

**NATIONAL AUDIT OFFICE OF THE
REPUBLIC OF LITHUANIA**

ANNUAL REPORT 2003

VILNIUS

TABLE OF CONTENTS

MISSION, VISION AND VALUES	4
AUDITOR GENERAL'S OVERVIEW	5
1. NATIONAL AUDIT OFFICE – SUPREME PUBLIC AUDIT INSTITUTION	8
1.1. BASIC PRINCIPLES OF ACTIVITY	8
1.2. CHANGES IN 2003	14
1.3. IMPROVING AUDIT QUALITY AND AUDIT METHODOLOGY	18
1.4. EUROPEAN UNION PHARE TWINNING PROJECT	22
1.5. INTERNATIONAL CO-OPERATION	20
2. EFFECTIVENESS OF ACTIVITY	23
2.1. IMPACT	24
2.2. SERVICES PROVIDED	29
2.3. RESOURCES USED	41
ANNEXES	44

NATIONAL AUDIT OFFICE

Mission

To help the Nation manage and use property, funds and other resources wisely

Vision

To assist the Seimas (the Lithuanian Parliament) in execution of Parliamentary control, to promote the highest standards in financial management in public sector, to promote efficient public services

Values

Professional Development

Integrity

Objectivity

Independence

Team Work

Responsibility



AUDITOR GENERAL'S OVERVIEW

The whole evolution of the National Audit Office in between the two World wars and after restoration of independence shows that people working at the Office were constantly looking for the ways how to help the State Authorities to manage State property and financial resources wisely.

Each period posed concrete objectives. In today's modern and fast changing world financial management has become an especially complicated and important management area.



The collapse of Enron, and currently taking place collapses of Parmalat and other international corporations have focussed an increased attention on the issues of finance management and accountability. Problems occurring in the private sector warn us that public sector management and financial accountability also has to strictly follow internationally recognised standards and best practices.

Therefore especially high requirements for professional qualification and ethics are raised for public auditors. They do not only examine financial accounts and assess how effectively and efficiently state property is managed and used but also are advisors and consultants of appropriations managers.

Our aim is to establish areas where our work will have material influence. Audits conducted from March 2002 demonstrate the benefits of the services we provide. We provide recommendations relating to the development of Results Oriented Management in public sector entities as well as introducing modern finance management and control systems in the public sector. A recently conducted survey revealed that even up to 73 per cent our clients (audited

entities) responded that public audit conducted in 2003 and this year gave (give) „more“ and „much more“ benefit to organisation's activity compared with the previous years.

Special attention should be paid to assessment of activities of institutions financed from the State budget as:

- the bureaucratic system itself does not ensure effective work organisation
- is intended to constantly grow, and
- functions are being duplicated.

All this increases the likelihood that some of the functions will not be performed at all.

The audits conducted by the National Audit Office give incentive to address these issues. For example, the audit of recovery of state debt established that public institutions responsible for recovery of state debt practically do not have data about the payments of other institutions to state debtors. Therefore debtors often do not perform their duties to the State although concurrently receiving funding from public institutions. Such a system does not meet the financial interests of the State. Random examinations show that the State suffers losses of millions of Litas. We believe that the positive attitude displayed by representatives of the Ministry of Finance and their willingness to address these issues will ensure creation of the appropriate system, protecting State financial interests and helping to implement National Audit Office recommendations.

The last decade in Lithuania is characterised by an abundance of reforms. Whether they ensure tax payer and state interests is the often concern of public audit. Our suggestions help to correct the implementation of the reforms in time and help to protect against possible losses. For example during the audit we brought to notice that the process of institutional bailiff reform might threaten collection of state revenue and that there might be a risk that public expenses will increase. We provided recommendations on how to improve the reform. The Ministry of Justice took them into consideration promptly and changed the Instruction on the Implementation of Decisions. Thus conditions were provided to save tens of millions of public expenses.

The National Audit Office aims at ensuring sustainable progress in newly adopted legislation. We conduct audits of the systems initiated by laws. For example, in 2003 we conducted

assessment of the system of internal control. We try to help managers to better understand the control environment and the role of risk assessment and risk management (preventive and corrective means) in achieving organisation's objectives and ensuring that state property and funds would be used wisely. This audit aims at providing Seimas and public sector with more knowledge and strategic perspective.

