



OVERVIEW OF METHODOLOGIES USED IN LOCAL GOVERNMENT AUDITING
IN DIFFERENT TFMA MEMBER SUPREME AUDIT INSTITUTIONS

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I INTRODUCTION

Task Force on Municipality Audit (TFMA) was established at the 44th EUROSAI Governing Board meeting in Luxembourg in June 2016. The main purpose of the TFMA is to create an open platform for sharing the best practice and experience on the local government auditing.

TFMA has set up three strategic goals. Under the Strategic goal 2 “Making the external municipal auditing system more efficient” is predicted to collect and analyse data on methodologies used in local government auditing and identify areas where guidelines tailored to local government auditing could be useful.

In the Overview, the term “local government units” refers to public institutions with legal personality, part of the state structure, below the level of central government and accountable to citizens. The term covers different tiers (levels) of local government units: municipalities, districts, counties, provinces, regions etc.

Under the Strategic goal 2 are set up, among others, Activity 2.4. and Activity 2.5. Activity 2.4. refers to conducting survey on methodologies used in local government auditing in different TFMA member supreme audit institutions (hereinafter: SAIs) while Activity 2.5. refers to identifying areas where recommendations and/or guidelines could be useful to all member SAIs.

Overview of methodologies used in local government auditing is a result of Activity 2.4. and Activity 2.5.

This Overview, as well as Questionnaire on methodologies used in local government auditing were prepared and analysed by representatives of SAIs of Latvia, Romania and Croatia.

The Overview consists of analysis of Questionnaire as well as conclusions which are result of conducted analysis. Answers were provided by twenty-four (24) SAIs¹. The Overview contains general information on local government auditing, methodology and information on financial, performance and compliance audit in local government units. The last part of the Overview contains Conclusion, presenting areas in which guidelines for auditing local government units could be useful to all SAIs.

¹ There are three independent Supreme Audit Institutions in Bosnia and Herzegovina: Audit Office of the Institutions of Bosnia and Herzegovina, Audit Office for the Institutions of the Federation of Bosnia and Herzegovina and The Supreme Office for the Republic of Srpska Public Sector Accounting. TFMA member SAIs are Audit Office for the Institutions of the Federation of Bosnia and Herzegovina and The Supreme Office for the Republic of Srpska Public Sector Accounting. More available at http://www.vrifbih.ba/about/msword/BROSHURA_VRIFBIH.pdf

SAls that provided the Questionnaire are as follow:

- Austria
- Azerbaijan
- Federation of Bosnia and Herzegovina
- Croatia
- Denmark
- Estonia
- Finland
- Georgia
- Greece
- Hungary
- Israel
- Italy
- Latvia
- Lithuania
- Moldova
- Montenegro
- North Macedonia
- Romania
- Serbia
- Republic of Srpska
- Slovakia
- Slovenia
- Spain
- Turkey.

II GENERAL INFORMATION

Supreme audit institutions conduct audit in accordance with national legal framework and international standards on auditing. International standards on auditing provide guidance for conducting financial, performance and compliance audit.

International Standards on Supreme Audit Institutions (hereinafter: ISSAI) defines the main types of audit conducted by supreme audit institutions.

All SAIs which answered the Questionnaire apply the ISSAI in preparing and conducting audit.

According to ISSAI 200, financial audit focuses on determining whether an auditee's financial information are presented in accordance with the applicable financial reporting and regulatory framework.

Performance auditing is, according to ISSAI 300, an independent, objective and reliable examination of whether government undertakings, systems, operations, programmes, activities or organisations are operating in accordance with principles of economy, efficiency and effectiveness and whether there is room for improvement.

According to ISSAI 400, compliance audit is the independent assessment of whether a given subject matter is in compliance with applicable authorities identified as criteria. Compliance audits are carried out as by assessing whether activities, financial transactions and information comply, in all material respects, with the authorities which govern the auditee.

SAls are organized as monocratic audit offices, collegiate bodies (without judicial functions) and the court of auditors (with judicial functions). The authority of analysed SAls is presented in the chart below.



