



SIGMA

Support for Improvement in Governance and Management

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BULGARIA EXTERNAL AUDIT ASSESSMENT JUNE 2005

1. Introduction

The National Audit Office (*Smetna Palata*, SP) is the Supreme Audit Institution in Bulgaria. The legal base is article 91 of the 1991 Constitution, effectively established through a law adopted by the National Assembly (NA) in 1995. On 4 December 2001, the National Assembly adopted a new National Audit Office Act (SP Act), which extended the mandate of the SP. Amendments to the SP Act were adopted by the National Assembly on 27 April 2004 and came into force on 14 May 2004..

The amendments made to the SP Act contribute to further harmonisation of the Bulgarian external audit legal framework with good EU practices. The SP is now in the position to improve its relationship with parliament, as it has been granted the right to submit to the National Assembly and to the Council of Ministers its opinions on amendments of laws and secondary legislation.

The SP has a collegial decision-making structure consisting of the president and ten members. In October 2004 the president's term of office ended, and the mandate of SP board members expired in November 2004. On 7 April 2005 a new president was appointed by parliament. One week later, ten new board members were appointed, one of whom had previously been a member of the board. A new secretary-general was also appointed in April 2005.

The total number of SP staff is currently 486 (530 staff were foreseen in the 2005 budget). The central office includes 289 staff, 197 of whom are auditors. The six regional offices employ a total of 186 staff, including 168 auditors. According to the organisational structure that has been in place since March 2004, the SP consists of five financial audit departments, three performance audit departments, one department for specific audits, and one department for legal "assurance" (legal counsel) and development of the legal audit framework. The new SP board adopted on 28 April 2005 a new organisational structure, which was subsequently put in place. The number of departments has been preserved (10). As was the case prior to 2002, the new SP audit departments have now been set up in accordance with similar areas of activity and functional relations among the entities (financial sector, social policy, health care and social insurance, security, etc.). All types of audits should be conducted by auditors in each department.

The scope of the six regional offices, which is in conformity with the Bulgarian administrative structure, has been maintained. The audit activities of regional offices concerning municipal budgets will be managed and monitored by one of the departments responsible for ensuring uniform practice and improving the quality of audit reports.

Administrative staff of the SP are assigned to one of four directorates: International Relations/Public Relations Directorate, Administrative and Information Services Directorate, Financial and Accounting/Property Management Directorate, and Legal and Methodological Directorate.

The SP budget for 2004 was 9.4 million leva (4.8 million euros), and for 2005 the budget is 10.5 million leva (5.3 million euros).

The total number of audit reports adopted by the SP in 2004 was 250. The number of audit reports adopted between 1 January and 15 March 2005 was 38.

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For the past six years, the SP has received considerable support in strengthening the professional skills of the institution. The implementation of the National Audit Office Act was supported by a twinning project carried out in co-operation with the UK National Audit Office, which ended in October 2003. A twinning light project concerning the formation and management of state debt was carried out with the support of the German *Bundesrechnungshof* and the Spanish *Tribunal de Cuentas*. A second twinning project for the further development of the SP, supported by the German *Bundesrechnungshof* and the Spanish *Tribunal de Cuentas* started in November 2004. Besides twinning activities, the SP has received support from USAID under the Open Government Initiative Project related to the fight against fraud and corruption and from other international organisations (INTOSAI, EUROSAL)

2. Baseline Questions

2.1 *Does the SAI have clear authority to satisfactorily audit all public and statutory funds and resources, bodies and entities, including EU resources?*

Baseline achieved (1999, 2000 and 2001 baselines substantially achieved; 2002, 2003 and 2004 baselines achieved)

The audit mandate of the SP is rather broad. It includes the state budget, State Social Insurance Fund budget, National Health Insurance Fund budget, budgets of municipalities, EU funds and programmes, as well as final beneficiaries. Furthermore, the mandate covers: the budget expenditures of the Bulgarian National Bank; state-owned enterprises by decision of the National Assembly; formation and management of state debt, state-guaranteed debt; debts of municipalities; proceeds from privatisation and concessions, as well as their allocation and spending; and execution of international treaties, contracts, covenants or other international acts envisaged in the respective act or assigned by an authorised body.

According to the SP Act, the audit of annual accounts on the execution of the budget, of extra-budgetary accounts and funds, and of annual financial statements of budgetary organisations must include an audit opinion. The Law on Political Parties, adopted in April 2005, gives to the SP the mandate to perform financial control on political party activities and on the management of their property. The law sets down the consequences for political parties if they do not submit their financial statements to the SP, as well as the procedure to be followed in the event of infringement of the law, as ascertained by the SP when auditing political party funds and management of their property.

