

Audit Office of the Republic of Cyprus

Performance Self-Assessment Report
based on the Supreme Audit Institutions Performance
Measurement Framework

(excerpt of full report)

April 2017

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Foreword

Soon after his appointment, the new Auditor General of the Republic of Cyprus decided that a self-assessment exercise should be carried out, in order to identify the strengths and weaknesses of the Audit Office and, where needed, take the necessary steps to implement actions for improvement. The self-assessment team was appointed by the Auditor General and comprised five Audit Officers, together with a Senior Principal Auditor, who led and coordinated the project. The terms of reference of the team were communicated to all staff on 6.2.2015.

The self-assessment was carried out in accordance with the Performance Measurement Framework for Supreme Audit Institutions (SAI PMF) (Pilot Version of 12.7.2013) and started in February 2015. The first draft report (in Greek) was completed on 5.2.2016 and was submitted to the Deputy Auditor General for a factual review. The factual review was completed on 11.3.2016 and the points identified were cleared with the self-assessment team on 19.4.2016. The report was then submitted for translation and after its completion, in August 2016, it was submitted to the INTOSAI Development Initiative (IDI) for a quality assurance review. The IDI comments were received in October 2016 and the team's responses and amendments were re submitted to IDI in January 2017. The quality assurance process was completed in April 2017 and the final report was issued.

Although not stipulated by the SAI PMF, the team submitted a number of suggestions for dealing with the problems/weaknesses identified. These were being discussed with the Auditor General in the course of the self-assessment and in many cases action has already been taken to address these issues, especially through the revision of the Office's Auditing Guidelines, which were being revised at that time.

(i) Findings

The self-assessment exercise revealed that the Auditor General, as the external auditor of the Government, has a mandate that is broad enough to ensure that it covers all public sector entities. The Office is entitled to perform all types of audit it considers necessary, and has unrestricted access to records and information. However, mainly due to a significant shortage of staff, the Office cannot cope with its workload, which results in a significant number of audits not being carried out. In the period that extended after the one examined for self-assessment purposes, a lot of the accumulated backlog, concerning mainly the audit of financial statements, was outsourced to private audit firms. It must be noted that the Office cannot deal with the problem of staff shortage itself, as it does not enjoy financial independence. Its annual budget (which also includes job positions) needs to be approved by the Executive (i.e. Ministry of Finance and Council of Ministers) before it is submitted to the Parliament for vote. The Parliament does not have the power to increase the amounts allocated in the Office's Budget (it can only decrease them if it deems it necessary), therefore there is a strong dependence on the Executive in ensuring the Office has the adequate capacity to carry out its mandate satisfactorily. This, in effect, limits the value added to society by the audits of the Office, as some issues relating to entities not audited are either not picked up, or are addressed with much delay, limiting the usefulness of any recommendations provided.

The Office did not have a strategic plan in place covering the period of the review, but one has since been developed, with the assistance of external consultants. The Office performs its audits in accordance with the International Auditing Standards and International Standards for Supreme Audit Institutions, so the foundation of the audits is satisfactory. However, in practice, in many cases there is not enough evidence in the working papers to support that these standards are indeed followed. For example, there is not always evidence for the calculation of materiality, risk assessment and sample selection. The audit planning documents are, in many cases, not detailed enough, and, most significantly, quality control (i.e. review of the working papers) is not evidenced in most cases. The quality of the work done is not consistent between Sections, highlighting the need for training and guidance. Also, the fact that quality assurance procedures are not in place makes it difficult for the Auditor General to ensure that Audit Guidelines and his instructions are followed adequately throughout the Office.

