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FORMER YUGOSLAV REPUBLIC OF MACEDONIA

EXTERNAL AUDIT

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1. Introduction

The State Audit Office (SAO) of the former Yugoslav Republic of Macedonia¹ was established by the State Audit Law of 1997, and the first Auditor General was appointed in May 1998. However, operations only started in 1999 following the transfer to the SAO of employees from the audit department of the former Agency for Payments (ZPP).

The SAO is clearly the Supreme Audit Institution (SAI) of Macedonia with regard to its role, organisation and the basic features of its supporting law. However, it has no constitutional anchorage and thus lacks one of the most essential means of securing and protecting the establishment and independence of such an institution. In September 2007, the government mandated the Ministry of Justice to draft an amendment proposal to incorporate the SAO in the Constitution. The number of SAO staff has grown from the initial 11 to 90, of whom 65 are directly involved in audit tasks. Of the 90 staff positions, seven are currently allocated to the audit authority for EU funds, the establishment of which now constitutes a major undertaking of the Macedonian SAO. Taking this into account, the target staff figure is now 145 by 2010, with 32 units for the audit authority. This remains an ambitious objective. Changes in the audit approach may improve the general productivity of audit work, and concentration on risk areas may help to make best use of the still scarce human resources so as to enable the expansion of audit coverage and the improvement of audit work without focusing too much on increasing the number of staff.

The SAO is headed by an Auditor General, who is appointed by parliament for a ten-year term together with a deputy. The SAO has a clear SAI office type of structure. However, it differs from the classical “monocratic” SAI type as audit reports are not signed and thereby endorsed by the head of the concerned institutions but only by the auditor who is in charge of the work (“authorised state auditor”).

Eight departments compose the SAO, each of which is led by an assistant auditor general. Five of these departments conduct the financial audit work, one department is specialised in performance audit, one is responsible for the development of the SAO (methodology, training, international co-operation, audit planning and analysis, reports), and one for logistical support (including SAO budget preparation). The assistant auditors general, together with the Auditor General, his/her deputy and some other key SAO persons, form the “collegium”, which has no legal base (only the internal SAO rulebook) but plays an important advisory role on certain issues, such as programming or approval of the annual report.

The budget was established at 55.9 million MKD (979,382 EUR) in 2006, 62.82 million MKD (1,049,087 EUR) in 2007, and 69.36 million MKD (1,127,804 EUR) in 2008. Budget execution was 53.38 million MKD (891,440 EUR) in 2006 and 56.83 million MKD (924,065 EUR) in 2007, thus apparently significantly below the budget. However, this figure does not include the SAO own resources (see below), which represented 2.06% of total resources in 2003, 2.32% in 2004, 7.43% in 2005, 18.26% in 2006 and 17.56% in 2007. Although slightly decreasing, own resources are still at an uncommon level in comparison with most

¹ In this report the former Yugoslav Republic of Macedonia will hereafter be referred to as “Macedonia”.

supreme audit institutions, and the SAO's dependence on such resources is still a matter of concern. Until 2007, the amount of resources coming from charged audit activity has constantly increased at a pace always superior to the rate of increase of the budget itself; this situation cannot continue in the long term and the decrease observed last year should as far as possible be pursued.

As a result of various inputs, in particular coming from foreign assistance, and in connection with its development strategy, the SAO produced in 2007 a draft law intended to consolidate certain key features of its set-up, strengthen its independence and take into account some shortcomings which had appeared during its first decade of operations. It is hoped that this act will now be adopted by the end of June 2008.

The SAO has been engaged since September 2005 in a three-year partnership with the Dutch Court of Audit, which is likely to be extended for another year. The German Court of Audit carried out a peer review of the SAO in the first half of 2007.

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?*

The SAO has a clear authority to audit all public institutions. According to article 1 of the State Audit Law, the SAO can audit the financial statements and financial transactions of state entities, including entities that are completely or partially financed by the budget of the Republic, as well as local entities, state-owned enterprises and the Central Bank of Macedonia. This covers namely the state budget (Budget of the Republic of Macedonia), local budgets, extra-budgetary funds, budget fund-users, legal entities in which the state is a major shareholder, political parties financed by budget funds, and electoral campaigns. In accordance with the law, the SAO can also audit the beneficiaries of EU funds, as well as projects funded by foreign and international institutions.

