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2014

Peer review of the National Audit Office of Lithuania

To: The Auditor General of Lithuania

We, the members of the international peer review team, are pleased to present the results of our review of the National Audit Office of Lithuania (NAOL). The team consisted of experienced financial, compliance and performance auditors from the supreme audit institutions of Norway and Finland, as well as from the European Court of Auditors.

The main objective of the peer review was to assess to what extent the NAOL's audit practices comply with the International Standards of Supreme Audit Institutions (ISSAIs). This entailed assessing the core processes of financial, compliance and performance audits. We also assessed the NAOL's relations with the Lithuanian parliament (the Seimas).

Overall, we found the NAOL's audit practices to be generally compliant with the ISSAIs, and relations with the Seimas to be effective. In particular, the NAOL communicates appropriately with its stakeholders, has effective quality control and reporting processes and completes audits swiftly. We also identified some opportunities for improvement, notably to the allocation of resources to strategic priorities, statistical sampling and review procedures. We hope the recommendations we provide will prove useful in addressing these issues.

We appreciate and would like to express our thanks for the cooperation and support provided by the National Audit Office of Lithuania and its staff. The high degree of openness and cooperation we experienced was invaluable in enabling us to complete our work.



**Eduardo Ruiz García, Secretary-General
European Court of Auditors
On behalf of the peer review team**

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01

The National Audit Office of Lithuania (NAOL) is the country's supreme audit institution and accountable to the Seimas (Parliament) of the Republic of Lithuania. The activities of the NAOL are regulated by the Lithuanian Constitution, the Law on the National Audit Office, and other laws and legal acts.

02

The main task of the NAOL is to oversee the legality and effectiveness of the management of public property and funds. It carries out financial, compliance¹ and performance audits in accordance with the national Audit Requirements. The NAOL applies the International Standards of Supreme Audit Institutions (ISSAIs) and, through these, the International Standards on Auditing (ISAs). The NAOL seeks to contribute to parliamentary scrutiny and, through its recommendations, increase accountability and cost-effectiveness in the public sector.

03

The objective of the peer review was to provide the NAOL and its stakeholders with an assessment of the extent to which:

- (a) its audit approach is appropriate with regard to audit standards, and
- (b) relations with the Seimas are adequately managed.

The review also sought to identify areas for improvement and make recommendations as to how such improvements might be achieved.

04

The peers assessed – against standards and best practices – the core processes of financial, compliance and performance audit, including task selection, planning, execution, quality control, reporting, the presentation of audit reports to the Seimas and follow-up.

05

The peer team consisted of representatives from the European Court of Auditors (lead reviewer) and the supreme audit institutions of Finland and Norway. The review work was carried out in early 2014 and involved examining the NAOL's financial, compliance and performance audit and quality-review practices. Interviews were held with the auditor general, deputy auditors general and directors/heads of department, as well as team leaders, auditors, and staff responsible for functional areas. Detailed examinations were made of two performance audits, two financial and compliance audits and a number of outcomes of the quality-control and review procedures. The peer review team also interviewed staff and Members of the Seimas, including five of the seven Members of the Committee on Audit.

1 As with a number of other SAIs, the NAOL uses the term 'regularity audit' for what is referred to as 'compliance audit' in the ISSAIs. For the sake of clarity, we use the term 'compliance audit' throughout this report

Audit practices are, overall, in accordance with standards

06

The peers consider that the NAOL's practices are for the most part in accordance with the ISSAIs, although some progress is still needed.

07

The NAOL recently carried out a gap analysis of whether its policies and practices comply with the ISSAIs. This represents good practice. The gap analysis identified areas of weakness, and an action plan of improvement has been prepared. The peer review identified similar areas.

Appropriate skills and expertise are mostly available, but there is room for better allocation of resources

08

In terms of staff development, the NAOL operates a comprehensive training programme for newly-recruited staff and provides continuing professional training. The NAOL also has a database detailing the skills and experience of audit staff that has the potential to match resources to needs. However, the NAOL does not systematically share experiences with all staff after audits have been completed.

09

The NAOL's audit staff have a wide range of backgrounds and qualifications that are used to good effect in its audit teams. For instance, a medical doctor and social worker were part of the team for an audit concerning family doctors, and a criminal lawyer formed part of the team for an audit of the handling of pre-trial investigations. However, the NAOL also needs to be aware of the risk that such specialisation of its staff may limit their usefulness in other audit areas.

