



FUTURE OF PUBLIC AUDIT AND ACCOUNTABILITY*

Speaking notes by Dr Tuomas PÖYSTI, Auditor General

European Court of Auditors' Seminar on "The future of public auditing and accountability in the European Union"

Luxembourg, 18th October 2007

* I thank Ms *Marjatta Kimmonen*, the Assistant Auditor General of Finland, Financial Audit, for valuable advice on the content of this presentation.

Executive summary

Future of public audit lies in the role of audit and accountability in the conception of democracy and good governance. Public audit has a successful history in the implementation of rule of law and democratic values in the domain of public finances. This year we are celebrating not only 30 years of existence of European Court of Auditors, but, we have 200 years anniversary of the French Court of Auditors. In my own country, Finland, public audit has a continuous tradition from the Swedish period during which in 1527 King Gustav Vasa established a Chamber Council to exercise among other duties financial control and to which in 1537 a specific Revision Department for audit was established. Department became in 1695 an independent agency, Chamber Revision, since 1799 Chamber Court. After Finland was detached as an Autonomic Grand Duchy from Swedish Realm the National Audit Office of Finland was established in 1824, under name General Revision Court and Revision Office. In the European Community the work of the European Court of Auditors has been effective in promotion of a culture of responsibility and sound financial management. The basic need of public audit is constant. In the future the Supreme Audit Institutions, through their audits and related consultancy service, will continue to be strong actors in the assurance of accountability and in the enhancement of good governance. They will continue to be strong actors in the creation trust towards public institutions and, eventually, in creation of trust to public finances.

The public audit has to live in time. The challenges for accountability in the context of social and economic change call for a better connection between audit and the exercise of legislative and budgetary power. To serve living democracy audit is expected to have more focus on the quality of governance and on the critical and objective appraisal of the effectiveness of various public policy programmes. Audit will be closer to the challenges of economic and fiscal policy. Public audit has to ensure that structures, procedures, management and actual behaviour of the governance and managements system uses resources according to the democratic decisions and produces the results and services – the common goods - intended by democratic decision-makers. Public audit will have an increasing role in the assurance of the quality of regulatory management. In financial audit more weight needs to be given to a risk based approach combined with audit and certification of the quality of management, control and accounting systems. Financial and compliance audit in which the risk prone sectors and stages of management chain are analytically identified will give the best results in terms of cost-effectiveness of audit and usability of audit findings. There is a need for further convergence and international benchmarking of working methods of public audit. Common analyses and understanding of risks of public finances and financial management are an area to start with the mutual learning. A profound understanding of the ICT environment of public administration and efficient use of ICT –based audit tools are conditions for quality and efficiency in the future public audit work.

FUTURE OF PUBLIC AUDIT AND ACCOUNTABILITY IS AN ASPECT TO THE FUTURE OF DEMOCRACY AND RULE OF LAW

Public audit enhances fundamental democratic values and secures rule of law

In Nordic or Scandinavian countries we use the expression "effektivt folkstyre", effective democracy or living democracy. Living democracy is as wide realisation as possible of the fundamental democratic values, which are (1) representation of political interests, (2) citizen's participation, (3) free building of opinions, (4) free access to information and openness, (5)

legal certainty and respect for the fundamental rights and freedoms, (6) division of powers, (7) control of political and administrative decisions and (7) accountability of political decision-makers and accountability of professional managers. Key element of democracy is free public discussion based on facts and sufficient background knowledge about the consequences of various lines of action. Public audit supports deliberative democracy and communicative power of the people by producing information to public discourse and by assuring the quality of financial and performance information used in policy making and assessment at the Parliament. The overall material objective is the enlightened governance by the people and for the people. Accountability entails the duty to report and assure the legality of actions and use of the public funds to the intended purposes but also accountability for the results achieved and for the efficiency of management and operations.

There is an increasing trend towards the so called *performing state* in which the citizens expect more quality and effectiveness of the money they give to the government. Right to quality, right to efficiency and right to well-performing public administration are citizenship rights of the 21st century in addition to the classic citizen's rights. Public audit is institutional support for citizens' claim and right to efficiency, performance and accountability.

Public audit is a key element of control of both political decisions at the executive branch of the government and an essential mechanism of the control of administration and governance preventing the take over by an internal logic of bureaucracy. As a mechanism of control public audit also focuses on structures and systems and, thus, complements, for example the judicial review, and control by ombudsman. Public audit contributes to trust and confidence at a systemic and institutional level.