This means that the SAO is now supposed to perform the audit of 1837 institutions. Of these, 168 are to be audited on a mandatory yearly basis: budgets (state and local budgets, funds), users of the state budget, and state-owned enterprises. Political parties constitute an additional category. The actual number of annual audits has always been fewer than that figure, even though constant progress has been made in that respect until last year: 110 entities were audited in 2005 and 131 in 2006, covering most of the total budgetary amounts to be audited. With 89 audited entities in 2007, this number has decreased significantly (by nearly one-third), which is due to changes in the audit methodology (implementation of audit manual) to improve the quality of audits and audit reports, and also to the allocation of resources to set up the audit authority for EU funds and to carry out specific pilot audits in the framework of the assistance project.

The human resources of the SAO are not sufficient to carry out the very broad audit mandate of this institution, and further strains on the workload result from the demanding function of the audit authority. This situation, which was also emphasized by the peer review carried out by the German SAI, is particularly true with regard to local institutions. As it seems inappropriate and indeed impossible to consider either creating specific audit capacities to deal with the local sector or fully contracting it out, e.g. to the private sector, additional staff will need to be recruited. Some areas that are non-standard or of lesser strategic importance for SAO audit work may nevertheless be reconsidered and excluded from the audit mandate, which would allow more flexibility in the allocation of resources and possible redeployment. This could be the case for the audit of political parties or state-owned enterprises. In the latter case, if deemed inappropriate to delete these companies from the SAO's remit, it is worth considering whether the annual audit of bodies working under company law should not be left to (private) statutory audit only. The audit of political parties is a recent addition to the remit of the SAO: four parties were audited in 2005, and there is apparently a growing interest in the SAO to carry out this work. This activity, although non-standard, is found quite often among central European SAIs. The resources it requires should be kept under strict control, and eventually the relevance of such a task could be subject to reconsideration.

The SAO has a broad audit remit and the authority to audit all public and statutory funds and resources, bodies and entities, including EU resources. The resources of the SAO, however, do not enable this institution to carry out its extensive mandate, and it would be appropriate to look for different arrangements.

2.2. Does the type of audit work carried out cover the full range of regularity and performance audit set out in INTOSAI auditing standards (1.0.38-1.0.44)?

The State Audit Law provides a definition of “state audit”, which generally fits the INTOSAI definition of financial audit: “examination of documents (...) accounting and financial procedures and other records from the point of view of whether the financial reports present truthfully and fairly the financial positions and the results of the financial activities”. State audit also includes an assessment of the extent to which “funds are spent economically, efficiently and effectively”. This gives to the SAO a clear mandate to carry out performance audit.

The SAO provides an opinion on the financial statements produced by its auditees. In 2006, 31% of the audit reports produced gave a negative opinion, compared to more than 40% in 2005. In 2007 the proportion shows a further decrease, with 28 % negative opinions, and this decrease could attest to the progress made by the SAO in working out its financial audit and in using more objective criteria to justify its opinions, taking into account risks and materiality. New guidance material to assist audit staff in their assessment of materiality and risk, prepared with the Dutch Court of Audit, has certainly contributed to this development.