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The peer review found that there is limited staff mobility within and between audit departments. Mobility helps safeguard the objectivity and independence of staff members, and can enhance learning and knowledge-sharing and provide more career-development options.

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External experts are frequently involved in audits on a non-remunerated and short-term basis. While this can be appropriate, some audits could also benefit from longer-term remunerated use of external expertise (without resorting to full-time employment). However, the NAOL has only very limited resources for such contracts.

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A notable practice at the NAOL is the assignment of two legal advisers to each audit department: one to support performance audits and the other, financial and compliance audits. This results in a high proportion of legal advisers in the organisation as a whole that may be disproportionate to the level of expertise actually required.

Recommendation 1

The NAOL should reinforce measures to make the best use of its staff resources. These could include increasing mobility, providing resources for the occasional contracting of external expertise, and reviewing of the type and extent of audit-related work done by legal advisers. The NAOL could also systematically organise 'lessons learnt' sessions after audits have been completed.

Appropriate communication with auditees

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The NAOL systematically discusses audit criteria with its auditees to ensure they have a full understanding of the audit approach being followed. NAOL staff also discuss emerging audit findings with auditees before report-drafting begins. These represent good practices, conducive to effective communication with auditees.

14

When reporting, the NAOL assesses and takes account of action plans prepared by auditees in response to prospective audit recommendations. This is good practice and should lead to a common understanding and interpretation of the recommendations, as well as to better implementation of the latter.

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The contradictory procedure is swift, giving auditees a minimum of seven working days (but in practice usually two weeks) to respond to the draft report prior to the contradictory meeting. Pre-contradictory meetings are held with individual auditees to clear up minor issues, unless they do not consider it necessary.

Good system for documentation, review and monitoring of audit work

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The NAOL takes a comprehensive approach to documenting audit work that is applied effectively and transparently. The peers found that the audits were well documented in the Teammate system, as were the review procedures. The system was used throughout the audit life cycle and key steps were clearly documented.

17

The recently introduced ViPSIS² system is intended to promote further improvement. It aims to facilitate the production of information about the progress of audit tasks so as to enable management to monitor audit work effectively. It also covers non-audit tasks and projects and will therefore serve as a planning and monitoring tool for the organisation as a whole in the future.

Comprehensive database for follow-up of audit results not fully exploited for progress reporting

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The NAOL has a sound system for recording audit results (ARAP³). The system contains the following: audit opinions; cases of non-compliance with legal acts and their correction; recommended recoveries to be obtained for public budgets, funds and assets; binding statements⁴ and their implementation; recommendations and their implementation; referral of audit results to law enforcement institutions; Seimas resolutions on NAOL reports.

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The database provides a powerful basis on which to analyse the impact of the NAOL's work and gives an overview of its activity. It provides comprehensive information that can be used when planning new audits. This represents good practice.

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However, the NAOL could make better use of the information in the database to compile informative progress reports and thereby help to increase transparency and accountability. Such progress reporting would also provide the Seimas with a high-level overview of the status of implementation of recommendations that could be used as a basis for its discussions with the government.