Out of all analysed SAls, according to answers gathered by the Questionnaire, 84 % of them have the authority to refer facts liable to criminal prosecution to the judicial authorities. In addition, 16 % of analysed SAls have the authority to pronounce judgments and sanctions on those responsible for managing public funds and assets as well as to refer facts liable to criminal prosecution to the judicial authorities.

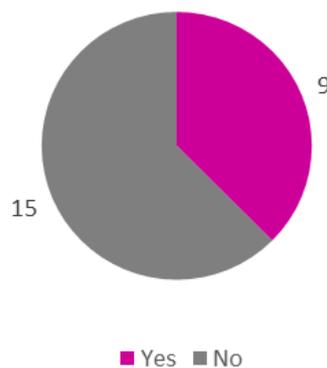
III METHODOLOGY

The main purpose of the Activity 2.5. is to identify audit areas where recommendations and guidelines on local government auditing could be useful.

As part of the Questionnaire SAIs have identified audit areas where recommendations and guidelines for local government auditing could be useful. Identified areas are listed below:

- monitoring/coverage of risks at local government units' level (in order not to let them become risks at national level)
- strategic research (monitoring of the topic or area, searching of risks arising)
- selecting audit sample
- monitoring how local government units' debts are reflected at national level
- inspection of local government units' budget creation process
- other (auditing the way in which local government units' revenues and expenditures are executed, auditing the management of the local government units' assets, auditing the reflection/reporting of budget execution results in relation to planned targets, and determining various levels of materiality when it can be considered that the local government units' actions have not ensured value for money).

Methodologies, process descriptions, handbooks,
guidelines specifically tailored to local
government auditing



More than half of SAIs (15) do not use methodologies, process descriptions, handbooks, guidelines specifically tailored to local government auditing. Nine (9) SAIs developed process descriptions, handbooks, guidelines specifically tailored to local government auditing.

While planning audits of local government units, the majority of SAIs (71 %) carry out strategic assessment, e.g. risk analysis to identify areas for auditing and up-to-date audit topics in the sphere of local government auditing.

Sources of information used for risk analyses are as follow:

- SAIs' audit reports (concerning previous year/s)
- database on auditees
- database on financial statements of auditees
- local government units' budget data
- local governments units' own internal audit reports
- analysis of local government units' legislation
- audit reports from other SAIs
- international commitments
- information from supervisory bodies
- analysis of research papers related to local government units and public administration
- analysis of citizens' complaints
- information and data gathered by means of different media (newspaper, Internet etc.)

Audit criteria used to identify areas for audit are as follow:

- mandate of SAI
- relationship to SAI's strategic documents
- auditing areas of the public sector that are of high risk
- mandatory audit prescribed by law
- proposals and requests from the parliament
- proposals from external stakeholders (institutions and legal entities, citizens)
- financial indicators of local government units (asset value, the total amount of revenues, receipts, expenses and expenditures, an amount of grants from central government, an amount of expenses for salaries, number of employees on 31 December of a previous year)
- key performance indicators of potential auditee
- whether the auditee has been subject to audit previously or not
- results of previously conducted audit (type and significance of findings and recommendations)
- news released in media
- audit engagements resulted from international commitments
- central - government programs
- development objectives of a respective country
- amendments to legislation on public administration.

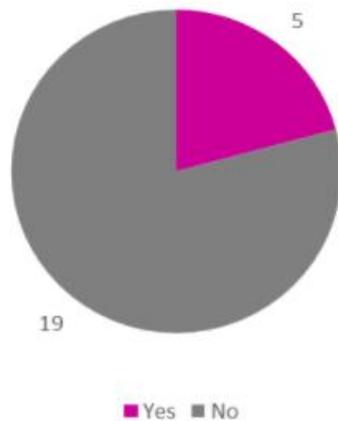
SAls often conduct audit (usually performance and compliance audit) in a way that audit sample includes several local government units. To effectively conduct audit when audit sample includes several local government units, SAls use different audit approaches and/or methodologies. Tools and/or document templates which have helped to effectively assess the same issue in several local government units refer to:

- standardized detailed audit plan
- benchmarking
- standardized questionnaires on distinct issues
- process descriptions in accordance with the quality management approach
- usage a national survey covering the topic of private legal services provision in all local government units
- check-lists.