The SAO still does not perform a specific audit of the consolidated state accounts, not even of the execution of the state budget as a whole. The annual audit of the state budget consists rather of compiling and summing up the results of the separate audits performed on each individual auditee. In fact, the current approach is almost totally disconnected from the budget process, as there is no linkage between the production of the audit report and either the submission of the annual draft budget, of a “spring budget” (which still does not exist in Macedonia) document or of the final (consolidated) state accounts. The audit report does not focus on the overall cash execution of the budget. On the income side, the SAO has carried out an audit of the tax and customs collection and has evaluated the risks of these activities, as well as the efficiency of internal control procedures. However, it has not been as far as certifying the revenue figures of the accounts or of the executed budget. This approach is possible, but it is certainly not in line with the good SAI practice of producing an overall report on the implementation of the consolidated state budget, which is a key output of any SAI and also provides a relevant matrix for further programming of audit work. In the current wording of the State Audit Law, moreover, there is no formal difference between the annual report on the audits performed and the activity report of the SAO, which are both contained in the same document. Furthermore, the annual report was supposed to be submitted to parliament at the latest seven months after the final deadline for submitting the financial statements, which may prove to be very late in the process. As a matter of fact, since 2005 the practice has been to submit the SAO annual report to parliament on 31 March each year. The new draft law envisages the submission of the annual report to parliament at the latest on 30 April, which seems a good balance, although it still gives little time to perform all of the audit work that is necessary after the accounts are produced.

As part of the financial audit, the SAO is to provide at the moment quarterly reports on its activity. The value-added and usefulness of such reports would deserve further scrutiny, as it might be worthwhile to save the resources used in preparing these reports for proper audit work. Indeed, the new draft external audit law only requests the SAO to submit to parliament periodical reports on the extent of implementation of the annual programme. Otherwise, consideration should be given to a change in audit approach, focusing more on risk areas and in particular on the delivery of an overall opinion on the execution of the state budget as a whole. In addition, more attention should be paid to systems audit, in parallel with the current development of internal audit and internal control procedures within the Macedonian public administration.

Performance audit work is only in an infant development phase: after three performance audits in 2005, 12 such audit reports were produced in 2007. As confirmed by the German peer review, the focus of the initial series of reports was more on the compliance of the audited programmes with the objectives than on the actual performance of programmes in terms of economy, efficiency and effectiveness. The capacity to build up performance audit would certainly be enhanced by developing cross-sector horizontal audits, aimed at addressing an issue of significant risk across various auditees, thus leading to fruitful comparisons as well as to identifying possible good practices. This would go together with the adoption of a more strategic approach to this development, taking into account for future audits those issues related to the performance of public policies that currently have the greatest interest for the public and for key stakeholders, such as parliament, while allowing for relevant practical training of SAO auditors. To date performance audits have been carried out by a special department of the SAO. The assignment of this function may still correspond to the current level of awareness and the competence of the staff in place. It is nevertheless possible to question this arrangement from a cost-efficiency perspective and in view of the scarce resources available. Most SAIs of CEE countries of a size comparable to that of Macedonia have adopted a “client-oriented” structure,

which allows for better co-ordination between financial and performance audits and for common training and practice of the staff in both areas. In addition, it is doubtful whether the importance of performance audit work really justifies the existence of a separate department. In any case, exchanges between the staff of this department and the staff of other components of the SAO should be encouraged.

The strategy of the SAO for 2006-2010 gave some consideration to the development of performance audit, but mostly by mentioning the objective of developing the performance audit department and increasing the number of performance audits in the SAO programme. The revised strategy for 2008-2012, still in draft at the time of this assessment, is more focused and devotes a full section to the development of performance audit. The current wording remains rather vague, as it only refers in general to the necessity to increase auditors' skills in this area and to meet the target number of auditors in the department specialised in performance audit. At this stage of development, it would be advisable for the SAO to design a performance audit policy for the coming years. The SAO should define more clearly the scope of future performance audits, the resources it can allocate to it, and how this could link with the financial audit activity. Furthermore, the SAO could program the performance audit activity in a way that would both serve its skills development needs and raise the interest and acceptance of its stakeholders, for example by focusing on similar functions or internal control procedures in sample ministries or other public bodies (e.g. procurement, human resources management issues, sound financial management of grants and subsidies, and management and protection of assets). Before moving to sophisticated performance audit activities, the SAO could consider looking at possible overlaps of Macedonian administrative structures, and opportunities for increasing productivity in the public administration and favouring the redeployment of staff across the administration. This could eventually lead to a reduction in the number of budget-users, thus making the audit remit of the SAO more workable. The current design of audit work does not support such a new approach.