The main output of the Office is the Annual Report of the Auditor General, which is submitted to the President of the Republic and laid before the Parliament. Only a limited number of performance audits is carried out, and in fact even some of the issues addressed to as "performance audit issues" relate mainly to compliance audit findings. The Annual Report attracts a lot of media coverage and the issues raised therein are discussed extensively at

the Parliamentary Committee on Development Plans and Public Expenditure Control. The Office is highly regarded by the general society and the various stakeholders (i.e. the Parliament, the Executive, the media) and is perceived as performing work that contributes significantly towards transparency, accountability and the fight against corruption. The implementation of the recommendations of the Auditor General is not compulsory, however, according to a recent Act of Law, all auditees, when submitting their Budget for approval to the Parliament, have to also prepare a report indicating their actions with regard to the recommendations of the Auditor General.

Taking the above into account, the main areas of the PMF in which weaknesses were identified include performance audit results (Indicator SAI-3), the strategy for organizational development (Indicator SAI-8), overall audit planning and quality management (Indicator SAI-9), quality assurance and audit processes (Indicator SAI-10), the financial and compliance audit processes (Indicators SAI-12 and SAI-14), professional development and training (Indicator SAI-21) and the communications strategy and internal communication (Indicator SAI-22). These weaknesses stem from the absence of a strategic plan and quality assurance processes, weak audit planning and documentation procedures, the absence of a professional development plan for the Office staff and the need for a more structured communications strategy. The summarized scores of the assessment per indicator, with a maximum score of 4, are presented in the following table.

Indicator	Description	Score
SAI-1	Financial audit results	2
SAI-2	Compliance audit results	2
SAI-3	Performance audit results	1
SAI-4	Judgment results	N/A
SAI-5	Annual report and other reports	3
SAI-6	Independence of the SAI	2
SAI-7	Mandate of the SAI	3
SAI-8	Strategy for organizational development	0
SAI-9	Overall audit planning and quality management	0
SAI-10	Quality assurance and audit processes	0
SAI-11	Financial audit foundations	3
SAI-12	Financial audit process	1
SAI-13	Compliance audit foundations	3
SAI-14	Compliance audit process	1
SAI-15	Performance audit foundations	2
SAI-16	Performance audit process	2
SAI-17	Judgment process	N/A
SAI-18	Ethics, management and internal control	2
SAI-19	Asset management and support services	3
SAI-20	Human resource leadership and function	N/A
SAI-21	Professional development and training	1
SAI-22	Communications strategy and internal communication	1
SAI-23	Communication with the Legislature, the Executive and the Judiciary	3

Indicator	Description	Score
SAI-24	Communication with the media, citizens and civil society organizations	3

(ii) Recommendations

The major recommendations to deal with identified weaknesses in each of the indicators examined are as follows:

SAI-1: From the analysis of the data collected and considering the normal practice of the preparation and submission of the Annual Report, it is noted that the audits of each calendar year are completed at around the third quarter of the following calendar year, i.e. when the Annual report is submitted to the President of the Republic, and not by the end of the defined audit year. It is also noted that, more than a third of the audit year examined was used for the completion of audits included in the previous audit year plan. There appears to be a need to alter the audit year timeframe. Based on a recent review of the Office Auditing Guidelines, the audit year has been altered and it now begins on 1st October and ends on 30th September of each year.

In addition, it is suggested that, in all cases, even where significant findings do not arise, a report is prepared to document the completion of each audit. The Office will need to take more drastic measures to deal with statutory bodies with significant delays in the submission of their financial statements.

The inability of the Office to timely execute all audits assigned, is primarily due to its significant understaffing. This problem is expected to be temporarily dealt with by assigning a large number of audits of statutory bodies to the private sector, and in future, by reinforcing the Office with additional personnel. It is noted that, towards this direction, nine vacancies for the position of Audit Officer, have recently been announced (in December 2015) and are in the process of being filled.

SAI-2: According to the assumptions underlying the assessment, all audits carried out by the Office include elements of financial and compliance audit, and, therefore, the same recommendations which were made for Indicator SAI-1 apply.