Most of the secondary and tertiary rules and regulations have been adjusted in accordance with the April 2004 amendments to the SP Act. Rules and procedures for the introduction of performance budgeting and audit standards also need to be developed. The internal regulating process is scheduled for completion under the new twinning contract.

2.2 *Do the types of audit carried out cover the full range of regularity and performance audit set out in INTOSAI auditing standards?*

Baseline substantially achieved (1999, 2000, 2001, 2002 and 2003 baselines partially achieved; 2004 baseline substantially achieved)

The SP has the authority to carry out all types of audit — financial audit, performance audit, and other specific audits.

In 2004 the SP covered all spending units in its audits. Of the 250 audits carried out, 215 were financial audits, 28 were performance audits (including six on EU funds), and seven were specific audits. For the first time, two horizontal audits on specific themes – government-wide or municipality-wide – are part of the 2005 audit programme. Furthermore, the programme comprises joint audits, in which the central office and regional offices are to co-operate in auditing the primary, secondary and tertiary levels of spenders.

The SP has made a first start by auditing concessions, procurement and the financing of political parties.

Under the new twinning contract, the focus is more on performance audit and EU funds rather than on certification audit, and regional offices in particular will be more involved. The new twinning partner has

proposed to concentrate specifically on public-private partnerships (large investments).

In carrying out financial and performance (pilot) audits in line with good European practice, the SP was confronted in 2003 with the problem of a lack of resources. To solve this problem, in 2003 and 2004 the SP restructured its departments and increased the capacity available for these types of audits in regional offices. In 2004 the SP agreed with the Ministry of Finance on a staff increase of ten positions a year until 2007, which will lead to a total number of staff of 550, which is considered to be the SP's optimal staff number.

Due to the 20% savings in resource time resulting from the new SP Act's abolition of a time-consuming task that was not related to external audit, the capacity of the SP to fulfil its tasks has been considerably extended, at central level as well as in regions and municipalities. However, the difference between the required capacity to fulfil the SP's broad mandate on a sound basis and available resources cannot be counterbalanced by an increase in staff, either in 2005 or in the future. To resolve this problem, the SP is considering ways of reducing the time required for preliminary studies and of re-allocating tasks between the central office and regional offices. These measures can without a doubt contribute to increasing the effective use of resources. A further extension of audit capacity should nevertheless be sought through a strategic approach in order to permanently improve the efficiency and effectiveness of audit work.

2.3. Does the SAI have the necessary operational and functional independence required to fulfil its tasks?

Baseline achieved (1999, 2000, 2001, 2002, and 2003 baselines substantially achieved; 2004 baseline achieved)

All of the basic aspects of independence described in the INTOSAI Lima Declaration are reflected in the legal framework for the SP. The National Assembly elects the SP President and members for a nine-year term. The President may serve only one term. In October 2004 the president's term of office ended, and the mandate of SP board members expired in November 2004. Contrary to the SP Act, the new president was appointed nearly six months later, on 7 April 2005, and the new board members on 13 April 2005.

Labour relations of SP auditors and officials are determined in accordance with the Labour Code.

The SP is operationally and financially independent. It determines its own audit programme, audit approach and time schedule. Up to five audits can be carried out upon special decisions of the National Assembly; in the past three years the NA has not taken such a decision. SP auditors have free access to all relevant information, with the exception of classified information. In that case, the conditions and provisions of the Law on Protection of Classified Information apply.

The SP has its own budget, which is a separate part of the state budget. The government has no power to amend the draft proposed by the SP. A committee appointed by the NA, comprised of five members of parliament and two certified public auditors, audited the annual report on the execution of the budget and the annual financial statement of the SP for the year 2003, which was sent to the NA together with SP's annual audit report at the beginning of October 2004. As at April 2005, the Parliamentary Committee on Budget and Finance had not yet approved the report on the SP's budget execution for 2003.

While the SP has considerably improved its primary task (audit operations) during the past few years, the development of supporting tasks has fallen short. In May 2003 the SP adopted a human resources policy directed towards strengthening the audit capacity of the departments and regional offices and increasing the employment of younger people. A *Long-Term Strategy for Training and Development of Personnel* was adopted in accordance with one of the main requirements of the human resources policy. A training programme foresees introductory training for new staff members, as well as training related to the professional development and personal careers of the staff. To meet the requirements for strengthening administrative capacity, the SP has adopted the profiles/competences for auditors, defining the requirements for development, professional achievements, communication, professional and computer skills for the various grades. It has also set out the framework competences for the managerial, expert and technical positions in the administration. Functional characteristics of different SP administrative units have been adopted. Rules on the assessment of SP administrative staff have been approved

The development of these important initiatives for professionalizing SP administrative capacity came to a standstill after spring 2004. The foreseen change in management led the former SP board to adopt a prudent policy and as a result no important decisions were taken. The implementation of not only the human resources management policy but also the IT strategy and the organisation of the audit process needs serious attention in the coming one and a half years remaining before Bulgaria's accession to the European Union. During this period, the SP and its twinning partner will also be faced with the full-fledged development and implementation of tools to improve their operations (planning system, time recording and budgeting systems) and to assist the management in fulfilling its task of creating a professional organisation.