The SAO is entitled to carry out both financial audit and performance audit. However, the work done in practice is still limited, as the financial audit does not include at the moment the attestation of the execution of the state budget as a whole and would need further development, and the performance audit activity is still in its very early stages.

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

The State Audit Law formally provides the Auditor General and the SAO with a good degree of independence from the legislative and the executive, as well as from the organisations that the SAO has the responsibility to audit. The Auditor General and his/her deputy are appointed for a ten-year term, which is certainly one of the longest among SAIs with fixed-term appointments. Both officials can only be dismissed by parliament on grounds laid down by the law, which are now more specific since the amendment adopted in May 2006. Otherwise, the law provides for incompatibilities concerning the Auditor General and his/her deputy aimed at preventing a possible conflict of interest in the discharge of their duties.

Auditors are appointed by the Auditor General; they are not civil servants but are subject to the Labour Code and to the State Audit Law. This arrangement differs from the more current practice in the region, according to which auditors have been made civil servants or they are subject to similar provisions as for civil servants. In the future it will be useful to ensure that such a situation does not constitute an obstacle to the exchange of personnel or mobility within the public administration, which could be an important element in terms of career development and human resources policy.

The independence of state auditors, in terms of preventing conflict of interest, is regulated by the State Audit Law.

With regard to staff management, the Auditor General is only bound by the limits set by the Labour Law, but this is less true with regard to the number of staff, which is strictly under the control of the Ministry of Finance, as for any other public administration in Macedonia. Even if this situation does not meet the most demanding standards for the operational independence of SAIs, it is hardly avoidable given the budget situation of Macedonia at the moment. However, working in the SAO seems to be attractive, and staff salaries are slightly higher than for civil servants of an equivalent category. The discrepancy has narrowed in recent years, but the SAO has obtained – in its discussions concerning changes to the State Audit Law – the benefit of a fixed bonus, expressed in proportion to salaries (20% for auditors and support staff, possibly higher with the expected adoption of the current new draft law).

Since the adoption of an amendment of May 2006, the budget of the SAO is subject to a separate vote by parliament. The control exercised so far by the Ministry of Finance has led until recently to a situation where the SAO has been severely under-resourced during its first phase of operations. This in addition constitutes a weakening of the SAO's financial and operational independence. The new draft law aims to mitigate this situation by giving the SAO authority to prepare its budget and to submit it as such to parliament, with the government only entitled to provide an opinion on the proposal made by the SAO. If adopted, the SAO would be given a degree of financial independence that is well above the average for comparable institutions in the region and even for SAIs across most of Europe.

The costs of mandatory and regular audits (including for the beneficiaries of EU funds and other international funds) are met from the national budget. For bodies whose main shareholder is the state, as well as for public enterprises, the Central Bank and other such legal entities are covered by fees established in a tariff approved by parliament. This financing of audit costs is regulated by article 16 of the State Audit Law. Audit carried out upon request is also paid for by fees, except in the case of a request from parliament. Funding of audit work by auditees exists, but it is rather rare in the public sector and is generally a feature of audit bodies working in conditions that are close to those of the private sector. This kind of funding can lead to bias in the establishment of the audit programme or in the relations of the auditor to the auditee, making the SAI dependent on such funding (or alternatively preventing it from performing certain useful audits because of a lack of financial coverage). This issue deserves further consideration, with a view to restricting as much as possible the scope of audit upon request, if not abolishing it altogether. With 31 auditees subject to tariffication, out of a total of 131 entities audited in 2006, and 23 out of 89 in 2007, this practice of funding by auditees is not negligible. As mentioned above, this practice has now reached and maintains a level of significance in terms of contribution to the SAO budget, which would have to be reduced and restricted.