SAI-3: The Office's involvement in other areas of public administration, the increase in the number of performance audits, the improvement of the process of selection of topics and its documentation, and in monitoring the implementation of the recommendations arising from performance audits, could contribute in the increase of the score of the Office for this Indicator. It is

noted that, during the audit year 2014-2015, audits have been conducted in the areas of defence (confidential), town and planning and management of Turkish Cypriot properties, while environmental audits in relation to the management of water resources and waste also commenced.

SAI-5: The score received could be improved if a process to compare results against the objectives of the Office was established and use was made of feedback from its stakeholders. We also recommend that the Office considers its involvement in evaluating the systems for generating national statistics, the privatization of statutory bodies, the country economic and financial environment etc., which are considered to add value to the services it offers.

SAI-6: To enhance the independence of the Audit Office, financial and organisational independence should be promoted. Legal immunity for the Auditor General should be adopted.

SAI-7: The current follow-up mechanism for pending audit issues could be improved, by designing a more proactive follow-up system.

SAI-8: The Office should proceed with the development of a strategic plan and draw up an annual plan based on its needs. Specifically:

(i) A strategic plan should be developed based on the requirements of the Office, which should cover the major functions of the Office and should identify the areas that need to be improved. The strategic plan should also include a framework and Indicators measuring the desired deliverables, identifying the work to be carried out, in order of importance, to achieve the goals of the strategic plan, while recognizing the risks that may arise in case of failure.

(ii) The strategic plan, which should be published, should be prepared by the Management of the Office, while giving all staff the opportunity to participate to a certain extent in its preparation. An annual monitoring process of the implementation of the strategic plan should be determined. The process of developing the plan should include clear responsibilities, actions and a timetable and should take into account the implementation of the previous strategic plan.

(iii) The annual plan should include:

- clearly defined activities, timeframes and responsibilities,
- all main support services, such as financial management, human resources management and training, computerization, etc.,

- a clear connection to the strategic plan,
- risk analysis,
- measurable results indicators, and
- baselines of current performance and milestones for major Indicators.

SAI-9: We recommend that, in the context of annual audit planning, the risk-based approach followed is documented, an indicative timeframe for carrying out the audits therein is prepared and the evaluation of the implementation of the annual plan at the end of each audit year is documented. Furthermore, the development of system evaluating potential risks for the non-implementation of the audit plan and the prioritization of work on a general level, in a manner that takes into account the need to maintain quality, will contribute in ensuring a standard of quality that is appropriate to the work of the Office. The review of audit work should be done against clearly established quality standards and should be appropriately documented. Finally, for purposes of applying the provisions of ISSAI 40, it is appropriate to establish a quality assurance system, in accordance with the detailed recommendations made for Indicator SAI-10.

SAI-10: For the purpose of the implementation of ISSAI 40, it is necessary to establish a quality management system of audits carried out by, or on behalf of, the Office.

According to the PMF, reviews of samples of completed audits should be performed at least annually, based on specified selection criteria, for the purpose of ensuring the quality of audit work. In accordance with the International Standards of Supreme Audit Institutions (ISSAI 40), the officers designated to select the sample for review and to conduct these reviews should be independent, i.e. not involved in the audit work or in any quality control process of the work.

According to the standard, it is imperative that there are written procedures and/or quality assurance programs for all types of audits carried out. These documents should determine the frequency of quality assurance reviews, which should be respected. The responsibility for the quality assurance procedures should be assigned to an officer or group of officers with sufficient and appropriate experience and authority in the Office. The review should result in clear conclusions and, where appropriate, include recommendations for corrective actions in case of deficiencies detected. The results should be forwarded promptly to the Auditor General, while the examination of the conclusions of the reviews should be documented by senior levels of management. In the context of the above activities and according to the provisions of ISSAI 40, the Office may consider the possibility of assigning the independent review of its procedures to a suitable external body.

