

RISK ASSESSMENT FEATURES IN PUBLIC SECTOR PERFORMANCE AUDIT

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Abstract

This paper discusses practices for using risk assessment in performance audit the challenges and opportunities of Supreme Audit Institution (SAI). Performance audits take a very important place in public sector as parliamentary oversight and governance instrument, delivers new information, insights and recommendations for improvement and modernization of public sector management based on audit findings. Audit risk and risk management assessment allows organizations to improve the efficiency and continuity of their activities, to manage new risks, like human capital risks more effectively. EUROSAI surveys results showed that a risk assessment is related to the whole audit process, from the drafting of the audit report to the use of the follow-up results. The purpose of this article is to investigate the theoretical assumptions of performance audit risk assessment, their expression through the review and application of standards. Performance audit analysis based on SAI of Lithuania activity plans, reports, and expert assessment. 2021 performance audits respond to the institution's chosen priorities: economic stimulus measures, evidence-based management and a safe environment and a healthy society. The findings of the study may be useful in view of growing role and importance of performance auditing and its positive impact on the public sector in Lithuania.

Key words: performance audit, risk assessment, supreme audit institutions, public sector

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Introduction

In today's global world, there is an increasing emphasis on uncertainties in the economy, finance, health, medical and country development. The importance and development of risk management in various fields is increasing. There is a growing interest in the application of risk management in new areas of human activity, development, and application of new methods. These processes are reflected in the abundance of articles, books on risk management, the emergence of new organizations, the development of old ones, and the

growth of influence. The authors used the works of foreign scientists: Johnsen A., Domokos, L., Kasztelnik, K., Reichborn-Kjennerud K, Pollitt C., Vabo S., Vasiliauskienė, M., Daujotaitė, D., Lonsdale J., Wilkins P., Ling, T. and others. Today everyone talks about integrating risk management into strategic planning and day-to-day management processes. Australia, New Zealand, the United Kingdom and Canada were among the first countries to adopt risk management in public institutions. In the United Kingdom, the Orange Paper was published in 2001, the first to systematise the methodology and structure of risk management in public bodies.

The risk-based approach is increasingly emphasized in European Union documents, moving from rules-based supervision to supervision, where risks and the quality of their risk management system are assessed dynamically. Risk-based supervision is an integral part of most ongoing business supervision reforms in the world. The Committee of Sponsoring Organizations of the Treadway Commission (COSO) published an Enterprise Risk Management (ERM) standard in 2004. Updated COSO ERM Framework in 2011, 2014 and 2017. International Standards are drafted in accordance with the rules given in the ISO/IEC Directives: ISO Guide 73:2002; ISO 31000:2009. ISO Guide 73:2009. According to the *ISO 31000:2018 Risk Management Guidelines*, risk is the effect of uncertainty on objectives.

Public sector audit entities should have the independence and responsibility to select which areas of public administration they will audit and which performance audit topics they will select.

This “revolution of thinking” is attested by the abundance of international literature that deals with risk management, along with the increased prevalence of regulations on risk-related activities and of “good practices” supporting regulatory compliance. There are, however, unique traits that characterize risk analysis and risk management as applied in the public sector, both in terms of areas of application and execution. Being mandatory is the foremost feature of risk management as applied in the public sector, with efforts to minimize risk, and the promotion of compliant operation and financial management serving as the goal (Domokos, et al. 2015). Performance improving is one of the main performance audit objectives. Performance audits play important role in each country in public sector as parliamentary oversight and governance instrument delivers new information, analysis or insights and recommendations for improvement and modernization of public sector management based on an analysis of audit findings. Performance audit aims to provide assurance or conclusions based on an evaluation of sufficient, appropriate evidence against stated criteria, such as specific requirements, measures, or defined business practices. They

provide objective analysis so that management and those charged with governance and oversight can use the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability (ISSAI 3100, Reichborn-Kjennerud & Vabo, 2017, Reichborn-Kjennerud & Johnsen, 2015).

In each EU country performance audits are a fast-growing area. SAIs seek to maximise their value for society by helping to create good public governance, by limiting negative financial and societal impacts of bad governance, and by stressing compliance of public sector officials with laws and regulations. EU countries give considerable prominence to the achievement of policy objectives and sound financial management, i.e., the risk that these are not attained (EUROSAI, 2021).