The SAI is free to decide which audit work it will carry out (article 9 of the State Audit Law prescribes that the SAO determine the scope of the tasks of the state audit, by means of its annual programme), but this decision has to take into account the mandatory audit work that it has to perform (which at the moment implies a degree of selection) and the audits that public bodies (including parliament) can request the SAO to perform but that the SAO is not obliged to accept. However, the criteria for programming a specific audit are largely at the discretion of the Auditor General, who in the last instance determines the annual programme. In practice, the collegium is consulted regarding this decision as on other management issues, but it has no decision-making competence. For the sake of transparency and independence, it would be worthwhile to consider defining the role and composition of the collegium in the State Audit Law in order to consolidate this advisory body within the State Audit Office. Criteria for defining the programme of audits would gain from being more clearly established, and this has also been stressed by the peer review of 2007. Above all, the State Audit Office should assess the resources allocated to audit upon request and the impact of such activity on its work. At the moment it is difficult to say whether there is an excessive practice of audit upon request. Most of the audit requests made in 2006 came from mayors and local communities, which could lead to the conclusion that national resources are diverted for the sake of purely local interests. In any case, it would be better to either remove completely this possibility so as to firmly guard the SAO's independence, or frame it by means of strict procedures, or possibly put a ceiling on the number of such audits that can be performed in a given year.

When performing audits, SAO auditors have full access to the auditee's premises, books and other records as well as the right to ask questions that are useful for the audit work. State confidentiality cannot be placed as an obstacle to the investigations of the auditors. Fines for non-compliance are foreseen by the State Audit Law. As the need may be, the SAO can hire external professionals to carry out expert work on specific issues in the course of an audit. This contracting-out of course depends on the resources available, and so far it has not been implemented in practice.

All audit reports are published on the SAO website (14 days following their submission to parliament for those subject to this procedure) and can be communicated to anyone who requests them. The results of the reports are also in principle published in the SAO Bulletin, but there has been only one issue of it and the new draft law does not make it an obligation for the SAO. The SAO must in any event transmit to parliament its annual report on audit activities as well as quarterly reports and reports containing findings of major irregularities.

The standard components of SAI independence are generally in place, but attention should be paid to the financial basis of the SAO in order to prevent too great a dependence on the production of audit fees. The practice of audit upon request should also be more regulated to restrict its importance.

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

Audits are normally carried out in accordance with the audit programme by teams working in compliance with the relevant legislation and the standards developed by the SAO (this concerns in principle the INTOSAI standards, which have been translated into Macedonian and are published in the *Official Gazette of Macedonia*). The IFAC standards are also used as a reference. Most teams comprise two staff. The State Audit Law contains proper provisions to prevent conflict of interest of auditors when carrying out an audit and to guarantee the respect of confidentiality. The draft report is submitted to the auditee, who has 15 days to provide written comments. The final report is produced, with the comments incorporated, and again submitted to the auditee, who has 30 days to lodge a complaint against the report. It is up to the General State Auditor to make the final decision, at the latest 30 days following receipt of the complaint. This procedure is rather standard and ensures fair reporting. Laid down in a law, it has by nature a certain degree of rigidity as the deadlines are fixed independently of the nature and complexity of the audit, and leave no room for appreciation to the auditors. It furthermore tends to focus on legal issues and relies heavily on controls by third parties. A general review of quality control/quality assurance policy has been undertaken and has resulted in the production of *Guidelines on Audit Quality*, aimed at higher built-in quality in the audit process as such.

The timely production of audit reports does not seem to be a problematic issue for the Macedonian SAO.

The annual report – despite its nature, more of compiling than of auditing – and other reports are prepared in a fair, factual and timely manner, but the procedure of reporting, including the “contradictory procedure”, would need to be reviewed.

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

In addition to the annual and quarterly reports, the General State Auditor submits to parliament the reports on ministries, budgets and funds, and state-owned enterprises. Reports containing a disclaimer of opinion and reports concluding that the financial statements do not give a true and fair view of the audited entity are also sent to parliament. However, this body has so far shown little interest, if any, in the work of the State Audit Office. The normal recipient of the reports is the budget committee. It is clear, however, that the audit reports have no impact on the discussion of the annual state budget. This lack of impact may be related, among other factors, to the date on which the report has been transmitted – until 2005 – to parliament (no later than seven months after the expiration of the deadline for submission of the annual financial statements, in practice in September) as well as to the contents of the report itself, which has not focused on the overall execution of the previous year's budget but on collecting the findings related to individual auditees. This situation could now change, as the new draft State Audit Law intends to regulate the deadline differently. An initial proposal was to submit the report at the latest by 30 April, but this date will be reconsidered. In any case, revising the deadlines for reporting should take into account the impact on the approach used thus far in audit work.