Public audit enhances good governance and supports fiscal, regulatory and management reform

Good governance in the governmental context is based on democracy, rule of law, which in the European Union context is captured by the principle that the European Union is a community of law, fundamental rights and freedoms and on the constitutional values of public administration and service. Good public governance requires also capacity to reform. Recent discussion on the appropriate growth policy in economic literature shows that current European societies, which are at the front of technological development, need different kind of policies and thereby also governance challenges are different than economies seeking to industrialise and which can improve by copying innovations. Public audit shall be a mean to enhance effectiveness and reform needed for this and a mean to enhance ethics and values which also create successes for reform.

Effectiveness of public audit in the assurance and enhancement of the democratic values, good governance and good level of effectiveness and performance requires a close link between audit and the use of audit findings in the government and in the exercise of the legislative and budgetary power. The National Audit Office of Finland is in the new strategy for 2007 – 2012 emphasising the timeliness and usability of audit reports in the exercise of legislative and budgetary powers of the Parliament and in the policy drafting of the Government. This also requires that the communicational quality of public audit shall be improved. Audit is essentially information and communication work. In the future public audit shall use multiple communication channels, tools and strategies so that audit information is increasing trust and will not disappear in the information overflow.

In the context of the European Union this means even further improvements between the communications and use of the audit findings in the European Commission but also, notably

in the work of the Council of the European Union. European Union is neither a comprehensive polity with complete and independent accountability discourses nor a federal structure. The Member States and their politics define to a great extent the course of the Union. This multilayered governance structure requires multiple accountability discourses in which also the Member States Supreme Audit Institutions together with the European Court of Auditors have a significant role.

Performance audit dimension shall be strengthened and public audit brought closer to the challenges of economic and fiscal policy

The best result in the enhancement of the good governance and democratic values is attained by a balanced mix of performance and financial audits. In current conditions allocation of 50 % of the resources to financial and 50 % to performance audits is considered by the National Audit Office of Finland as an appropriate balance. However, in Finland financial audit regularity audits performance target setting by the Ministries and the sufficiency of performance information with regards to productivity, economy and also number of outputs. Hence, the coverage in the financial audit is larger than in the private sector audit. In the context of the European Union future challenges are related to the need for more effectiveness audits and value-for-money perspective.

Effectiveness audit is needed to be more transparently connected with the issues of the financial, social and environmental sustainability and challenges of economic and fiscal policy. To realise this National Audit Office of Finland has launched an audit theme programme concerning the reliability and soundness of the informational foundations of fiscal policy and concerning the effectiveness of the fiscal policy rules has been commenced. Our Swedish neighbours are also carrying out an audit programme related to public finances and fiscal policy and we have established good bilateral contacts for learning and building up expertise and methodology. Audit perspectives on several effectiveness audits on the social and health sector and also on performance audit concerning municipal planning and supply of land for building have been defined against the context of fiscal sustainability and conditions for enduring economic growth.

In the audit of the European Union finances good performance audit topics could be, for example, the reliability of the assessments of the added value of the various Community programmes which are now required in the Financial Regulation (EC, Euratom) N:o 1605 applicable to the General Budget article 27 concerning financial statements and article 33 concerning activity statements. Finnish National Audit Office will improve and secure the informational foundations for the coming debate on the financial perspectives after 2013 by conducting an effectiveness audit of all major EU funded programmes in Finland. Network of public audit consisting of European Court of Auditors and Member States Supreme Audit Institutions have much more potential than actually is used in the effectiveness audits of EU related programmes and in the combination of Member States and Community perspectives.

The co-operation between European Union Supreme Audit Institutions is currently focused on the issues related to the audit of the implementation of the European Union budget. This leaves a certain caveat compared to the potential of public sector audit. Several reasons call for widening of the co-operation to cover audit of the Stability and Growth Pact objectives, European Union regulatory management and the effectiveness of the Lisbon strategy. For example, the national reform programmes and the contribution of the European Union funding to the Lisbon strategy objectives should also be audited in order to have a sufficient audit coverage assuring accountability of key decisions and promoting proper responsibility, transparency and ownership of action at national and EU levels. Implementation of the Lisbon

strategy is also a key issue in the budget and financial management of the European Union. This is an issue which could and also should be tackled in co-operation between European Union Supreme Audit Institutions.