In the case of assigning the performance of audits to third parties (e.g. hiring services), ISSAI 40 provides that policies and procedures should be established, providing reasonable assurance that the parties who carry out the audits comply with relevant ethical requirements and are bound by signing confidentiality agreements. The Office should also ensure, through its procedures, that the parties possess the necessary competence and are committed to the required ethical principles in order to perform the work of the Office in accordance with the relevant standards and legislation and assist the Office in issuing appropriate, under the circumstances, reports. It should be ensured that all documentation (e.g. working papers) is the property of the Office, regardless of whether the work is carried out by external auditors and that those entrusted with audit work operate an effective quality control system. The established procedures for the selection of firms/persons entrusted with audit work by the Office, should be based on their competence to carry out the outsourced audits and the Office should implement a system to prevent and manage conflicts of interest between the external auditor and the audited entity, which should be included in the written contract.

SAI-11 & 13: The Office can improve the quality and technical support offered to its audit officers by organizing more training seminars at regular intervals in collaboration with experts, and by allowing for more training time, within the capacity of the Office. Also, we recommend that the setting up of a quality control team is considered, which will examine, on a sample basis, the procedures followed and the working papers in order to ensure the quality of audit work. Alternatively, the assigning of this work to other Professional Bodies (e.g., ICPAC, ICAEW, ACCA) could be considered, while the assigning of independent review of the overall system of quality control (such as a peer review) to other Supreme Audit Institutions, at regular intervals (e.g. every 5 years) could also be considered.

Finally, we recommend that, wherever possible, an officer with a professional qualification in accounting should participate in the groups carrying out audits of financial statements which are prepared on an accrual basis.

SAI-12: As mentioned in chapter "Indicators SAI-11 and SAI 13", the technical support offered to the officers needs to be improved and strengthened in order to address the shortcomings presented above.

The documentation process of documenting audit work at all stages should be improved, in order to comply both with the applicable auditing standards, and the issued Auditing Guidelines. The Auditing Guidelines are in need of an update, which is expected to be addressed by their revision by the Working Group set up for this purpose. We suggest that, within the revision of the

Guidelines, quality assurance procedures are defined, as described in detail in chapter "SAI-10", in order to monitor compliance with the respective applicable auditing standards and Auditing Guidelines in all cases.

There is a need to provide adequate evidence in the audit planning documents of the understanding of the audited organization by the audit team.

The Office may consider the possibility of hiring expert services for further improvement of the audit procedures and the possibility of performing market research into financial audit manuals and audit software, in addition to the existing TeamMate software. In particular, we propose examining the possibility of utilising an audit software and manual, which would define the audit steps and would provide guidance on the audit work to be carried out in accordance with auditing standards, and the presentation of this work in the audit files. Also, there are audit software options and manuals which give guidance on the presentation of financial statements. It would also be useful to consider hiring services regarding to the establishment of sampling techniques. It is stressed that, as stated above the implementation of quality assurance procedures will be vital, so as to monitor the uniform application and use of the available software by the Office.

Auditors should evaluate whether or not uncorrected misstatements are material, individually or in aggregate.

Documentation procedures must be followed in all cases and, where applicable, we recommend that the processes of documenting audit work at the stages of planning, carrying out and completion of an audit, are distinct for each type of audit, such as financial, compliance and performance audit. Additionally, compliance with the procedures for the timely preparation and the format of the working papers must be documented at the completion stage. Moreover, audit reports must contain all required elements and auditors must provide adequate evidence that the audit opinion formed is based on evaluation of the conclusions drawn from the audit evidence obtained. As mentioned above, the revision of the Auditing Guidelines of the Office is currently in process. It is expected that many of the weaknesses mentioned will be addressed through the adoption of the revised Guidelines, some of which have already been put into practice. Specifically, revised Audit Guideline No. 1, which was put into effect on 24.7.2015, provides that, for the selection of audit areas and the audit scope (given the available man-days), the risk-assessment, the materiality level and the evaluation of internal control systems, should be taken into account, among other factors. In addition, a working paper should be prepared, containing the audit topics selected by the Section heads, in cooperation with the Directors of Audit/Senior Principal Auditors, to be audited during the planned audit. It is also explicitly mentioned in the Guideline, that the completion of the programs should be done electronically using the TeamMate software.