In 2002 the SP established a Public Advisory Council to assist SP management in the elaboration of strategies and policies and in discussions of audit activities. The Council met twice in 2003, but it did not come up to SP expectations. The meetings were too theoretical and were not directly related to SP operations. This initiative to meet representatives from the private business sector and the scientific community was not continued after 2003. The SP expected that the Twinning Steering Committee's meetings would be more useful. As recommended in the 2004 Sigma assessment, the SP is advised to reconsider its decision to discontinue meetings of the Public Advisory Council. In general, such initiatives require time to prove their effectiveness. After all, a public advisory council could play an important role in contributing to greater publicity and transparency of SP activities and could serve as an external quality assurance measure. In this way, the esteem of the Bulgarian public for the SP as well as the quality of management decision capabilities could be increased.

2.4. *Are the SAI's annual and other reports prepared in a fair, factual and timely manner?*

Baseline substantially achieved (1999, 2000, 2001, 2002, 2003 and 2004 baselines substantially achieved)

A stable base has been established for ensuring fair, factual and timely reporting. According to the SP Act, auditors have access to information related to SP audit activities from every authority in the country. In the event of a disclaimer of information or of a legal person or "sole trader" hindering the audit, the law provides sanctions, including the possibility of addressing the case to the prosecutor. All findings and assessments included in the audit report have to be supported by audit evidence according to adopted standards. A contradictory procedure aims to guarantee the quality (fairness and factuality) of the audit report.

The SP Act also regulates the time frame for the annual audit reporting on the accounts of the execution of the state budget, the State Social Insurance Fund budget, and the National Health Insurance Fund budget, as well as on the Bulgarian National Bank budget expenditures for the preceding year.

The SP should submit its Annual Activity Report for the previous year to the NA by 30 September of the current year. In 2002 and 2003 the Annual Activity Reports for 2001 and 2002 were not published in time. The Annual Activity Report for 2003 was published in time.

Besides the Annual Activity Report, the SP publishes reports on audit results (on average, 20 annually).

Although SP reports are factually correct and are published on time, the quality of the reports is still not in line with international standards. Compliance audits are presented as performance audits, and the reports are mainly descriptive and exhibit an obvious lack of thorough analysis, concise conclusions and recommendations.

2.5. *Is the work of the SAI effectively considered by government and parliament, e.g. by a designated committee that also reports on its own findings?*

Baseline partially achieved (1999, 2000 and 2001 baselines not achieved; 2002 baseline partially achieved; 2003 and 2004 baselines substantially achieved)

The 2001 SP Act and the amendments to the SP Act of April 2004 regulate the relationship between the and the NA and provide a basis for establishing a better relationship mechanism.

The annual audit programme is submitted to the NA within a seven-day time frame as from its adoption or amendment by the SP, and quarterly reporting on the adopted audit reports has been introduced. According to the SP Act, reports on audit findings may be considered by the Committee on Budget and Finance or by other parliamentary standing committees, and concrete decisions may be proposed.

So far the attention given to SP reports by the Committee on Budget and Finance is minimal. The committee does not consider the Annual Activity Report is as very useful for interpellating the government to take action, as the timing of the publication is perceived to be rather late in the year. As at May 2005, the committee had still not discussed the activity reports for 2001, 2002 and 2003. The committee did not foresee the approval of these reports before the NA elections in June 2005.

SP audit reports are appreciated much more by the respective committees of the NA. The SP has regular contacts with the Committee on the Health Insurance Fund and on the Social Security Institute. At the invitation of the committees, the SP president – and sometimes board members and auditors – can attend as observers the committee meetings focusing on SP interim reports. Four times a year the Committee on Budget and Finance and the SP Board meet officially.