Audit standards (ISSAI 300, 3100) international control frameworks (COSO 2017), academic studies (Pollitt, et al. 1999) highlights the relevance of the risk-assessment approach in order to determine the audit plans that could meet the expectations of the different SAIs' stakeholders. Standards require auditors to actively manage audit risk to avoid the development of incorrect or incomplete audit findings, conclusions, and recommendations, providing unbalanced information or failing to add value.

Audit planning documents should state the possible or known risks of the work envisaged and show how these risks will be handled.

1 Performance audit risk conception and role during the pandemic

The concept of performance audit risk is presented in various ways in both the economic and legal literature. After the analysis of different sources, it can be said that performance audit risk is a multidimensional concept; there is a variety of approaches, also significant differences in the definition of parameters and ratios describing it; there is no single universally recognized performance audit risk model suitable for all organizations, as the nature of operations of organizations is very different, as well as their objectives, structure, and their circumstances. Risk could arise, through exposure to financial loss; loss of reputation; failure to deliver a policy or program economically, efficiently or effectively; etc. Risks may vary in nature and concern any level of the organization.

Organizations levels risk can face numerous types, see Table 1.

Tab. 1: Organizations risks types

Risk types	Examples
<i>Strategy risk</i>	Lack of strategic thinking, strategic planning; adverse or improperly implemented decisions; lack of responsiveness to changes in the external environment; and other considerations.
<i>Governance risk</i>	probability of corruption and misuse of authority; failure to establish appropriate processes and structures for informing, directing, managing and monitoring the activities; insufficiencies in senior management leadership; and the absence of an ethical culture.
<i>Human resources risk</i>	the failure to develop and implement appropriate human resources policies, procedures and practices, health, security, errors, fraud, abuse.
<i>Operational risk</i>	Inadequate, inefficient, or failed internal processes or failure to conduct operations economically, efficiently or effectively.
<i>Compliance risk</i>	violations of or the failure or inability to comply with laws, rules, and regulations, prescribed practices, policies, procedures or ethical standards.
<i>Financial risk</i>	Insufficient funding; inappropriate use of funds; inadequate management of financial performance; or unreliable financial reporting or disclosure.
<i>Information risk</i>	The failure to establish and maintain appropriate information and communications technology systems and infrastructure.

Source: Own research based on INTOSAI (2019). ISSAI 300 and Pollitt et al. (1999)

Table 1 reflects an overview of types of risk assessment areas for performance audits. While nowadays the same risk factors exist, but assessments in the current environment are unlike any others, as clients are dealing with significant changes to their businesses, the work environment, and the economy overall as a result of pandemic. While governments in countries are already deploying rapid action and provide urgent relief measures at an enormous financial cost, there is an elevated risk of mismanagement, waste, corruption and fraud whenever governance and accountability mechanisms, including media and civil society freedoms are already underdeveloped. Despite the added complexities, auditors must continue to focus on high-quality audits that fully comply with standards for objectivity and professional scepticism.

The SAIs also faces challenges caused due to complete or partial lockdowns, the question for each SAI to answer is: how to conduct high quality and high impact performance audits during pandemic? According to INTOSAI IDI, it is important to consider three essential things: what to audit, when to audit and how to audit.

What to audit? Audit focus – orientation for better recovery and/or government performance in dealing with current pandemic crisis. Potential audit areas: effectiveness of government response to pandemic; Strong and resilient national public health systems.

When to audit? Probable timelines for audit: conduct agile performance audits in real time and issue audit reports; Start the audit process, build capacity and partnerships, collect

information and start field work immediately after the crisis; Build in audits focused on better recovery and preparedness in the longer-term performance audit portfolio of the SAI.

How to audit? Potential solutions: Create stakeholder coalitions at the very beginning of the audit and engage with them throughout; Keep the audit scope manageable; Provide safety training and equipment to staff to manage risk of exposure; Explore and experiment with online tools to strengthen communication and collaboration. The incorporation of risk assessment into the selection of audit topics and the creation of a performance audit plan helps an audit entity to ensure that it is using its limited resources to audit the areas of highest risk and priority with the public sector. This increases the audit entity's ability to be relevant, dynamic and effective. Each SAI has a framework for strategic and annual planning, based on the criteria relating to materiality, topicality, feasibility and added value. Education, property and finance, justice, health and social security, culture – these are the main, but just selected areas of the public sector that can be covered by performance audits (Vasiliauskienė & Daujotaitė, 2019). Risk coverage at the whole-of-system level is important to impact on public sector administration more broadly and also at the individual program level.