This current situation does not mean, however, that there is no follow-up on audit reports. Follow-up is first of all linked to the recommendations suggesting further proceedings by means of investigations by administrative or law-enforcement bodies, such as the Ministry of Finance (in particular the Central Internal Audit Department, now renamed the Public Internal Financial Control Department), Public Revenue Office, Public Procurement Office, Public Prosecutor, Anti-corruption Committee and Financial Crime Department in the Ministry of Interior. All of these bodies are said to co-operate efficiently with the State Audit Office and to provide feedback on the work that they have undertaken in reaction to the SAO's findings. This co-operation on follow-up is normally reflected in the SAO annual report, and it is particularly true insofar as the Public Prosecutor is concerned. It is based solely on the interpretation of the current legal provisions: article 28 of the State Audit Law provides that these authorities are to inform the SAO within 90 days of any measures taken as a result of an audit report. There is no specific procedural agreement between the SAO and any of these bodies, but this is not seen as an obstacle to efficient co-operation. The SAO currently finalises specific internal guidelines on the follow-up of audit reports.

As far as co-operation with other bodies is concerned, the SAO and the Ministry of Finance concluded a protocol of co-operation in October 2006, which would provide the basis for further co-operation between the Public Internal Financial Control Department and the SAO.

An interesting development could have been the fact that an institution has been given specific competence for following up audit reports on auditees having the government as its supervisory body: the Commission

on Economic Systems and Current Economic Policy has the task of reporting on measures taken to implement the recommendations of the SAO. However, there has been apparently no feedback from this procedure and another attempt at establishing such monitoring results from the conclusions of the government session of 6 September 2007, requesting the creation of a special audit committee, within the executive, to review audit reports and propose measures and activities for the implementation of the recommendations. Moreover, a “special organisational unit” of the Government Office should be made responsible for supporting this central audit committee. However, none of these initiatives appears to have been carried out for the moment.

The same is true of another conclusion of the same government meeting, entrusting the Ministry of Finance with responsibility for the “relevant commission in the National Assembly to review the audit reports, and propose measures and activities to the competent bodies” in order to implement the recommendations made. For the moment, the creation of this commission remains an intention, since the draft law on audit, which was supposed to incorporate this procedure, has still not been adopted.

The annual activity report of the SAO contains statistical information about the implementation of its recommendations. The SAO otherwise systematically follows up in its report on the implementation of the recommendations resulting from its previous audit work. The Strategic Plan for the period 2006-2010 puts a special stress on the issue of efficiency of audit reports, and consequently on the audit follow-up, and in particular sets as a strategic goal the development of a recommendations tracking system, “to enable the SAO to better monitor and report” on the implementation of the audit recommendations.

The consideration given by parliament to audit reports remains limited, but most other follow-up activities seem to be efficient.

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

As mentioned above, the INTOSAI standards have been translated into Macedonian and have been published in the *Official Gazette of Macedonia*. According to the State Audit Law, audits are to be conducted in accordance with the applicable laws and regulations and follow the INTOSAI auditing standards. It is difficult to assess what this means in practice, since few audit institutions, if any, can be said to completely follow the standards. At least the German peer review ascertained that audits were carried out in such a way that they met the essential requirements of a fair and transparent approach.

The SAO has produced a financial audit manual. Its implementation is still recent as it only started at the end of 2005. According to its development strategy, the SAO planned to issue a performance audit strategy as early as December 2005. This has proved to be too ambitious a deadline, and the work still has to be carried out; neither the Strategic Development Plan for 2006-2010 nor its updated draft for the period 2008-2012 mentions a specific performance audit strategy. A proper policy is currently being developed in the area of quality control and assurance, resulting notably in the issuing of audit quality guidelines. There is still no policy in key areas, such as human resources management and communications, but this is expected to be undertaken with the future implementation of the development strategy. An IT strategy has been adopted in connection with the IT component of the current technical assistance project.