A general feeling within the NA and the SP is that their mutual relationship can and should be improved. From the NA side, consideration is being given to establishing a committee specifically designated to deal with SP reports and other SP matters. The SP on its side recognizes that its interactions with the NA need to be improved. The best way to strengthen relations with the NA – and with the general public – is by preparing audit reports of high quality. All of the key players interviewed, both within and outside the government, were of the opinion that the quality of audit reports needed to be improved. The reports are perceived as being formalistic, with references to small mistakes and lacking thorough analyses as to why these mistakes had occurred. In general, the reports were seen as lengthy and descriptive but lacking concise conclusions and recommendations; all in all, they do not encourage the reader to take action.

A communications strategy – with special attention given to communication of the main issues in the reports, media coverage and publishing – has not been developed.

When recommendations for an audited entity have not been fulfilled, the SP has the right to forward the report to the NA with recommendations of measures to be taken. The SP Act obliges the Council of Ministers and other executive authorities (municipal council and regional governor) to inform the SP of actions undertaken. When a criminal action is detected, the audit documents (or audit report) are to be forwarded to the Prosecutor's Office, which is obliged to inform the SP of the actions undertaken. Since 2004 the audit files or audit reports constitute a legal basis for initiating a preliminary procedure.

In 2004 four reports were submitted to the competent authorities for the pursuit of property and administrative penal liability, and 93 reports on violations of public procurement procedures were submitted to the Minister of Finance and the Minister for Public Administration in order to initiate appropriate action in accordance with their legitimate powers. In 76 cases, actions have been undertaken.

The SP's audit reports and annual activity reports are posted on the SP web site.

The SP has concluded agreements with a number of central-level institutions regulating in which cases, when and how they shall co-operate and interact. In practice, these formal agreements are “dead letters”. The desired co-operation with key players – such as the NA, Ministry of Finance (Central Harmonisation Unit for Financial Management Control and Internal Audit), other audit and control bodies within the public sector, and professional organisations – is more often based on informal relations than on formal agreements. It is of paramount importance for the SP to place greater emphasis on establishing and fostering a climate of trust and mutual assistance in these operations.

2.6. *Has the SAI adopted internationally and generally recognised auditing standards compatible with EU requirements, and how far have they been implemented?*

Baseline partially achieved (1999, 2000, 2001, 2002, 2003 and 2004 baselines partially achieved)

In 2001 the SP became a member of INTOSAI and EUROSAI. The INTOSAI Auditing Standards and Code of Ethics were translated into Bulgarian and distributed in the Office. Pursuant to the 2001 SP Act, the SP published in June 2002 its audit standards (10), which are in line with international external audit standards. Auditing standards are referred to in every audit. Amendments to the audit standards – based on the 2004 amendments to the SP Act – are in preparation and will be published before the end of 2005.

To date the audit manual has not been finalised. Just as auditing standards are essential, so are clear guidelines and an audit manual to enable SP staff to carry out audits in a sound and professional way. By the end of 2005 the SP intends to put all available materials together in one folder, which should function as an audit manual. This collective action is a step forward but still insufficient. An audit manual includes a description of all audit processes and audit supporting processes for different types of audits, and not all phases of the different audit processes have been developed. The quality control measures carried out in every phase of the audit process and the review of work done by other audit and control bodies are still being developed in the SP – or in some cases have not even begun.

2.7. Is the SAI appropriately aware of the requirements of the EU accession process?

Baseline achieved (1999, 2000, 2001, 2002 baselines partially achieved; 2003 baseline substantially achieved, 2004 baseline achieved)

The challenges of the pre-accession process had already been addressed when the Strategic Development Plan was adopted at the beginning of 1999. Progress has been achieved in this area during the past few years.

The Office has carried out several audits of activities financed by Phare funds in a number of ministries and government agencies. The SAPARD Agency was audited in 2003, and ISPA in 2004. The ISPA audit led to questions in parliament, and resulted in a request for an ad hoc investigation regarding the use of EU funds during the period 1999-2004.

Training in the auditing of EU funds - with a focus on performance audit – will be required under the new twinning project. SP auditors participate frequently in national and international seminars dealing with EU-related issues.

In 2003 the part of the SP Annual Audit Programme covering the audit of EU funds and programmes was sent to the European Court of Auditors (ECA) and to the European Commission. Reports on audit results are also submitted to the ECA and to the EC regarding relevant resources. A Directorate for International Relations and European Integration was set up to optimize EU accession activities; in 2004 the staff of this directorate increased from 8 to 15 members.