Further specific recommendations arising from the sample examined, for each dimension tested, are listed below:

(i) Planning financial audits.

- The standard audit programs should be improved so that the planned audit procedures are in line with the risk assessment and address the risk of fraud and non-compliance with laws and regulations.

(ii) Implementing financial audits.

- The approval and implementation of the standard program prepared for statutory bodies will facilitate the application of uniform audit procedures.
- The final signed financial statements (together with the independent auditor's report) the letter of representations, the letter of pending legal cases, as well as the final management letter should be included in the audit file, with references to the audit work done.
- In cases where planned audit procedures are not performed, relevant explanations should be recorded in the working papers, properly reviewed by the Section Heads.

(iii) Evaluating audit evidence, concluding and reporting in financial audits.

- The guidance regarding the form and content of working papers (in printed and/or electronic form) should be revised so as to ensure uniformity and quality in presenting and assembling audit findings, and their summary in a way that the expressed audit opinion, where an auditor's report is issued, is verified. At the same time, it is necessary to specify the requirements for numbering and referencing of working papers, in order to facilitate their review and improve the audit file presentation.
- In order to substantiate the audit opinion, the preparation of a working paper with the audit conclusions and the duly documented opinion on the financial statements, would be useful.
- In cases involving independent auditors, there should be an established procedure that ensures the process of reviewing their work, in accordance with auditing standards.
- A working paper with all the adjusting entries should be recorded in the audit file. Also, uncorrected misstatements that were identified during the audit should be collectively evaluated based on their aggregate materiality.
- The review of the audit work by the Section Heads should be adequately documented. Additionally, where the audit is carried out with the use of

TeamMate software, the process of electronic "completion" of the audit should be followed, so that no changes are permitted in the final working papers.

- It would be good practice to complete Part II of the Audit Planning form(AO7), in which the date of the audit completion, and any discrepancy between the actual and budgeted man-days, as well as relevant comments, are recorded. As a result, information will be included in the audit file regarding the implementation of the plan, which is necessary for the evaluation of the audit and/or of the auditors, as well as for planning the following audit.
- Where there no significant audit findings, we recommend that a letter is sent to the audited entity, informing them, in writing, of the completion of the audit and of the fact that there were no significant observations.

SAI-14: The weaknesses concerning risk assessment and the determination of the materiality level is expected to be resolved with the implementation of the revised Audit Guideline no. 1, regarding audit programs, which was put into effect on 24.7.2015.

As mentioned in chapter "SAI-11 and SAI-13", the technical support offered to officers needs improvement and strengthening.

The Office may consider the hiring of expert services and encourage cooperation with other Supreme Audit Institutions, in order to improve the audit procedures further.

Also, we recommend that, during the review of the Auditing Guidelines, quality assurance procedures in relation to compliance audits should be established, as described in detail in chapter "Indicator SAI-10", so that, in all cases, compliance is monitored, with the Auditing Standards and Auditing Guidelines.

Where possible, we suggest that the documentation procedures of audit work at the stages of planning, performance and completion of an audit, are distinguished into the different types of audit, i.e. financial audit, compliance audit and performance audit.

Additional specific recommendations arising from the sample assessment, for each dimension examined, are listed below:

(i) Planning compliance audits.

- The standard audit programs should be improved so that the planned audit procedures comply with the risk assessment and address the risks of fraud and non-compliance with laws and regulations. Also, the audit strategy

should include, inter alia, the main audit areas and the relevant legislation to be examined.

- Procedures for informing the Sections regarding the work carried out by the Directorate of Technical Audit should be established.