IV FINANCIAL AUDIT IN LOCAL GOVERNMENT UNITS

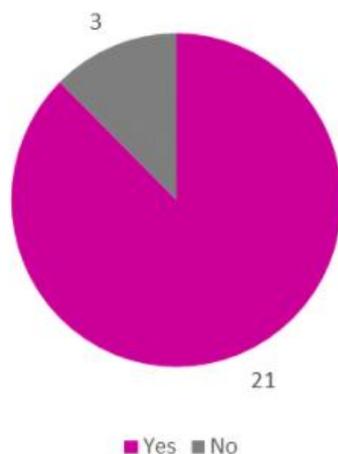
According to answers gathered by the Questionnaire, some SAIs have developed national standards while most of them have developed internal regulation for conducting financial audit. Mentioned is presented in charts below.

National standards for financial audit



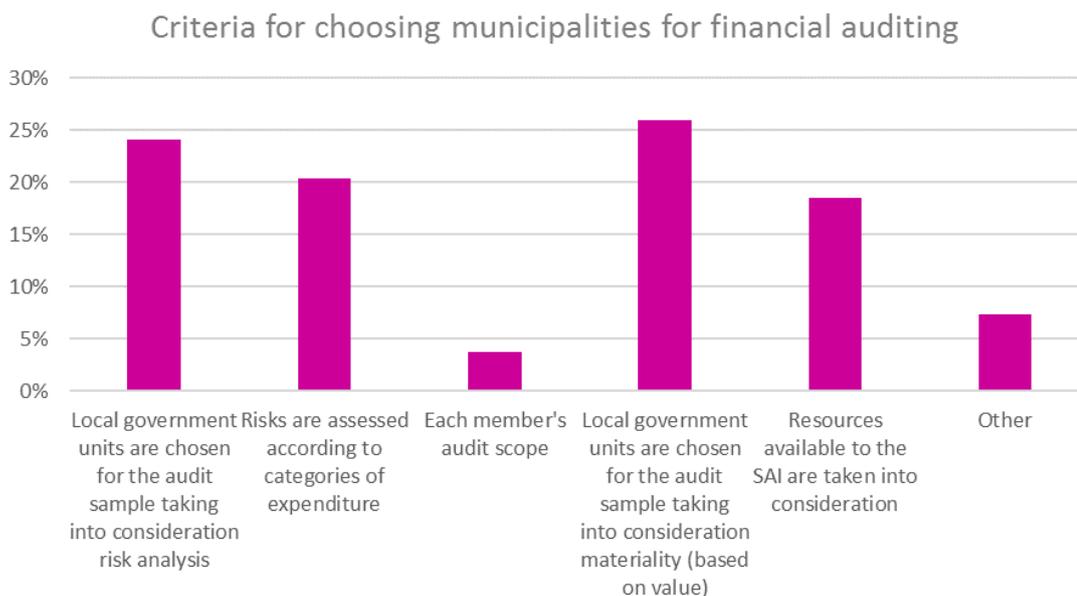
Five (5) SAIs have developed authoritative (national) standards for financial audit based on international standards on auditing while nineteen (19) have not developed it.

Internal regulation for financial audit



The majority of SAIs have adopted internal regulation in form of written processes, descriptions, handbooks and guidelines that should be used in conducting financial audit.

The most important criteria used to select local government units for financial audit and to determine the audit scope are presented in the chart below.



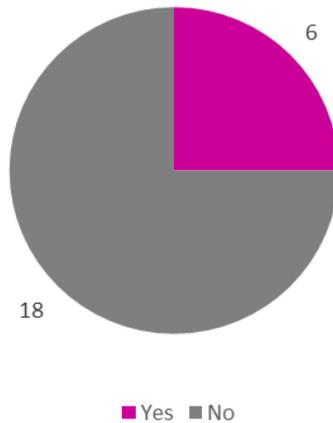
Other criteria used to select local government units for financial audit and to determine the audit scope are as follow: special requests from parliament, how long is the period of time from the previously conducted audit, auditor's opinion expressed in previously conducted audit, budget and other indicators of the size of the local government unit, the amount of funds invested for local government unit's capital projects and to conduct audit of each local government unit at least once during the mandate of an auditor general.

