutions.

The SAIFed has approximately 1,700 auditees, spread over more than 40 budget-users (budget chapters). It is anticipated that the number of auditees will diminish as a result of privatisations and mergers of funds.

The auditors are trained to perform systems audits and performance audits as well as regularity audits. However, the pressure put upon the SAIFed to carry out regularity audits means that few, if any, special audits are carried out. Since the SAIFed has been obliged by law since 2005 to audit all auditees every year, it has become even more difficult to carry out special audits or joint audits with the other SAIs; the focus on annual financial (regularity) audits will consume a significant amount of time and human resources. However, the SAIFed – like its sister organisations – has started to experiment performance audit in the field of education.

The main difficulties identified by the SAIFed are the following:

- the importance of its audit remit, which makes it practically impossible for the SAIFed to entirely discharge its duties; the SAIFed still has to define a strategy for dealing with an unfeasible mandate;
- internal control systems and accountability arrangements in ministries and cantons are ineffective;
- although most of the recommendations made by the SAIFed have been considered relevant by the Assembly, further efforts are needed to ensure that recommendations are observed and implemented by budget-spenders.

Republika Srpska

The SAI/RS has significantly increased in staff numbers, both in terms of “systematisation” (65 positions compared to 36 formerly), and in terms of posts actually filled (55 compared to 29), which makes it the largest of the three audit offices of Bosnia and Herzegovina. In addition to management and support functions, the SAI/RS has a financial audit department (including three sections for state budget, municipalities and publicly-owned enterprises), a small performance audit department and a planning and development department.

The Auditor General and his deputy have divided their responsibilities: the Auditor General deals with the Assembly, while the deputy is responsible for internal management and monitoring of the work of the audit teams.

The SAI/RS has more than 300 first-line budget-spenders and about 700 second-line budget-spenders. These include the government, ministries, central agencies, state-owned enterprises, local authorities, schools and health institutions. In addition, the SAI/RS has an audit mandate for four funds: pensions, health, unemployment and child protection.

The large number of auditees, coupled with the limited capacity of the SAI/RS, forces the SAI to use some risk analysis when drawing up its audit plan, in particular with regard to state-owned enterprises. In this regard, in line with a request from the Assembly, the SAI focuses on auditing the larger companies, e.g. postal services, forest protection, housing authorities and banks. The audit activity of the SAI/RS is often subject to public attention throughout Bosnia and Herzegovina, which has recently been illustrated by the adverse opinion delivered on the accounts of the public road company of RS. The construction of the new offices of the RS Presidency and the RS Government will also give rise to many concerns, since these two brand-new buildings were apparently constructed without following public procurement procedures.

The SAI/RS has also started to carry out performance audit activities. It has completed an audit on the efficiency in issuing to enterprises administrative forms, licenses and other documents for the purpose of registration. It currently is considering the possibility of carrying out performance audits in the areas of health policies, agriculture support, road construction, and the role of the state in higher education.

The SAI/RS has designed its own development strategy based on the common strategic document adopted by all three SAIs. It has been very supportive of the ongoing process to establish public internal financial control in Bosnia and Herzegovina.

3. Assessment

The three Supreme Audit Institutions of Bosnia and Herzegovina have achieved significant results in a complicated environment and with very limited resources. The period 2005-2006 could have represented a turning point in their common development as it would have normally seen a quasi-complete renewal of their management and the termination of technical assistance. The latter did not occur, and the adoption of new laws for the offices has made it possible to reappoint the previous management (with the notable exception so far of the SAIBiH). Thus the risk of losing the capital of knowledge and experience gained since the establishment of the audit institutions seems to have been avoided for the time being.

Since 2000 the three SAIs have gradually improved their audit capacity and enhanced their audit coverage. They have played a key role in strengthening responsibility, transparency and efficiency of financial management in all of Bosnia and Herzegovina. Some of their audits have led to court proceedings against officials and have sometimes raised considerable public interest.

Moreover, the SAIs have made themselves available for activities conducted outside their legal mandate and scope but contributing to the development of public finance in Bosnia and Herzegovina. This has been most notably the case for the drafting of the framework internal audit law and the development of public internal financial control in general.

The work of the Co-ordination Board of Audit Institutions has had a positive impact on the strengthening of the three SAIs and on the development and implementation of common approaches. The setting up of a permanent secretariat will further contribute to these achievements.

The SAIs provide their respective Assemblies with audit reports and concrete recommendations. However, the Assemblies do not always make appropriate use of this information, and neither the SAIs nor the Assemblies have yet established an adequate system for monitoring the implementation of recommendations. The new laws provide for the creation of parliamentary committees specifically dedicated to the examination and follow-up of audit reports. For the moment these provisions have only been implemented at the entity level. The establishment of such bodies at the state level depends on the constitutional amendment currently underway. The question remains open, however, of the efficiency and effectiveness of the handling of audit reports by parliamentary committees in Bosnia and Herzegovina, thereby depriving the reports of substance. Indeed, the establishment of such committees can only be useful if they are supported by a sufficient number of competent staff and if their relations with the SAIs are regulated by efficient and structured procedures. For the moment there are doubts about the short-term potential for meeting these conditions in Bosnia and Herzegovina. Nevertheless, it seems that the SAI/RS has started to improve its relationship with the Parliament of RS. The main concern, however, relates to the possibility for such parliamentary committees, if and when established, to deal with audit reports in a non-partisan way; this possibility is not to be taken for granted in Bosnia and Herzegovina at the present time. Due to this situation, useful provisions – such as those allowing the parliaments to reduce the budgets of institutions that have received negative audit reports – have so far been meaningless and will remain so. The efforts made in the area of performance audit do not seem to meet with interest or understanding on the parliamentary side, and it is expected that a long time will

be needed before this stakeholder really seizes the opportunity of the development of performance audit activity.