The SAO has adopted the INTOSAI auditing standards, but practical implementation is still limited for the time being.

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

Since December 2005 Macedonia has been an official candidate for EU accession. The SAO’s awareness of EU requirements has considerably increased since that date. The SAO has indeed taken action on certain points, such as the right to access end-users of funds and suggestions for amending the State Audit Law accordingly.

More generally, in spite of its recent establishment and limited resources, the SAO already plays an active role in various international forums. A member of INTOSAI since March 2001, the SAO is also a member of EUROSAI since May 2002 and in particular a member of its working groups on environmental audit and IT audit. Furthermore, the SAO is represented in various training activities, and staff have been trained and certified as IDI (INTOSAI Development Initiative) trainers. The SAO is also a member of the network of SAIs of EU candidate and potential candidate countries and the European Court of Auditors, and it is taking

part in parallel audits with other SAIs of the network. The SAO is sending a second intern to the European Court of Auditors.

A very important development in this area is the fact that the SAO accepted to become the audit authority for the upcoming EU pre-accession funds (IPA) and was formally designated as such by the government in April 2007; the Audit Authority was created on 31 July 2007, and its head was designated. While linked to the SAO, benefiting from SAO staff secondment and located in the same premises, the Audit Authority operates in full independence and its budget is strictly separate from that of the SAO. This compliance with accession requirements should not go as far as creating an artificial separation between the two institutions as there is very much to be obtained in terms of synergies and cross-fertilisation, for instance through a common training exercise. Since the Audit Authority will not be immediately operational on a full-time basis, the continuing engagement of its staff in normal audit work of the SAO will make a good use of resources.

The SAO has made quick progress on the issue of the EU accession process, and this can only develop further, taking into account the fact that Macedonia has only recently been granted candidate status and the fact that the SAO will act as audit authority for pre-accession funds. The independent status of the Audit Authority should not prevent mutually supportive co-operation between this body and its matrix organisation, the SAO.

3. Capacity to Further Develop the System

The State Audit Office of Macedonia has demonstrated in recent years a firm determination to develop and improve its capacities and operations in order to become an efficient SAI.

As a priority, important efforts have been dedicated to the staffing of the institution. Even if the current number of staff may still seem insufficient and in particular cannot cover the – very broad – audit remit of the office, it is not a small achievement to have reached a level that is fully comparable to sister organisations in the region.

The legal framework is in place and is generally in line with INTOSAI principles. As such it does not seem to require substantial changes. Possible amendments should result from the practice of audit activities and their constant improvement rather than corresponding to attempts to reach ideal standards. However, the SAO management has decided to prepare and submit for approval a new law on state audit to better express the contents of some INTOSAI standards to which the SAO is committed. This basically relates to the strengthening of the financial independence of the SAO, its co-operation with parliament, and enhanced audit coverage of EU funds as well as of the revenue side of the Macedonian budget. After a rather long process of maturation, this law is expected to be adopted by the end of June 2008.

The SAO has suffered from financial restrictions and, like all public institutions in Macedonia, it is subject to strong interference from the Ministry of Finance in its financial management. This interference of course diverges from the spirit of the INTOSAI Lima Declaration and would require adjustment in a way that is compatible with the still fragile situation of the country's public finances.

The adoption of an initial development strategy for the period 2005-2009 was a good indicator of the commitment of the SAO to constant improvement. The strategic document has been reviewed and now concerns the period 2006-2010; it now lists five strategic goals: independence, strengthening of institutional capacities, development of new types of audits and improving the quality of audits, IT system, and communication policies. It is unfortunately unclear how far the strategy, and in particular its revisions, reflect current developments in the Macedonian public administration, e.g. the introduction of Public Internal Financial Control. In any case, a proper procedure is needed to steer and monitor the implementation of the strategy and to provide feedback. This procedure as such is not in place at the moment, as implementation is left to the twinning mechanisms. The SAO is now engaged in the updating of this strategic document for the period 2008-2012, and the new strategy will include policy on human resources and communications. The current draft has been enriched by the incorporation of the main conclusions of the peer review carried out by the German Court of Audit in 2007, in particular insofar as the development of new forms of audit is concerned.