During financial audit of local government units, certain material issues related to compliance or performance audit are assessed in most SAIs. If during the course of financial audit of local government units, certain material issues arises related to compliance or performance local government units assessed, audit plan defines audit approach and criteria for assessing compliance and performance issues.

V PERFORMANCE AUDIT IN LOCAL GOVERNMENT UNITS

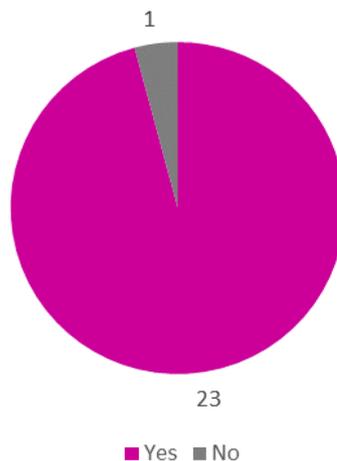
According to answers gathered by the Questionnaire, some SAIs have developed national standards while most of them have developed internal regulation for conducting performance audit. Mentioned is presented in charts below.

National standards for performance audit



Six (6) SAIs have developed authoritative (national) standards for performance audit based on international standards on auditing while eighteen (18) have not developed it.

Internal regulation for performance audit



The majority of SAIs have adopted internal regulation in form of written processes, descriptions, handbooks and guidelines for conducting performance audits.

Out of all SAIs, 54 % of them conduct performance audit of local government units as stand - alone audit, while at 31 % SAIs elements of performance audit are part of another type of audit (usually compliance audit). It is important to mention that one SAI does not conduct performance audit of local government units.

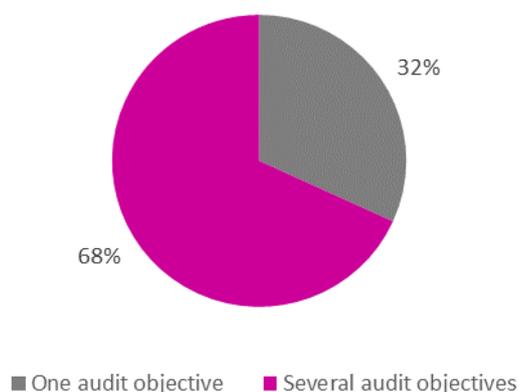
Also, one SAI has mandate to conduct performance audit only over state property transferred into the possession of local government units and the use of EU funds allocated through local government units or conduct performance audit as part of the audit of ministries.

Limitations to selecting the subject matter of a performance audit of local government units are presented in 21 % of analysed SAIs, until 79 % of analysed SAIs do not have any limitations to selecting the subject matter of a performance audit of local government units.

According to ISSAI 3000 Articles 35 - 37, the auditor shall set a clearly-defined audit objective(s) that relates to the principles of economy, efficiency and/or effectiveness. The auditor shall articulate the audit objective(s) in sufficient detail in order to be clear about the questions that will be answered and to allow logical development of the audit design. If the audit objective(s) is formulated as audit question and broken down into sub - questions, then the auditor shall ensure that they are thematically related, complementary, not overlapping and collectively exhaustive in addressing the overall audit question.

Out of all analysed SAIs, 68 % of them have one audit objective and 32 % of them have several audit objectives in the course of conducting performance audits of local government units.

Audit objectives at performance audits of local government units



The audit objective is formulated as an audit question in 87 % of SAIs, while 13 % of SAIs do not formulate audit objective as an audit question.

According to ISSAI 3000 Article 99 and ISSAI 3200 Article 16 pre-study refers to the preliminary work (research, testing various audit designs, checking whether the necessary data are available) that is necessary for properly planning an audit.