We emphasise that public audit quality is our priority that could be achieved via high competence of our auditors. The above mentioned survey demonstrated that even up to 73 per cent our clients (audited entities) responded that they evaluate professionalism of our auditors in 2003–2004 “better” and “much better” compared with previous years.

The United Kingdom National Audit Office has become one of the main consultants to our staff. This year we started to implement the second one and a half year Phare Twinning project.

We continue to develop public audit methodologies. We attempt to integrate practical and theoretical experiences and different practices of the National Audit Office staff, foreign countries and private sector.

Considerable changes are taking place in our relations with audited entities. We try to establish long-term relations based on mutual confidence and interest that could provide for possibility to manage State property more wisely.

However we have to admit that not all appropriations managers or public entities managers understand that recommendations of public auditors, as well as statements of the Auditor General and Deputy Auditor Generals if violations are not eliminated during the audit, are written not to be discussed but to be implemented. Such “discussions” with appropriations managers occur less often at present.

We emphasise the promptness of elimination of deficiencies established and indicated by our auditors. If they are not eliminated before the audit report is signed we write statements that have the power of legal act and the audited entity then must implement it.

Seimas devotes increased attention to the audits conducted by the National Audit Office. Last year the Audit Sub-Committee was established within the Seimas Budget and Finance Committee which considers the most significant audit reports. More often the other Committees consider public audit reports too. This encourages implementation of the audit recommendations. We hope that by the end of 2004 the Audit Sub-Committee will be granted the status of Seimas Committee.

In 2003 the National Audit Office continued reorganisation of its activities following the internationally recognised standards and best practices of the European Union countries.

At present we are facing two great challenges. The first challenge is that the National Audit Office was granted the duty and responsibility to audit European Union funds assigned to Lithuania. Not all the Supreme Audit Institutions of the European Union countries were assigned this function by their Parliaments and not all of them took this challenge.

Another area of activities which is new to our office is the audit of municipalities. Seimas delegated to the National Audit Office auditing the use of the State funds allocated to municipalities, carrying out external review of audits conducted by municipality controllers and providing them with methodological support.

Once again I would like to attract your attention to the name of the National Audit Office - State Control. The name identifies the institution. Therefore its role is very important.

We would think that changing the name "State Control" to the "Chamber of Public Audit" would be justifiable, useful and not misleading. The sphere of our work is targeted exceptionally at public sector. The National Audit Office is becoming more and more modern. The name of the organisation should be related to its main activities. With this name we would be easier recognisable both in Lithuania and in the World.

Herewith we present the National Audit Office Annual Report for 2003.

We hope that this report will allow the reader to evaluate the contribution of the National Audit Office to the improvement of the activities of the public sector especially in the area of finance management. It contains all the main reports and conclusions as well as the results of our activity in 2003.

Jonas Liaučius
Auditor General

1. THE NATIONAL AUDIT OFFICE – SUPREME PUBLIC AUDIT INSTITUTION

1.1. BASIC PRINCIPLES OF ACTIVITY

Constitution of the Republic of Lithuania

Article 134

State control shall supervise the legality of the management and utilisation of State property and the realisation of the State budget. The State Controller shall give an account to the Seimas on the annual execution of the State budget.

1.1.1. THE ROLE OF THE NATIONAL AUDIT OFFICE

■ The National Audit Office supervises the lawfulness and effectiveness of the management and utilisation of State property and realisation of the State budget and carries out external audit.

■ Strategic objectives of the National Audit Office:

- to strengthen Parliamentary control exercised by the Seimas (Lithuanian Parliament);
- to promote sound, transparent and effective management of funds received from various EU sources, and to protect financial interests of the European Communities;
- to promote implementation of modern financial management and control systems in the public sector;
- to promote Result Oriented Management in public sector entities.

■ The primary target audience of the National Audit Office is the Seimas and tax payers.

■ The National Audit Office informs the Seimas about the lawfulness and keeping to the legislators' will in their use of the State funds. The National Audit Office is interested not only in the formal keeping to the laws – we analyse if the activity of the Government safeguards properly the purposeful and effective use of funds. The National Audit Office makes suggestions to the Seimas on improvement of management.