Quality and results of regulatory management shall be subject for public audit

Performance of the public service delivery system and quality of public finances is tied to the direct and dynamic effects and functioning of legislation and other forms of regulation. Public audit has a particular contribution to make in the efforts to realise better regulation and better regulatory management. National Audit Office of Finland of Finland has defined the quality and economic impact assessment of legislation to be among key strategic theme of our audit activities. On performance audits we will always, if the question is relevant to the audit topic, analyse whether legislation and other forms of regulation have been optimal as a policy instruments in the attainment of governmental policy objectives and analyse the quality of economic impact assessments. We have also performed a specific audit on the quality of economic impact assessments in the Finnish government memorandums concerning Commission proposals for new Community legislative acts and submitted to the Parliament in the consultation procedure stipulated by the Constitution of Finland.

Legislation and regulation are the main products of the European Union and, therefore regulatory management should be high on the agenda of the European Union and it should also be subject for external audit. Regulatory management is also a key issue in the Lisbon strategy and in the efforts to simplify financial rules applicable to the EU financing with the concurrent aim to improve the quality of financial management systems. Best results of the audit of the regulatory management and the quality of economic impact assessments would be attained if such audits are carried out as joint efforts of European Court of Auditors and the Member States Supreme Audit Institutions.

Financial audit develops towards audit and certification of management, control and accounting systems

The future of financial audit is partly in the audit and audit-based certification of management, control and accounting systems and the certification of the governance systems in a wider perspective. Working with the systems gives the best return on audit investments in terms of cost-effectiveness and improvement of the quality of financial management and public finances. Systemic view with sufficient emphasis on the IT systems audit, including audit of the information security, is vital since the reliability of financial information and functioning of internal control depends increasingly of the quality and reliability of the information systems used in public financial management.

National Audit Office of Finland is taken steps towards this direction by strengthening the IT systems audit as part of the financial audit and by introducing certification of the cost accounting and management accounting systems as an audit product of our standard financial audits. This also includes that we will provide governmental research institutions, in which the National Audit Office of Finland is the external auditor, the certification of the costs calculation methods foreseen in the financial rules of EU 7th framework programme for research.

Fundamental issue in financial audit is whether there can a presumption of reasonable public trust to the legality of underlying transactions or whether trust has to be attained each time by analyses a sample of transactions in detail. If the financial audit focuses on the certification of the management, control and accounting systems and verifies their quality to provide assur-

ance with risk based analytical samples and if the financial audit is able to provide a statement on the various aspects and stages of the management chain, a reasonable trust and assurance can be presumed. The performance of audit here is dependent on the financial management systems. Efficiently organised ITC infrastructure together with modern IT based audit tools enable auditors have focused testing of quite number of transactions. This is also the approach we currently have in the National Audit Office of Finland.

Methodology of financial audit is based fairly universal principles. However, there are considerable differences between European Union Supreme Audit Institutions in the application of financial audit methods. Given these differences the added value of the audit by national Supreme Audit Institutions of the eventual national declarations of assurance of the management of EU funds will not necessarily provide much added value at this stage in terms of contributing to a European wide assurance. Voluntary convergence based on the development of public sector applications of the IFAC standards and developing further the European practise advisory guides of the INTOSAI and IFAC standards, on the basis of equal interests of EU Supreme Audit Institutions covering both Member States public finances and EU finances, will provide the best contribution. Convergence of the financial audit and performance audit methodologies and their application will increase and will provide better foundations in the future for a functioning network of supreme public auditors in the European Union.

An area where good results would be attained relatively quickly and where needs of mutual developments are urgent is the risk analyses methods and trying to arrive at a common understanding of the risk. Methodology, skills and even the carriers of public auditors will become increasingly international and international bench-marking and quality assurance should be essential aspects of the work of supreme public auditors. This is a vital since public auditors have a specific duty towards society concerning the quality of their work and adequacy of their skills. Auditors must continue to improve their skills so that the intellectual capital of public audit system prepares the auditors to be one step forward and then provide objective and critical assessment of the management of public funds in the new environment.

Future of public audit in the realisation of accountability

Accountability is a fundamental democratic value and, at the face of the conditions and challenges of tomorrow with the even increased complexity and risks there is a stronger societal need for auditors to assure accountability and transparency for fiscal soundness, reliability of financial information and financial management systems but also for policy efficiency and effectiveness and performance of public administration. The advantage of the Supreme Audit Institutions is that we know well the administrations we audit. We have then a particular responsibility to respond to this inherent expectation and communicate the results to the citizens.