Pre-study is considered as a separate phase of the audit cycle and is followed by the audit planning phase in fourteen (14) SAIs, while pre-study is synonymous with the audit planning phase in seven (7) SAIs.

Audits start with the planning phase and the concept of pre-study is not recognised in two (2) SAIs and in one (1) SAI pre-study is included in the audit planning phase. Concept of pre-study in SAIs is presented in the table below.

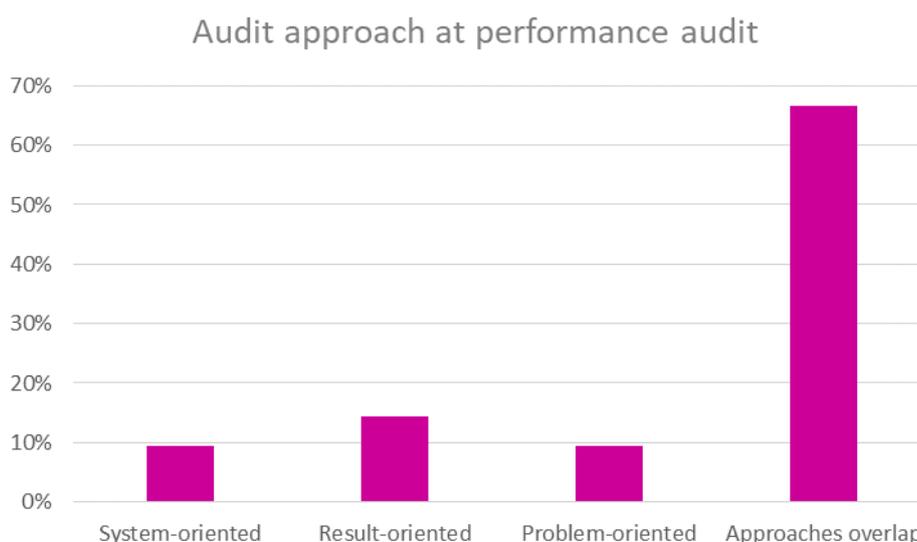
SAI	Pre-study is synonymous with the audit planning phase	Pre-study is considered as a separate phase of the audit cycle and followed by the audit planning phase	Audits start with the planning phase and the concept of pre-study is not recognised	Other ²
Austria		▪		
Azerbaijan	▪			
Federation of Bosnia and Herzegovina	▪			
Croatia		▪		
Denmark		▪		
Estonia		▪		
Finland	▪			
Georgia		▪		
Greece		▪		
Hungary		▪		
Israel		▪		
Italy		▪		
Latvia			▪	
Lithuania	▪			
Moldova	▪			
Montenegro		▪		
North Macedonia				▪
Romania		▪		
Serbia		▪		
Republic of Srpska		▪		
Slovakia		▪		
Slovenia	▪			
Spain	▪			
Turkey			▪	

ISSAI 300 - Fundamental principles for performance audit indicate that auditors should select a system-oriented, result or problem approach, or a combination thereof, to facilitate the soundness of audit design while conducting performance audit.

² Pre-study is included in the audit planning phase

According to ISSAI 3000 Articles 42 - 44, a system-oriented approach examines the proper functioning of management systems. Frequently, elementary principles of good management will be helpful in examining the conditions for efficiency or effectiveness even when there is a lack of a clear consensus on a problem or when outcomes or outputs are not clearly stated. A result-oriented approach assesses whether outcome or output objectives have been achieved as intended or programmes and services are operating as intended. It can be used most easily when there is a clear statement of desired outcomes or outputs (e.g. in the law or a strategy decided upon by the responsible parties). A problem-oriented approach examines, verifies and analyses the causes of particular problems or deviations from audit criteria. It can be used when there is a clear consensus on a problem, even if there is no clear statement of the desired outcomes or outputs. Conclusions and recommendations are primarily based on the process of analysing and confirming causes rather than comparing audit evidence with audit criteria.

The most SAs apply a combination of audit approaches, e.g. approaches overlap. Audit approaches in performance audit of local government units are presented in the chart below.