2 Research design

This study includes meta-analysis, documentation analyses and expert evaluation methods covering EUROSAI members and SAI experts of Lithuania.

According to the audit principles defined in INTOSAI, *the value and benefits of SAIs* – making a difference to the lives of citizens, SAIs need to demonstrate their ongoing relevance to citizens, parliament, and other stakeholders. In this approach, SAIs should evaluate the changes resulting from their audit activities (INTOSAI, 2019 ISSAI 300).

Many authors have investigated issue of implementation of audit recommendations and factors that influence the impact of audit reports. According scientific literature, evaluating impact can be done in various ways, such as *conceptual impact*, which refers to changes in learning processes, mentality and behavior at the auditee or society; *strategic impact*, which refers to the use of audit reports by stakeholders in political or public debates; *instrumental impact*, which is a more direct impact by implementing the audit recommendations (Johnsen et al., 2019, Lonsdale et al., 2011). As most of the audit reports connect their findings with suggestions for solving the problems, these recommendations are an appropriate instrument for measuring the impact resulting from the audit, so most SAIs use the implementation of recommendations to measure *instrumental impact*. The analysis of the EUROSAI project provided information on the implementation of members' audit recommendations and various

systems, of follow-up of the implementation of audit recommendations. The information was gathered through a survey, which was sent on 2019 to all 50 EUROSAI members (the SAIs of 49 European states and the European Court of Auditors - ECA). Have replied to the survey 33 SAIs, including ECA- 66 percent). Survey questions include the recommendations, use of the follow-up results in the performance monitoring and risk assessment processes. The study seeks to extend the research on performance audit risks by examining empirically how risk base approach is practiced in the EUROSAI members.

Documentary data that were collected and analyzed included SAI of Lithuania annual reports and activity plans (National Audit Office of Lithuania, 2021). The period subject to report analysis was 2020 to 2021.

The expert assessment was chosen to reveal the recent changes in the Lithuanian Supreme Audit Institution and the attitude of specialists to the performance audit based on risk assessment. 5 experts were selected, taking into account their professional competence and many years of experience in the field of performance auditing, as well as the possibility to reliably assess issues related to performance auditing.

3 Research results

EUROSAI survey include five factors that are relevant in the context of the survey questions: Constructive relationship between auditor and auditee; Audit report quality; Existence of a follow-up mechanism; Parliamentary involvement; Dissemination of the follow-up report.

These survey questions include the recommendations, use of the follow-up results in the performance monitoring and risk examining empirically how risk base approach is practiced in the EUROSAI members.

Tab. 2: Impact of independent variables in audit reports

Independent Variables	The answer (total 33)		Comments
	Yes	No	
Constructive relationship between auditor and auditee	27	6	The recommendation based on a dialogue with the auditee: Engage the auditee in the follow-up of the implementation of recommendations.
Audit report quality	28	~ 5	The SAIs issue recommendations in their reports: 28 SAIs is done in all reports and 5 SAIs is done in some of the reports.
Existence of follow-up system	30	3	Set clear and realistic deadlines for the implementation of recommendations.
Parliamentary involvement	30	3	The respective legislative bodies play a role in the implementation of audit recommendations.
Report the results of the follow-up system	23	10	SAI make a global report on the follow-up of recommendations/reports and is it communicated to external stakeholders. The results of SAIs' follow-up exercises communicate publicly.
Use of the follow-up results for the performance monitoring system and the risk assessment	21	5 and 7	The results of the follow-ups are an important element for the risk assessment of SAIs. 7 sometimes

Source: Own research based on EUROSAI (2021)

This surveys results showed that a follow-up system should go beyond the existence of a follow-up procedure and is related to the whole audit process, from the drafting of the audit report to the use of the follow-up results in the context of a risk assessment. Similarly, SAIs should not act alone and must engage their stakeholders in this process: the auditee, parliament, media, and the general public.

The documentary analyses show, that the Lithuanian SAI and the applied professional standards encourage the institution to see the problems of the public sector, focus on their assessment and make suggestions on how to solve them. Performance audits shall be included in the public audit program taking into account the importance of the issues they address in achieving the country's strategic objectives, assessing the level of risk in the amount of funds and assets under management, listening to the recommendations of parliamentary committees, other public sector institutions, non-governmental organizations and taking into account the relevance of the problems observed and the possibility of examining them using audit methods. Audits assess the performance of one or more institutions, certain parts of the activities of the institution (s) or the principles of economy, efficiency and effectiveness of the program. Each audit aims to identify opportunities for improvement.