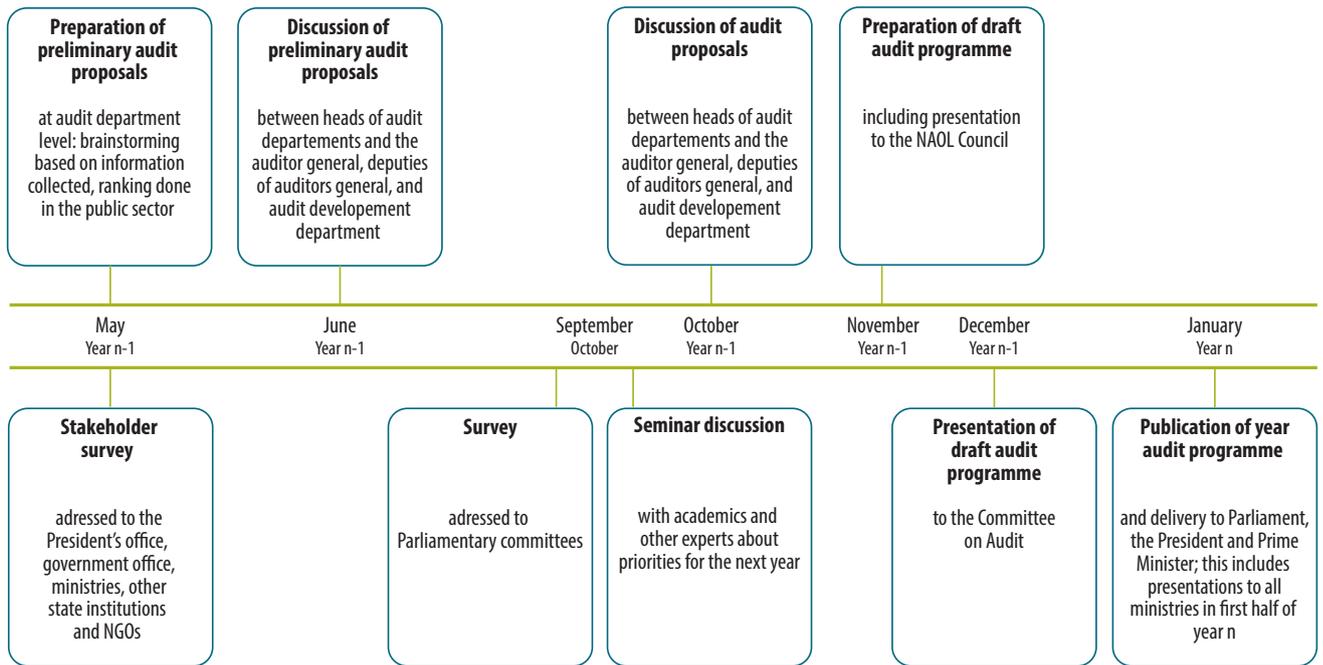
Recommendation 2

Consider introducing annual (or bi-annual) reporting on the progress made in implementing the highest-priority recommendations. The NAOL should address a report to the Seimas and the government.

- 2 ViPSIS: planning, management and monitoring system
- 3 ARAP: subsystem for recording audit results
- 4 The auditees have a legal obligation to comply with statements

Task selection involves a good level of stakeholder consultation, but strategic priority-setting should be improved

Figure Timeline of annual planning



Data collection (all year round), including citizens complaints and proposals via the NAOL website/intranet

21

The NAOL has a solid framework for annual planning that has clear deadlines, as depicted in the figure above. The NAOL uses a transparent and quantified approach to ranking risks/audit proposals that is based on criteria relating to materiality, topicality, feasibility and added value. Stakeholders are consulted at several stages in the process. This represents good practice. By way of illustration, the survey of stakeholders conducted for the 2014 work programme received 31 replies and 121 suggestions.

22

Proposals for audit tasks are typically made by the audit departments, which take account of stakeholder input. Given this predominantly bottom-up approach, audit proposals may reflect existing resource allocation rather more than overall strategic priorities. The bottom-up approach also entails the risk of a silo effect, whereby insufficient priority is given to cross-cutting issues and appropriate audit proposals are less likely to emerge as a result.

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Strategic priority areas are defined by the NAOL. However, they are very broad and not complemented by more detailed objectives. For instance, in 2014 and 2015 the priorities are *accessibility and quality of public service and improvement of the governance of the public sector*. As such, each audit department is able to match some of its tasks to the priorities. There is therefore no global NAOL-wide analysis giving rise to organisation-wide establishment of the level and allocation of resources. Audit proposals addressing the priority areas receive more points and are more likely to be chosen but, as the priorities are very general, this process is ineffective.

Recommendation 3

Consider establishing audit-office-wide strategic priorities with an adequate level of detail, and allocating resources to high priorities among all audit departments.

Audits are completed relatively quickly, helping ensure they are timely

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With the inclusion of the preliminary study, on average⁵ the NAOL's performance audits take ten-and-a-half months from the start of the work to publication of the report. We consider this to be relatively quick and conclude that this enables the NAOL to respond quickly to stakeholder needs and produce timely audit reports.

⁵ Audits completed in the years 2012 and 2013

Effective quality-control arrangements, but number and scope of control layers could be reduced

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The NAOL has developed and operates a complex quality-control system. It involves three main elements: day-to-day supervision; the External Review Commission (ERC) reviewing ongoing audits (hot review); checks on completed audits (cold review).