The progress of the SAO, including implementation of the Strategic Development Plan, is still supported by a bilateral assistance project, in the form of "twinning", provided by the Dutch Court of Audit. This long-term project (initially three years until September 2008, but likely to be extended for an additional year) has four components that address the key challenges of the SAO: audit process (auditors' skill enhancement), including the introduction of performance audit; administrative capacity of the institution; IT and IT audit;

and the legal framework. The approach of this project also demonstrates a keen interest in a process of change and modernisation. Another important point in that respect is the setting up of a division specifically concerned with development and training issues. There will be a need soon, however, to plan for the situation when the technical assistance will have terminated, in particular insofar as training is concerned, and the revised strategy should focus more on this issue.

While focusing on the relation with its long-term partner, it is worthwhile for the SAO to expand the scope of exchanges of experience and confrontation with other external audit models. This would enable the SAO to base its further development on a broader knowledge of the existing possibilities and to contribute to resolving some specific Macedonian problems. In this perspective, the fact that the SAO has asked another homologue organisation, the German Court of Audit, to carry out a peer review of its functioning and activity speaks for its acceptance of exposure in order to submit its current development and change process to external scrutiny. The peer review report was released in the summer of 2007 and, while recognising the many achievements of the SAO since its establishment, makes recommendations for the current process of change and improvement of this body. However, the report states that the SAO's further development largely depends on decisions that are to be taken by others. Whether the SAO can influence or determine these decisions will depend on its ability to communicate its objectives in a transparent and credible way.

4. Summary and Next Steps

External audit in Macedonia generally meets the requirements of the Lima Declaration of INTOSAI. The need for improvement suggested above is real but is not in major contradiction with a fair alignment with the applicable principles.

After ten years of operation, the SAO has achieved substantial progress in many aspects of its activity. However, further work is needed to reinforce the SAO's audit capacity, strengthen its professionalism and move progressively towards an SAI that contributes to establishing sound management of public finance in Macedonia. This will become even more acute as the current assistance project comes to an end.

Priority should be given to the following actions:

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

- Continue with the implementation of its revised strategy, ensuring a clear and continuous linkage between strategy development and implementation and the current long-term technical assistance activity;
- Assess the impact of audit work requested by external parties and take appropriate steps, as needed, to give full priority to the SAO's own programmed work;
- Take further steps to restrict the dependence on chargeable audit work;
- Finalise current policy development activities;
- Define clearer procedures for the programming of audit work;
- Define policies and procedures to cover the current broad audit remit of the SAO, and contribute to revising policies related to the audit of local entities;
- Become involved, as appropriate, in current plans for reforming key aspects of the Macedonian public service and public finance, e.g. reform of the accounting system, setting-up of management and control systems for EU funds;
- Continue to assume an active approach to international co-operation and contribute to the exchange of working methods and experience;
- Strengthen, as appropriate, the SAO's relations with parliament;
- Finalise the current legislative process;
- Carry on with the development of the function of audit authority, which, while acting independently, should not be seen as a completely separate body;
- Continue to develop performance audit capacity and design plans for future implementation, selecting topics with a potentially useful impact related to the current needs of the public sector; initiate more pilot audits and cross-sector activities;
- In due course, seek an opportunity to secure the constitutional position of the SAO.

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

- Revisit the concept of the annual audit on the execution of the budget, with a view to expressing an opinion on the budget process as a whole, rather than providing a compilation of reports on individual budget-users; this change of approach will require more use of the concepts of risk and materiality;
- Use the above audit approach so that the annual report on budget execution becomes a key document focused on the validity of figures and the reliability of the system of internal (management) control.