1.1.2. AUDIT AREAS

■ The National Audit Office supervises the lawfulness and effectiveness of the management and use of State property and realisation of the State budget and carries out audit of:

Figure 1. Audit areas

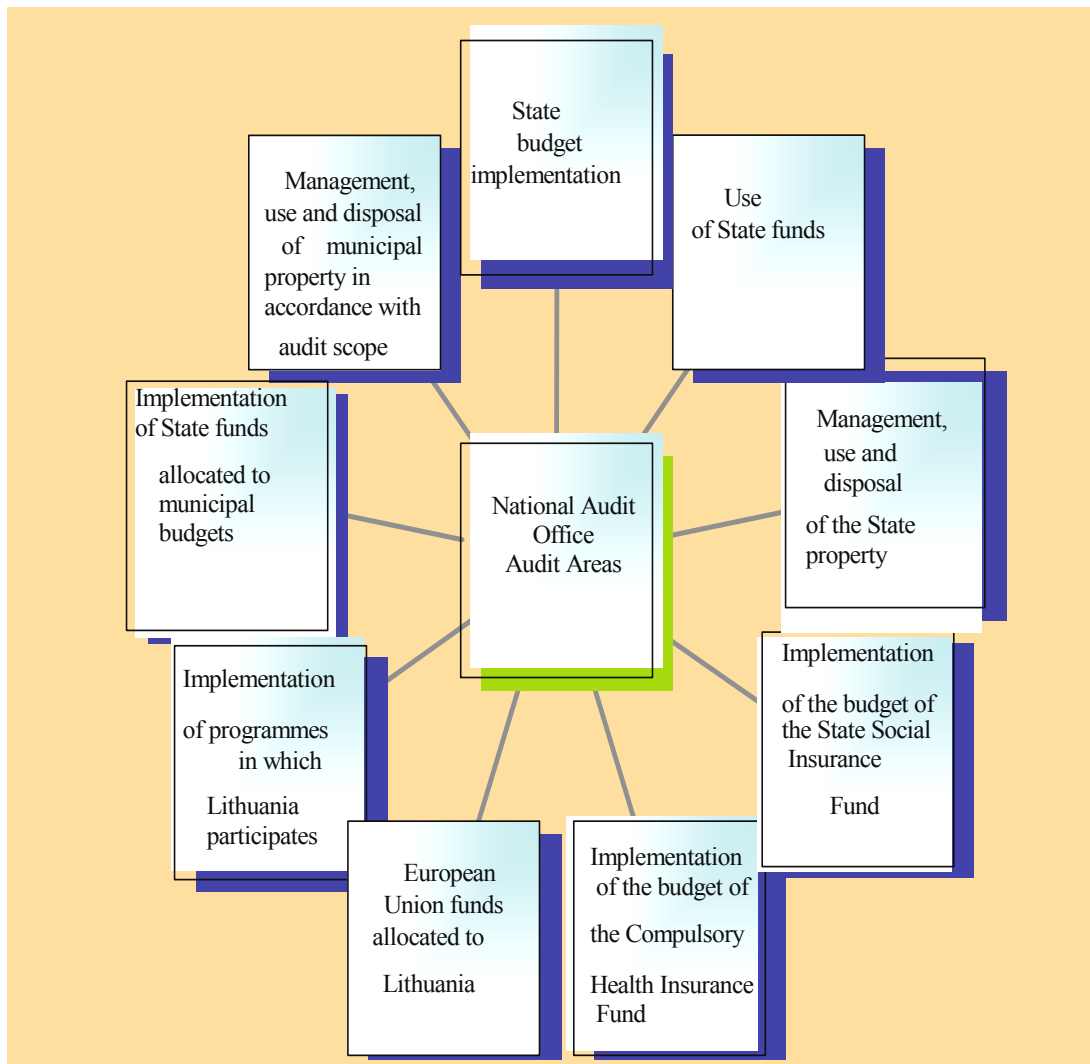
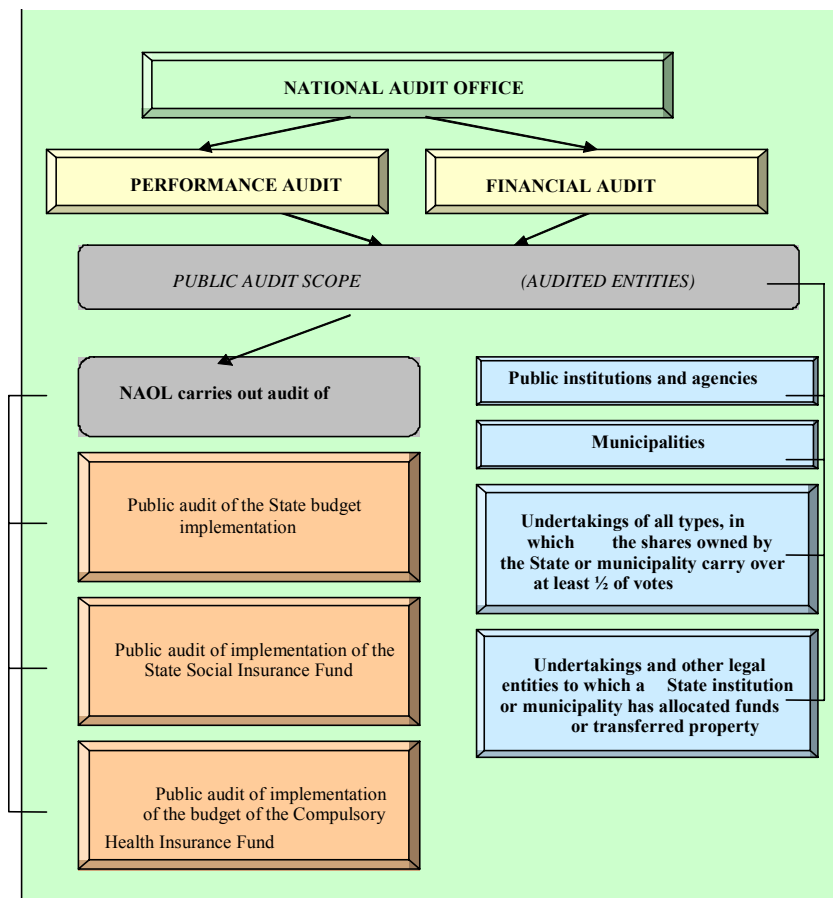