3. Capacity to Further Develop the System

The board of the SP has been determined to develop better professional capacities, starting with its commitment to the Strategic Development Plan of 1999. In the last few years, the SP has increased its capacity for further development as a supreme audit institution. The foreseen change in leadership in October 2004 did logically stagnate development of the SP after spring 2004. The nearly complete new management team is facing some big challenges, which had already been mentioned in the 2004 assessment and are still applicable. On the one hand, the SP has to find its way in a completely new area with its own dynamics, and on the other hand, in a very short time it has to make strategic decisions defining the course that the SP will follow in the one and a half years leading up to Bulgaria's accession to the European Union. In view of EU membership, the SP should concentrate on developing its capacity so as to assume its role after accession. Close co-operation with relevant counterparts in the government is therefore indispensable. However, the development of an effective external audit system also depends on the interest given to its work by its natural ally, parliament. It is therefore absolutely necessary to reinforce relations between parliamentarian committees and the SP.

A big challenge for the institution is still to find the proper balance between operational tasks and development activities, and between improvement of the primary audit process and supporting processes, such as management development, human resources management (including training) and information technology. The extension of the SP mandate during the past two years has created high expectations and put more pressure on the efficient use of available resources. Enhancing its authority in relation to the NA and the general public is another challenge faced by the SP, and it should seriously reconsider its external policy.

The formation of a new management team seems to be an excellent moment for an upgrading of the Strategic Development Plan. In that connection, the elaboration of an audit strategy based on reliable information about SP operations could form the basis for further development of the SP into an effective, well respected supreme

audit institution. Efforts to lighten pressure on resources should be sought by adopting a strategic approach to permanently improving the efficiency and effectiveness of audit work.

In view of these important challenges, a stabilisation of SP's organisational structure is indispensable. The very recent reorganisation of the SP, following three structural changes over a three-year period, has placed SP's preparation of the post-accession period seriously at risk. New staff changes will undoubtedly negatively influence SP development.

4. Summary and Next Steps

External audit substantially meets the requirements of the INTOSAI Auditing Standards and EU Implementing Guidelines for effective and efficient audit of public funds and resources.

However, the oversight of governance by parliament and the SP can be improved. Parliamentary committees, especially the Committee on Budget and Finance, do not use the SP often enough as a tool for controlling the government's activities. SP reports, on the other hand, do not really invite parliamentarians to take action.

The SP as an institution has made considerable progress during the past few years in a particularly difficult environment. The foreseen change in leadership in 2004, however, has stagnated further development of the institution. The SP should therefore summon everything in its power to continue to implement and update its Strategic Development Plan. Priority should be given to establishing institution-wide audit practices in line with international standards that have substantial impact on the development of sound financial management in the public sector. Where possible and relevant, the SP should pursue closer co-operation with other control institutions.

In this process, focus must be kept on the basic elements of a professional, operating supreme audit institution with sound support processes. Effective reporting should be a main feature of this support in the coming years.

Priority should be given to the following actions, most of which date from the 2004 Sigma assessment, but are still valid:

A. Should be applied (or started) in the short term (or next 12 months):

- Focus on both the operative work and the development processes to create operational results and added-value in the areas of financial management and financial control;
- Upgrade the Strategic Development Plan, paying particular attention to the existing imbalance between the required capacity to fulfil SP's broad mandate and available resources, and to the external impact of SP work;
- Develop an audit strategy to:
 - maximise the efficient use of SP resources in the central office and in regional offices;
 - come to a proper division of resources between the different types of audit, with attention being given to both horizontal and vertical audits;
 - clarify within which public sector bodies an annual audit shall be carried out in the future and whether such an audit shall include an audit opinion;
 - improve the quality of reports, with emphasis on shifting the current compliance-oriented reporting to performance-oriented reporting;
 - improve quality control and quality assurance procedures, including measuring the effectiveness of SP products;
- Develop a communications strategy, with emphasis on:
 - raising awareness of SP outputs;
 - enhancing the impact of SP products and thereby SP prestige;
 - editorial capacity-building;
 - improvement of staff report-writing capabilities;
 - exploration of ways of improving external transparency of SP operations;
- Continue with the implementation of the supporting processes for human resources management and IT, with special attention being given to regional offices;
- Develop a policy for improving management capabilities;
- Finalise the audit manual in line with good practices of EU SAIs;
- Initiate mutual assistance in SP operations with other control bodies and with the administration, in

particular the PIFC Agency;

- Actively seek opportunities for dialogue with parliament and government to strengthen SP relations with both bodies in terms of reporting and follow-up of actions taken on audit findings;
- Seriously reconsider the continuation of regular meetings with external representatives in the Public Advisory Council;
- Actively seek opportunities to participate in the organic budgetary and financial management law-making processes.

B. Should be applied (or started) in the medium term (or next two years):

- Initiate brainstorming sessions with professional organisations and non-governmental organisations to generate opinions, with a view to gathering input for the SP's future long-term strategy;
- Seek peer assurance to assess the progress resulting from the current changes and reform process.