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Day-to-day supervision takes two forms. Firstly, within the audit team and under the direct responsibility of the deputy audit director. This process is well documented in Teammate (see para. 16). Secondly, as the audit progresses, reviews are made by the audit director, the deputy auditor general responsible for performance audit, and the auditor general. Taken together, this long chain of reviewers brings about the risk of disengagement, and unclear demarcation of responsibilities.

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The ERC consists of the deputy auditor general responsible for performance audit, two heads of audit departments (selected at random) and a methodology support officer from the Audit Development Department. The ERC reviews draft preliminary studies/audit plans and draft reports.

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The ERC review takes place in one round in just three weeks and is documented transparently and efficiently in a (consolidated) document in which changes are tracked. It thus combines central quality-support designed to ensure consistency with a peer assessment made by the heads of other audit departments in one slimline procedure. The overall feedback from NAOL audit staff and managers about the ERC's work was positive, with both the process and its results being approved.

29

Lastly, the NAOL also performs cold reviews in a focused way. The results are summarised and published internally. The minutes of ERC meetings are also published on the NAOL intranet site. This provides transparency and raises quality awareness.

Recommendation 4

The NAOL should maintain the efficient external review arrangements, but reconsider the number and scope of the control layers in its supervision procedures.

Efficient reporting processes, but formulation of recommendations should be improved

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The peers found the NAOL's reports to be well structured, appropriate in length and clearly written. The NAOL has recently taken steps to further improve its audit reporting by introducing new processes for drawing conclusions.

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Some preliminary studies are published when it has been decided that a full audit should not be conducted. This represents good practice, by making any relevant information available to the outside world.

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The NAOL pays particular attention to drafting relevant and practical recommendations which are published in the report and accompanied by the implementing measures proposed by the auditee (see para. 14). This represents good practice. However, the often numerous recommendations are not prioritised. This makes it difficult for the auditee to identify the most important and therefore to allocate resources for their implementation. Furthermore, the NAOL does not explicitly assess the cost and benefits of implementing its recommendations.

Recommendation 5

The NAOL should consider prioritising recommendations and explicitly assessing their cost and benefit whenever possible.

Sampling should be statistically-based and adequately documented

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Statistical sampling is widely used by SAs and in the audit profession as a whole, as it gives robust results and leads to efficient use of resources. However, the NAOL applies statistical-sampling techniques on only a few occasions, even though the financial and compliance audit manual provides for their use. The auditors mostly use judgemental sampling based on materiality and risk to determine the selection and number of items for detailed audit.

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Non-statistical sampling means that results cannot be extrapolated, as the representativeness of the sample cannot be proven. This may result in more testing work being done than is actually necessary, resulting in inefficient use of resources. Other samples may be too small, but in neither case can the auditor demonstrate representativeness.

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In addition, in the audits that were reviewed, the sampling methods and assumptions were not always adequately documented to demonstrate the basis on which the samples had been selected, the reliability of the results and the actual test coverage.

Recommendation 6

The NAOL should consider increasing statistical sampling in order to achieve representativeness of testing and efficient resource use. This could be facilitated by centralised sampling support to auditors. In addition, the sampling methodology, sampling assumptions and the coverage achieved should always be fully documented in the audit files.

Increasing potential for using tests of controls

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According to ISSAIs 1315, 1330 and 1700, the auditor considers internal control relevant to the entity's preparation of the financial statements in order to design audit procedures that are appropriate to the circumstances.

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Furthermore, the NAOL applies an audit assurance model based on statistical sampling on only a few occasions. Such sampling on a systematic basis would allow substantive testing to be reduced when control systems were found to be reliable. As Lithuanian public sector accounting systems have been modernised and are computerised, there may be room for greater reliance on internal control systems in the future.

Recommendation 7

As control systems improve, the NAOL should ensure that it uses every opportunity to undertake tests of controls and rely on good systems as appropriate. This will require systematic implementation of the audit assurance model.

Audit opinions on compliance should better explain scope limitations

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The NAOL provides opinions on compliance to individual government entities and the state as a whole. This involves giving reasonable assurance that all applicable laws and regulations concerning the use, management and disposal of state funds and assets have been respected. In practice, the auditors do not test compliance with all rules and regulations in all areas. However, this limitation in scope is not explained in the audit opinion, despite this being a requirement of international standards.

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The opinions are based on criteria that differ for each entity. However, the criteria are not disclosed in the respective audit opinions. Neither are the criteria explained in the 'global' opinion on the state budget as a whole. This is not in accordance with the standards and reduces the informational value to users of these key outputs.