According to ISSAI 3000 Articles 45 and 51, the auditor shall establish suitable audit criteria, which correspond to the audit objective(s) and audit questions and are related to the principles of economy, efficiency, and/or effectiveness. The auditor shall, as part of planning and/or conducting the audit, discuss the audit criteria with the auditee.

According to results of the analysis of the Questionnaire on methodologies used in local government auditing, 66 % of SAs agree that international standards on auditing sufficiently define what criteria are suitable for performance auditing of local government units while 34 % of them disagree.

ISSAI 3000 Article 48 defines that the audit criteria need to provide an appropriate and reasonable basis for assessing against audit objectives. Audit criteria have to be relevant, understandable, complete, reliable, and objective in the context of the subject matter, the audit objective(s) and/or the audit questions.

Methodology of SAIs for performance audit follows ISSAI, but many SAIs do not have sufficiently defined criteria for performance auditing of local government units.

Methodology of some SAIs sufficiently defines criteria for performance auditing of local government units, but most SAIs use their general internal handbooks, guidelines or manuals for performance audit which do not define sufficiently criteria for performance auditing of local government units.

Methodology of SAIs specifies how performance criteria are determined and SAIs make a distinction between compliance and performance criteria. Criteria of economy, efficiency and effectiveness are used for performance auditing of local government units.

According to ISSAI 3000 Article 49 - 51, the auditor shall, as part of planning and/or conducting the audit, discuss the audit criteria with the auditee. The audit criteria have to be discussed with the auditee, but it is ultimately the auditor's responsibility to select suitable audit criteria.

Discussing the audit criteria with the auditee serves to ensure that there is a shared and common understanding of what quantitative and qualitative audit criteria will be used as benchmarks when evaluating the subject matter. This is particularly important when the audit criteria are not defined directly by laws or other authoritative documents, or the audit criteria have to be developed and refined throughout the course of the audit work.

Methodology of 60 % of analysed SAIs defines a procedure for discussing the audit criteria with the auditee, while methodology of 40 % of analysed SAIs does not cover these matter. Four SAIs have shared their experience in situation where the auditee disagrees with SAI about suitability of the criteria.

Steps that were taken to effectively solve the situation and continue the audit are listed below:

- dialogue and discussions with arguments on suitability of the criteria (auditors explain reasons why such criteria are suitable)
- to persuade the auditee and justify criteria by indicating that they correspond to features and characteristics specified in international standards on auditing
- arrange a meeting with the auditee's management in which the importance of the audit criteria, as benchmarks when evaluating the subject matter, were explained and discussed.

The Questionnaire on methodologies used in local government auditing contains question regarding methods for obtaining evidence in performance and compliance audit in local government units. Mentioned methods are presented in the table below, according to the answers gathered by the Questionnaire. They are ordered from 1 to 10 according to their priority (1 - the most effective method, 10 - the least effective method).

Methods for obtaining evidence in performance and compliance audit
in local government units

Method	Effectiveness of method									
	1	2	3	4	5	6	7	8	9	10
Inspection ³	▪									
Inquiry ⁴		▪								
Substantive testing ⁵			▪							
Analytical procedures ⁶				▪						
Test of key controls ⁷					▪					
Observation ⁸						▪				
Re - calculation ⁹							▪			
Re - performance ¹⁰								▪		
External confirmation ¹¹									▪	
Other ¹²										▪

³ Inspection - examining books, records or documents, whether internal or external, either in paper form, electronic form or a physical examination

⁴ Inquiry - seeking information from relevant persons, both within and outside the auditee - interviews and/or questionnaires

⁵ Substantive testing - testing detailed transactions or activities against the audit criteria

⁶ Analytical procedures - comparing data, investigating fluctuations or identifying relationships that appear inconsistent with what was expected

⁷ Test of key controls - testing the controls that management has put in place

⁸ Observation - looking at a process or procedure being performed by others

⁹ Re - calculation - checking the mathematical accuracy of documents or records

¹⁰ Re - performance - independently carrying out the same procedures already performed by the auditee, controls that were originally performed as part of the entity's internal control