Figure 2. Public audit scope

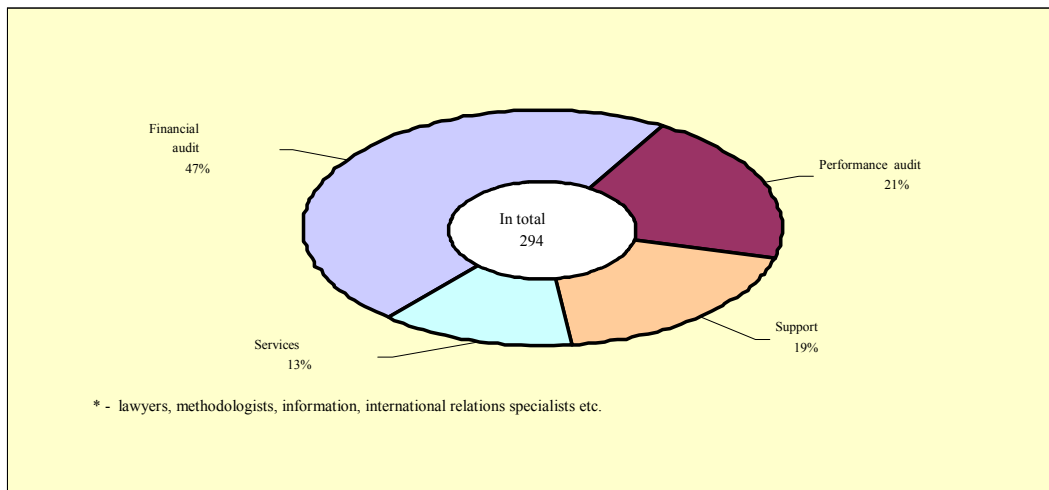


1.1.5. THE STRUCTURE OF THE NATIONAL AUDIT OFFICE

■ The National Audit Office is reformed according to the Strategic Plan in such a way that the Office would effectively, economically and efficiently implement its mandate delegated by the Constitution of the Republic of Lithuania and other legal acts.

■ Most of the staff of the National Audit Office – 68 % - are auditors: 47 % Financial auditors and 21 % Performance auditors. 19 % of our staff are support departments that carry out public audit (lawyers, information and international relations specialists etc.) and 13% of staff provide services.

Figure 4. Number of staff (percentage)



1.1.6. LOCATION OF REGIONAL UNITS

■ Performance auditors are situated in Vilnius. Some Financial audit departments are located in regions of Lithuania. Offices of regional units are established in Kaunas, Klaipėda and Panevėžys.

Central office in Vilnius covers Vilnius region. In addition, financial auditors are located in Šiauliai, Alytus and Utena.