It is possible to say that the impact of audit activities, while positive, has not been as important and efficient as would have been desired. There is even a sort of gap between the rather generous transparency of reporting (practically all audit reports are open to the public and are frequently commented on in the media) and the few identifiable results. In addition, the audit mandate has always been interpreted in a narrow way, leading to very segmented and institution-based audits, which do not question the existing and expensive administrative structure at all levels of government in BiH. Often reports lack specificity in their findings and recommendations, mentioning a generic and thus vague “weakness of internal control(s)”; as such they are insufficient and do not allow for the concrete implementation of recommendations.

The SAIs have reached a level of staffing that makes them relatively privileged among BiH institutions, in particular when compared to the still weak administrative capacity – despite recent improvements – of the Ministries of Finance. There is still a relatively sharp contrast in that sense between the situation of the SAIs and the situation in other parts of the BiH administration at governmental level. The capacity to audit the system is more operational than the system itself; although this may be the result of the availability and efficiency of technical assistance, it gives the impression of reversed priorities.

However, none of the three SAIs has sufficient staff to carry out its legal tasks and obligations. This circumstance, together with the development of competencies at state level, should lead the SAIs to increase the role and tasks of the Co-ordination Board as well as their common operational activities, such as the recent issuing of quality control guidelines. This expansion of the Board’s mandate was initiated in principle with the decision to create its permanent secretariat, which has now become a reality.

In 2004-2005 the three SAIs requested Sigma to carry out a peer review of their capacities and functioning after five years of operation. This request demonstrated an acceptance of transparency and exposure, which speaks for the maturity of these institutions in the BiH context. The peer review stressed the potential for further common work of the three audit institutions and the benefits to be obtained from such co-operation, in terms of both the quality of audit work and the best use of scarce resources. New and creative approaches, regarding co-ordination or co-operation, will be needed here.

In particular, the peer review recommended that the SAIs agree on a common Strategic Development Plan. This is now the case, with a document adopted in March 2007 and covering the period 2007-2012 that clearly aims to define the functioning of the SAIs in the period when technical assistance will no longer be available, in particular with regard to training. However, operational audit activities are only slightly concerned by this strategic document.

4. Recommendations

It is recommended that the three SAIs continue their planned development activities, with the objectives of:

- increasing their capacity to audit all budget-spenders within their scope and auditing in accordance with international audit standards;
- ensuring the effectiveness, impact and follow-up of their recommendations;
- pursuing common activities in the areas of audit, quality control and assurance, and human resources management;
- further contributing to the development of PIFC across the whole public sector of Bosnia and Herzegovina by improving co-ordination and co-operation with the respective Ministries of Finance;
- based on the adopted common strategy, defining training needs and common training plans and arrangements, notably for the period when technical assistance will no longer be available.

Now that a permanent secretariat of the Co-ordination Board has been established, it is still recommended to expand the mandate of the Board to ensure the coherent development of the audit function in BiH. The tasks of the Co-ordination Board should include:

- co-ordination of audits, exchange of professional experience and joint training activities for staff; for training activities, special attention should be given to risk analysis so that the scarce audit resources are used most efficiently;
- development of effective audit solutions in the event that institutions and responsibilities are transferred from one level of government to another;
- assumption of responsibility and ownership of common strategies and audit policies.
- promoting the existence and independence of the SAIs by ensuring in due course that adequate provisions are incorporated in the constitutional texts governing Bosnia and Herzegovina.

The current part-time support of the secretariat should become full-time as soon as needs arise.

The SAIs should seek opportunities to induce the parliamentary assemblies to improve their handling of external audit findings and recommendations. In particular, structures and procedures should be developed that enable parliaments to ensure the implementation of SAI recommendations by the auditee. Parliamentary audit committees need to be resourced in order to deal with reports in a competent and efficient way. Education and awareness-raising events are needed to enable the development of non-political relations between the SAIs and parliaments and the non-political handling of audit reports by parliaments.

4. External Assistance

The long-standing bilateral co-operation project between the Swedish SIDA/*Riksrevisionen* (SNAO) and the SAIs in Bosnia and Herzegovina was renewed as from 2006 for another three years. It will normally terminate at the end of 2008 and is not expected to be extended further at that date, as this would correspond to more than six years of co-operation between the four institutions, which goes far beyond any twinning arrangement. The SAIs are interested in further technical assistance, e.g. in the form of twinning, but it is realised at the management level that a certain period is needed before getting involved in another heavy technical assistance project. The SAIs are now in a better position than before to determine exactly what their real needs for assistance are and in which form and with which partner these needs would be best met. Some time will be needed after the current project is over to take stock of the project's achievements and to ensure that sufficient preparations are made for the SAIs to display the enhanced absorption capacity that will be required.