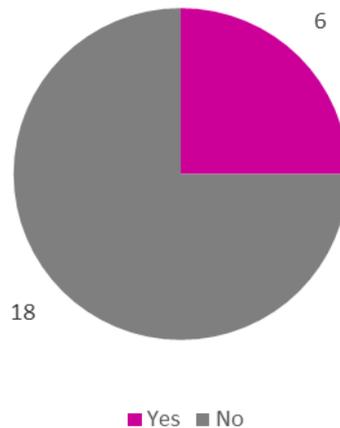
¹¹ External confirmation - audit evidence obtained by the auditor as a direct written response to the auditor from a third party

¹² Other - interview, news released in media

V COMPLIANCE AUDIT IN LOCAL GOVERNMENT UNITS

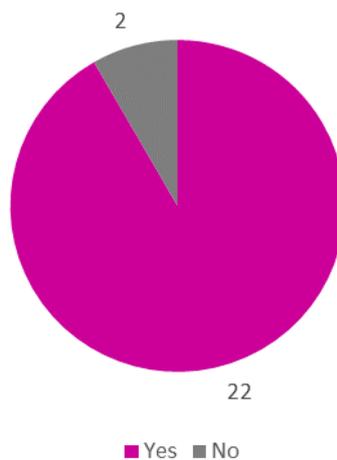
According to answers gathered by the Questionnaire, some SAIs have developed national standards while most of them have developed internal regulation for conducting compliance audit. Mentioned is presented in charts below.

National standards for compliance audit



Six (6) SAIs have developed authoritative (national) standards for compliance audit based on international standards on auditing while eighteen (18) of them have not developed it.

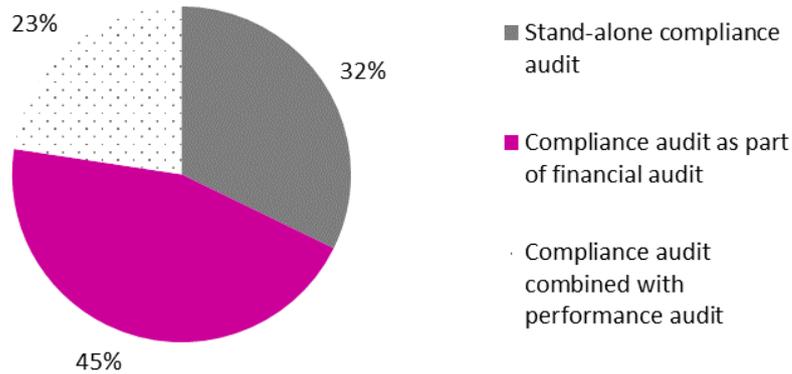
Internal regulations for compliance audit



The majority of SAIs have adopted internal regulations in form of written processes, descriptions, handbooks and/or guidelines for conducting compliance audits.

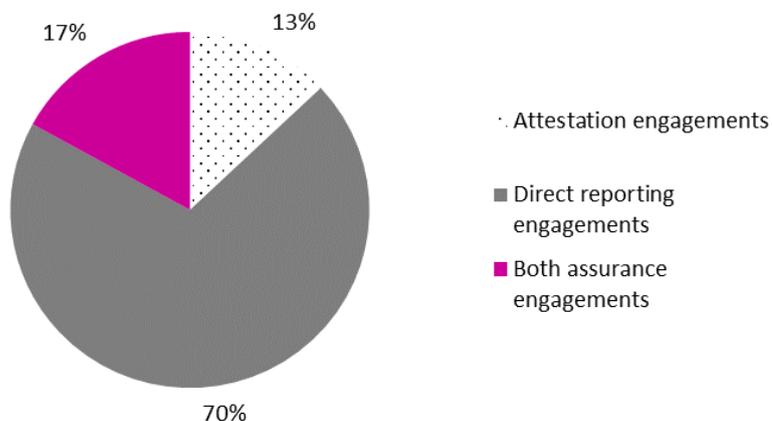
Compliance audit of local government units are usually conducted as part of financial audit, less as stand - alone audit or combined with performance audit. Some SAIs conduct compliance audit as stand-alone audit as well as part of financial audit or combined with performance audit. The chart below presents the conduction of compliance audit of local government units in SAIs.