Figure 5. Regional location of financial auditors

1.2. CHANGES IN 2003

1.2.1. AUDIT OF THE EUROPEAN UNION SUPPORT

Probably the greatest appreciation of the ongoing changes in the NAOL is the acknowledgement of the Office's competence in delegating to it new important audit areas. It is not only acknowledgement of the NAOL competence, but an entrusted duty and responsibility as well.

Article 9 of the Law on the Amendment of the Law on the State Control issued on 1 July 2003, defines exceptional mandate – carrying out audits of financial support allocated to the Republic of Lithuania by the European Union in accordance with the order set in international agreements and treaties, European Union and Lithuanian Republic legal acts, and submitting documents of the audits to the appropriate institutions.

Until now certification audit for SAPARD support was performed by a private international audit firm Pricewaterhouse Coopers.

Public auditors of the NAOL have already experience in auditing and administration of programmes and projects financed by the European Union funds: together with the European Court of Auditors we have carried out audit of evaluation of environmental projects financed by PHARE and ISPA and Economical and Social Cohesion programmes, audit of evaluation of PHARE projects' administration, financial audit of SAPARD expenditure declaration, the final audit of ISPA investment project. Currently audit of SAPARD expenditure declaration of 2003 and two final audits of ISPA technical support projects are being carried out.

1.2.2. AUDIT OF STATE FUNDS ALLOCATED TO MUNICIPALITIES

In the end of 2003 as a result of long discussions a decision was made on system of municipalities' external audit. On 25 November the Seimas evaluated the contribution of the NAOL in creating control systems in our state, and amended the Law on the State Control

assigning a new task to the NAOL – auditing the use of the State budget funds allocated to municipalities. The assignment included preparation of audit methodologies for controllers' services of municipalities and performance of external review of audits carried out by municipality controllers (municipality controller's service).

This important assignment will require a lot of material and human resources, organizational and coordination capacities.

Audit of municipalities is not new to the NAOL – in 2003 public audits related to municipalities were performed.

1.2.3. STATE REVENUE AUDIT

Development of the National Audit Office performance is promoted not only by new laws. With the use of new audit methods the NAOL saves resources and undertakes audits of new fields. Pursuing to strengthen the function of Parliamentary control of budget execution the NAOL undertook a new audit function in 2003 – state revenue audit.

1.3. IMPROVING AUDIT QUALITY AND AUDIT METHODOLOGIES

In 2003 after performing of external review of Financial and Performance audits, a Report of Public Audit External Review was prepared. This Report indicated the main fields where public audit should be developed.

The external review was conducted in accordance with the Law on the State Control, Public Auditing Requirements, other legal acts and recommendation of experts of the NAO UK.

Deputy Auditor General **Viktoras Švedas**,
Chairman of the Audit Methodology Committee of the
National Audit Office



17 Financial audit documents were reviewed (8 % of performed audits). Financial audit documents were evaluated according to Audit Manual evaluation system (levels A, B and C). Level B was assigned to 16 documents while level C was assigned to 1 document.

Audit methodology has to be developed. To this end it is being closely supervised and controlled.

We have an ambition to unite theoretical and practical knowledge of the NAOL as well as foreign countries' and private sector auditors and that is why Audit Methodology Committee was established. PHARE 1 and PHARE 2 projects provide support for audit methodology development: we are cooperating with the SAIs of United Kingdom, Sweden, Denmark and Portugal.

1.4. EUROPEAN UNION PHARE TWINNING PROJECT

In 2003 the first PHARE Twinning Project was finished. It lasted for 18 months and had a budget of 850 thousand Euros. The project was comprised of 5 components which covered almost all the fields of work of the NAOL, 74 activities and subactivities, 36 short term experts.

Investment part of the PHARE project financed the procurement of the computer equipment in 2003: 8 servers, 62 stationary and 185 laptop computers, 35 network printers, network commutation equipment etc. The grand total of the purchase was 475 thousands Euros, 329 thousands of which were financed by PHARE and national cofinancing was 146 thousands Euros (excluding VAT). This gives a possibility for every public auditor to use laptop computer both while working in the Office and in the audited entities. Contemporary computer equipment gives possibility of using the most advanced computer programmes for both performance of some particular audit and for management of audit process. The further emphasis will be layed on reformation of the computer network, automation of audit working documents, supervision of audit and administration processes, and resource management.