Recommendation 8

The scope and criteria need to be described clearly in compliance audit reports and opinions. (The NAOL has in the meantime informed the peer review team that this recommendation has been implemented.)

Room for improving ongoing quality control and its documentation

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The Audit Development Department's ongoing quality review of financial and compliance audits focuses mainly on the planning and reporting stages and less on the fieldwork stage. In addition, these quality reviews and their outcomes are generally not documented in detail. This is left to the discretion of the auditor rather than being a formal requirement.

41

The adequacy of the audit evidence is only examined independently ('hot review') when the issue is raised by the audit team or in the event of an adverse opinion or a disclaimer of opinion. This increases the risk of potential problems as a result of unmodified opinions not being detected.

Recommendation 9

The NAOL should fully include the fieldwork stage in its ongoing quality review. The adequacy of audit evidence should be checked independently. The results of the quality review and its follow-up should be documented in the file.

Room for improvement in reporting

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International standards (ISSAI 400, para. 59), as well as the NAOL's audit manual, require audit reports to take account of auditee replies where appropriate. There is no evidence of that in the reviewed Reports.

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The audit report and audit opinion/conclusion are addressed to the auditee. According to ISSAI 100, para. 43, the NAOL should also consider reporting to a higher level of management (e.g. the ministry responsible). Moreover, the ministry bearing overall responsibility for the budget should receive a copy of all audit reports.

Recommendation 10

Audit reports should always explicitly take into account the replies of the auditees and - in the case of reports on subordinate agencies - be addressed to the ministries responsible.

Members of the Seimas are mindful of the independence, role and output of the NAOL

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All the Members of the Seimas that were interviewed concurred in highlighting the importance of an independent and respected audit office. They consider the NAOL to be a modern institution that is widely respected in the public sector. The Members of the Committee on Audit in particular see the NAOL as a crucial partner in pursuing the shared objective of improving financial management and accountability.

45

The Members of the Seimas considered that they generally had a good understanding of the NAOL's role and output. In the past, informal high-level meetings between the NAOL's top management and the Members of the Committee on Audit have contributed to good mutual understanding and effective working relations. These meetings have become less regular, although they are viewed as being particularly useful when new Members join the Committee.

Recommendation 11

The NAOL should seek to strengthen the relationship with the Seimas by organising more formal and informal events. This could include annual conferences, regular exchanges of views on accountability issues, discussions of their respective work programmes and strategies, and special presentations to explain the NAOL's role and working methods to new Members of the Committee.

The NAOL's audit reports play an important role in the work of the Committee on Audit

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Other than in the case of unmodified opinions on financial audits, all audit reports are sent to the Committee on Audit, and around two-thirds are presented at a committee meeting. This means that NAOL reports are discussed in almost all meetings of the Committee. The NAOL is usually represented by the auditor general and the audit teams.

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Members of the Committee on Audit find the NAOL's audit reports to be well drafted and useful, with appropriate scope and coverage, and recommendations that are conducive to improving financial management.

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The NAOL generally indicates which reports particularly merit presentation to the Committee on Audit and which other specialised committee(s) should receive them. In some cases the NAOL also presents the audit reports to specialised committees.

Members of the Seimas have sufficient opportunities to contribute to the NAOL's choice of audit topics

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There are several ways in which Members of the Seimas are able to provide input with regard to the NAOL's work priorities. These include the survey used to collect data for the work programme (see paragraph 21), discussion of the draft annual work programme, the presentation of the final work programme, binding requests decided in plenary made during the course of the year, and *ad hoc* suggestions made by committees.

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Members of the Seimas consider these opportunities sufficient and do not seek further rights. The binding requests formulated by the Seimas plenary during the year are few in number and do not seem to disrupt the NAOL's activities disproportionately.

The peer review of the National Audit Office of Lithuania (NAOL) was carried out by the representatives of the following Supreme Audit Institutions (SAIs):

The European Court of Auditors (ECA) - Lead reviewer

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Mr Andreas Bolkart
Mr Gediminas Macys

The National Audit Office of Finland

Ms Johanna Kormu
Mr Lassi Perkinen

The National Audit Office of Norway

Ms Anne Fikkan
Ms Åse Kristin Hemsén

The contributions of other individuals from these audit institutions were most appreciated. We also thank the UK National Audit Office for their logistic support.



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