2021 performance audits respond institutions selected priorities for action: economic stimulus measures, evidence-based management, safe environment and healthy society. More than half (68 percent) in 2021 to focus performance audits and evaluations on priority issues. 2021 audits and evaluations are planned to directly address the consequences of the COVID-19

pandemic and its management measures. As a result of the changes, more rapid assessments are planned, and a permanent group has been set up to monitor the Government's decisions to combat the consequences of COVID-19.

It is innovative and it should be noted that Lithuanian SAI is one of the first started to assess the impact of audits on changes in the public sector according to the approved public audit impact assessment methodology. It recognizes the audit recommendations as being implemented only when they result in a real indicator-measurable change.

Summarizing the experts' answers to the question how can the essential features of the public audit impact assessment methodology be described, which show the change in the assessment of the implementation of audit recommendations? How is this measured?

Answer: The object of the public audit impact assessment methodology is direct instrumental impact, as this type of impact can be assessed at the level of each public audit. The direct instrumental impact is assessed by analyzing the changes caused by the audit and its recommendations, the audit's contribution to the changes and the financial benefits of the audit.

To summarizing the results of the impact assessment of public audits, six types of changes that may be caused by public audit and the implementation of its recommendations have been identified: a) related to operating costs (economy); b) relates to operating income; c) relating to operational efficiency; d) related to performance (quantitative aspect of performance); e) related to performance (qualitative aspect of performance); f) relating to the content (adequacy) and / or implementation of public policy.

What are the challenges faced by auditors in continuing the coronavirus pandemic and moving routine work to e. space? What were the risks?

Answer: With the onset of the pandemic, Lithuanian SAI was one of the first to start teleworking, adapting very quickly to the changed situation, no technical problems and one of the reasons for this smooth transition, all documents are processed by electronic means and information programs.

Experts and ISSAI standards state: Human resource risk arises from failure to develop and implement appropriate human resource policies, procedures and practices, health, security, errors, fraud, abuse. Most human resource problems start with a failure to design and implement a proper human resources policy.

Answer: Performance auditing covers many of the areas of activity being audited, so professional development is one of the most important tools for achieving the best audit results. Each performance audit is a different area to be audited, a new direction, and

additional knowledge is required, so it is very important to be able to process large amounts of information quickly and to have strong analytical skills. The most important motivating factors for the employees: evaluation of employee performance, respect, and cooperation.

Lithuanian SAI aiming at increasing the institution's added value to society and to evaluate problems in the public sector systematically, have updated:

- The system of planning and selection of public audits.
- developed a system (map) of indicators to assess risks in public sector areas.
- improved the monitoring of the implementation of recommendations, refused to extend the implementation deadlines.
- opened the results of the monitoring to the public and started submitting reports on the implementation of recommendations every six months to the Seimas Committee on Audit.
- cooperate more actively with audited entities during formulation and implementation of recommendations.

Also have included in plans new and faster products - assessments. This allows to provide the necessary data and possible solutions to decision making at the relevant time.

According to experts, it is necessary to find ways to implement the recommendations of public audits, because the changes initiated by them can significantly contribute to positive changes in the public sector. Changes in the quality and accessibility of health care, the management of the program budget, public investment, education, information resources, public procurement and social support systems can lead to a more transparent and accountable allocation of financial resources, greater public safety, and awareness.

Conclusion

Performance audits shall be included in the public audit program taking into account the importance of the issues they address in achieving the country's strategic objectives, assessing the level of risk in the amount of funds and assets under management.

The follow-up of the implementation of recommendations is a practical method for evaluating the impact of the SAI's activity, the results of this follow-up should be used as an indicator for the SAI's performance. Also, follow-up results can be used as an input for the risk assessment of the SAI, whether on a strategic or operational level.

SAI of Lithuania apply new methodology, that assess the impact of audits on changes in the public sector and recognizes the audit recommendations as being implemented only when they result in a real indicator-measurable change.

Human resource risk arises from failure to develop and implement appropriate human resource policies, procedures and practices, health, security, errors, fraud, abuse. Most human resource problems start with a failure to design and implement a proper human resources policy. The most important motivating factors for the employees: evaluation of employee performance, respect, and cooperation.

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