The first European Union PHARE project in the National Audit Office was not an accidental event, but a result of a consistent and systematic reformation of the NAOL. The objective of the reformation was to implement provisions of the new Law on the State Control and to come over from the control to audit.

Our partners of the PHARE Twinning Project are National Audit Offices of the United Kingdom, Denmark and Sweden.

Project results are obvious: NAOL Council regulations, Plan for Implementation of Information Technologies Strategic Development Plan Measures, the NAOL Personnel Development Strategy, the NAOL Personnel Training Order are prepared, Financial and Performance Audit Manuals are updated. The NAOL Strategic Management and Risk Management Commission was established.

Most probably the greatest common achievement of the PHARE project and the NAOL is the received recognition: in 2003 a second PHARE project was approved that will be a follow-up of the started works (budget of the Twinning part is 950 thousand Euros, it covered 5 components, 74 activities, 22 short term experts; budget of the investment part is 144 thousand Euros; services part budget is 400 thousand Euros).

1.5. INTERNATIONAL CO-OPERATION

In 2003 the National Audit Office developed successfully international cooperation and looked for new useful cooperation opportunities.

In 1992 the National Audit Office of Lithuania became a full member of INTOSAI (International Organization of Supreme Audit Institutions). INTOSAI was founded in 1953 and has a membership of over 100 SAIs. In 2003 the NAOL participated in work of Committees of Auditing Standards, Accounting Standards, Internal Control Standards, IT Audit and Public Debt and in work of Working Groups on Privatisation, Programme Evaluation and Environmental Auditing.

INTOSAI publications often include information on international activities of the National Audit Office of Lithuania.

The National Audit Office has a 6-year membership of the Governing Board of EUROSAI (European Organization of Supreme Audit Institutions). In addition to the Baltic region states – Estonia and Latvia - our institution will represent Poland in the Governing Board.

October 2003 was the first time that the Auditor General Mr. Jonas Liaučius participated in the meeting of EUROSAI Governing Board held in Rome. The next meeting of the Governing Board will take place in Vilnius in September 2004. This shows the increasing attention given to the Baltic region.

In preparations for the accession to the European Union the National Audit Office of Lithuania cooperates actively with the highest EU institutions – European Commission and European Court of Auditors. In 1996 the Declaration of Cooperation was signed on common work guidelines concerning participation in annual meetings of the Heads of Supreme Audit Institutions of Central and Eastern European countries, Cyprus, Malta and Turkey and representatives of the European Court of Auditors, performance of joint audit-missions.

Seeking membership of the EU cooperation with neighbouring states – the Baltic and Nordic countries SAIs has become very important. The NAOL participates actively in meetings of Heads and representatives of Baltic and Nordic countries SAIs, which are organized once a year in rotation in one of the Baltic states. This year the 4th annual meeting will be held in Vilnius and by common assent representatives of the Polish Supreme Chamber of Control will take part in the event as well.

There is an intensive cooperation with Nordic countries – Danish, Finnish, Norwegian and Swedish – Supreme Audit Institutions. The cooperation is both in terms of pilot

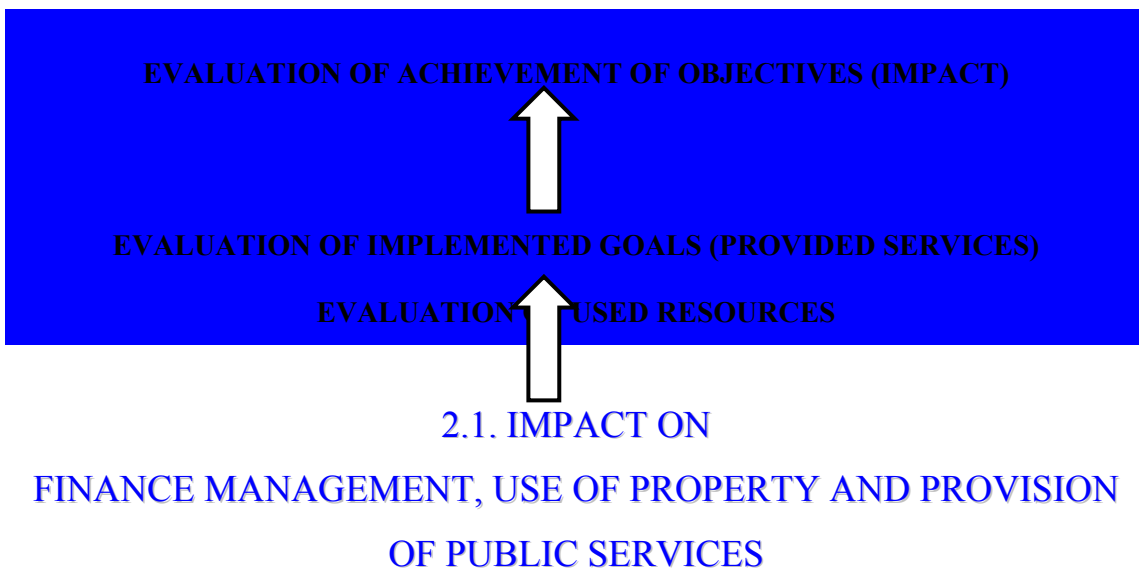
audits activities agreed upon in bilateral protocols and in allowing our auditors to benefit from study visits to the above mentioned institutions.