Conduction of compliance audit in local government units



According to ISSAI 4000 Article 31, each assurance engagement is either an attestation engagement or a direct reporting engagement. Direct reporting engagement and attestation engagement differs based on who prepares and measure/evaluate the subject matter. The subject matter could either be set out in the mandate or selected by the SAI. As shown in the chart below, out of all analysed SAIs, 70 % of them carry out compliance audit of local government units as direct report engagements and 13 % of them conduct compliance audit as attestation engagements. In addition, 17 % of them carry out compliance audit of local government units as direct reporting engagements as well as attestation engagements.

Assurance engagements



To determine local government units to be selected for compliance and performance audit SAIs take into consideration risk analysis and materiality (based on value). Also, local government units are selected for the audit sample taking into consideration period of time from the previously conducted audit, expressed auditor's opinion in previously conducted audit, number of previously conducted audits, budget and other indicators of the size of the local government units, information from the media and other sources and special requests from the parliament.

SAIs use criteria in compliance audit of local government units listed below:

- primary legislation
- local government units' legislation
- statutory instruments (regulations)
- respecting internal acts by the auditee
- ministerial agreements (agreed upon terms and conditions)
- generally accepted management principles
- accurate financial management (public financial management expectations)
- conduct of public officials (professionalism and ethics)
- other sources which can be applied and which conforms to the characteristics of audit criteria specified in international standards.

The auditee can set out compliance requirements for itself. In many cases, auditors do not consider them suitable to be used as audit criteria. SAIs shared their experience on actions that are taken in situations when the auditee set compliance requirements for itself, but the auditors do not consider them suitable to be used as audit criteria. Examples of some actions are listed below:

- using primary legislation and warn the auditee
- evaluation of suitability of the criteria
- giving recommendations for upgrading internally regulations to become more accurate as compliance indicators
- the audit criteria have to be discussed with the auditee
- each non-compliance criteria are included in the report, though they will be assessed according the importance
- the auditors are free in its evaluations but take into considerations the internal requirements of auditees.

According to ISSAI 4000 Article 40, in an attestation engagement the responsible party measures the subject matter against the criteria and presents the subject matter information, on which the auditor then gathers sufficient and appropriate audit evidence to provide a reasonable basis for forming a conclusion. The conclusion is expressed in the form of findings, conclusions, recommendations or an opinion. The result of measuring the subject matter against the criteria presented is in the auditor's report in the form of findings, conclusions and recommendations in each SAI. Only in five (5) SAIs the result is in auditor's report and as an opinion.

VI CONCLUSION

The primary goal of the Overview was to collect data on methodologies that SAIs use for local government auditing. The secondary purpose of the Overview was to identify areas where recommendations and guidelines on local government auditing could be useful.

The Overview provides information on the methodology used by the SAIs, which is the basis for continuing the activity and identifying good practice examples of methodologies used in local government auditing.

Although SAIs' responses were often general, the Overview showed that guidelines for local government auditing would be useful in areas as follow:

- monitoring/coverage of risks at local government units' level (in order not to let them become risks at national level),
- strategic research (monitoring of the topic or area, searching of risks arising),
- selecting audit sample
- monitoring how local government units' debts are reflected at national level
- inspection of local government units' budget creation process
- other areas (auditing the way in which local government units' revenues and expenditures are executed, auditing the management of the local public authority assets, auditing the reflection/reporting of budget execution results in relation to planned targets, and determining various levels of materiality when it can be considered that the local government units' actions have not ensured value for money).

Conclusion is that the situations and circumstances of the SAIs, as well as the legal framework, are diverse, which might not allow the development of uniform and detailed methodologies. However, TFMA should consider the possibility of initiating working groups or teams in several directions that could gather the best practices in the areas of monitoring of risks at local government level, strategic research, selecting audit sample and other areas where guidelines for local government auditing would be useful and distribute this information to all SAIs. This would certainly contribute to the improvement of the methodology and the efficiency of the SAIs' work.