No less important is the NAOL cooperation with neighbouring states of the Eastern European region – Belarus and Ukraine.

2. EFFECTIVENESS OF ACTIVITY

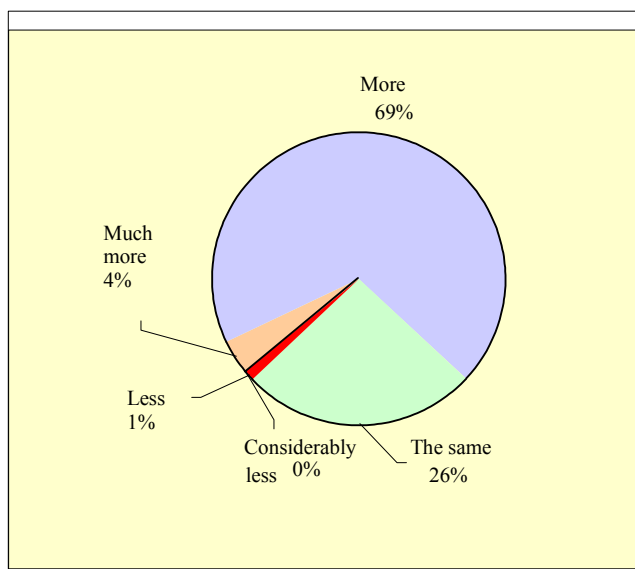
Transition from control and revision to public audit changed priorities, ways of activity and procedures. Our basic goal is not only to find offenders, but also to help correct violations and to evaluate work of audited entities in the sense of economy, effectiveness and efficiency and to find possibilities of development of public sector performance. The NAOL seeks to initiate real changes in public audit.

Figure 8. Hierarchy of criteria for evaluating the National Audit Office performance



A survey conducted in January – February 2004 revealed that public audit carried out in 2003 - 2004 benefited performance of organization “more” and “much more” compared with the previous years. Only 26 % of respondents think that the benefit was the same.

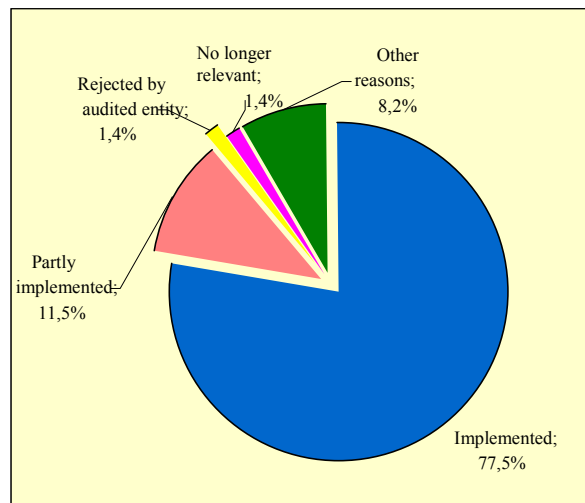
Figure 9. Benefit of public audit to organizations in 2003 – 2004 in comparison with controls (revisions) conducted in previous years
(Source: survey for audited entities)



■ The basic idea underlying public audit reform is that the goal of audit is besides finding mistakes and deficiencies of audited entities also assessing their environment and presenting recommendations for them which would allow avoiding further mistakes and would enhance internal control, accountability, management of finance and effective use of the State assets. That is why the NAOL seeks to evaluate own results not only in terms of quantity - number of provided services (audits)) or costs, - but, what is the most important – in terms of impact of the NAOL performance.

■ 89 % of recommendations of audits finished in 2003 are implemented and partly implemented (77.5 % implemented and 11.5 % partly implemented).

10 pav. Implementation of recommendations



2.2. PROVISION OF SERVICES

2.2.1. AUDITS

Financial audits

■ In 2003 207 Financial audits were finished. In the same year Financial audits of public institutions were performed and opinion on financial statement was stated for the first time.

■ In 2003 Financial audits in 276 public institutions were started (in 115 appropriations managers and in 161 subordinate institutions). These audits will be finished in the first half-year of 2004.

Performance audits

■ 40 Performance audits were carried out in 2003. Often during one audit several auditees were audited and separate audit reports were prepared. As a result of this 67 public audit reports were prepared in 2003. In the same year 6 preliminary studies were performed and 6 reports of preliminary studies were prepared.

■ 10 Performance audits which were started in 2003 will be finished in 2004.

General

- In 2003 4 mandatory opinions were presented: on report of the State budget implementation, on report on the State debt etc.

2.2.3. INFORMING THE PUBLIC

- Every citizen has a right to know if taxes collected to the budget are spent wisely. For that reason public audit opinions and reports are presented to the media and the public. The NAOL has a consistent and effective Public Relations policy which is based on openness and transparency of institution. Proper presentation of information enhances confidence of taxpayers in the submitted information, in the State and democracy.

- Public audit reports are presented to the public and interested institutions in the NAOL external Web site www.vkontrola.lt.

- 39 press-releases on the performed audits were prepared and presented to the public in 2003. 109 responses and comments to inquiries of the media representatives were prepared. 4 press-conferences which covered most relevant public audits were organized. On the basis of information presented by the NAOL news agencies ELTA and BNS prepared reports, the mass media published and presented around 380 articles, radio and television broadcasts.

- Last year saw a renewed publication of the NAOL bulletin. The bulletin called “Public Audit” presents articles of specialists, the most relevant public audit reports and a chronicle of performance of the NAOL.

- A new version of the NAOL external Web site will be launched in March 2004.

2.3. RESOURCES USED

2.3.1. STAFF

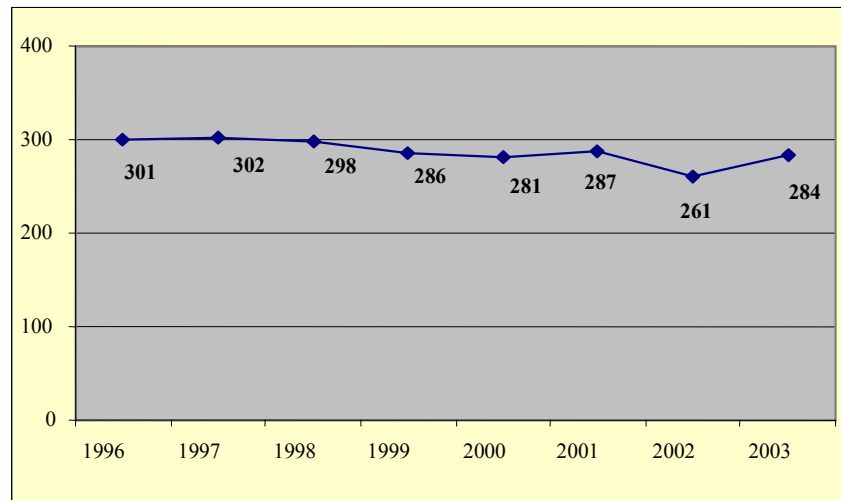
- Number of employees of the NAOL reached 284 in 2003 (see Figure 17).

- 67 % of employees are women.

- Average age of employees is 43 years (the same as was in 2002).

■ All the officers of the NAOL have university education. In comparison to years 2001 and 2002 there is only a slight change in education structure of officers; the most part of employees have economical education (around 65%). There are 4 PhD's as well.

Figure 17. Dynamics of average number of officers and other employees



■ In 2003 a Competence Evaluation System for all the NAOL officers was prepared and put into implementation. This system gives the possibility to evaluate the level of competence of every officer and to prepare Personal Development Plans for them. On the ground of these plans the NAOL Officers Annual Training Plan for 2003 - 2004 was prepared.

■ On average, training of one officer lasted for 114 academic hours, which is considerably more than in previous years. 81 000 Lt of the State budget funds were spent on development of the NAOL officers in 2003, but the most part of training was financed by the PHARE funds.

Figure 18. Academic hours per year of training of one officer