(ii) Implementing compliance audits.

- Where planned audit procedures are not carried out, justified explanations should be recorded in the working papers, properly reviewed by the Heads of the Sections.

(iii) Evaluating audit evidence, concluding and reporting in compliance audits.

- The review of the audit work by the Section Heads should be adequately documented.
- It would be good practice to complete Part II of the Audit Planning Form (AO7), in which the date of audit completion, any discrepancy between actual and budgeted man-days, as well as relevant comments would be recorded.
- Where there are no significant audit findings, we recommend that a letter informing the audited entity that the audit was completed and no significant observations were identified, is sent.

SAI-15: The Audit Office should take strategic decisions in relation to performance audits. With advice from experts it can shape policies and principles for the implementation of these audits, as well as improve the quality and technical support and training offered to audit officers. It is suggested that, at a later stage, purposes, visits by other Supreme Audit Institutions (SAIs) for quality monitoring, is planned at regular intervals (e.g. every three years).

SAI-16: We recommend that an activity plan is prepared for each performance audit, specifying the budgeted days, the timeframe for carrying out the audit, and the members of the audit staff who will be conducting the audit. Performance audit reports should make reference to the auditing standards used and in addition, the follow-up procedures should be formally documented.

SAI-18: The Office should establish an effective system of ensuring compliance with the Code of Ethics and determine corrective actions to be taken in case of non-compliance. The establishment of a periodic rotation

policy for staff will contribute in avoiding potential conflicts of interest and it would be useful to assess the vulnerability and resilience of the Office to violations of the principle of integrity.

Dealing with the weaknesses regarding the documentation of the review of the audit work, as explained in chapter SAI-12, the evaluation of the internal control environment and the establishment of clearly defined system for identifying, mitigating and monitoring major business risks, would help to further improve the performance of the Office in relation to this Indicator.

SAI-19: The Office may delegate responsibilities for asset management and administrative support functions to a Committee, which would meet at least annually and study suggestions for improvements, proposed either by its members or others. The Committee's decisions should be supported by financial and qualitative data, properly documented. Important decisions could be included in the Annual Report, for transparency.

SAI-20: We suggest that a procedure for holding (e.g. monthly) management meetings for decision-making purposes is established. Additionally, we suggest that periodic meetings of the management with all staff are held, e.g. on a quarterly basis or at a frequency deemed necessary, in order to inform the staff about issues the Office is confronted with and to timely communicate management decisions which have a direct impact on staff (e.g. decisions of announcing vacancies, staff secondments to other Services, proposed changes in the structure of the Office etc.). It would be important to develop training strategies for professional development and incentives for improving staff performance, as well as to define key indicators in relation to human resources and establish a monitoring system to assess annually the achievement of the targets in the human resource strategy.

SAI-21: It is recommended to develop and implement an annual plan for professional development and training, which will be in line with the strategic objectives of the Office. The plan should be based on training needs of staff, identified in the annual staff appraisals, and be linked to training needs of the audit teams within the Office.

SAI-22: We recommend the establishment of a formal communications strategy plan, which will be assessed at regular intervals by the interested parties, with respect to its effectiveness. In this way, the communications strategy will be continuously adjusted and improved.

We also suggest that the Audit Office reviews the existing internal communication procedures and sets up regular management meetings, as well as regular organizational and unit-wide briefings to middle and lower level staff. Internal communication procedures should include elements for effective two-way communication throughout the Office.

SAI-23:

- (i) The Audit Office should ensure that is not involved or seen to be involved, in any manner, in the management of the organizations they audit.
- (ii) The possibility of adopting a formal procedure of receiving feedback from the Judiciary and the Executive, in matters relating to the role and the work of the Audit Office, should be considered.

SAI-24: We recommend that the establishment of a strategy/plan regarding communication with the media, the public and other interested parties is considered. This should be monitored and evaluated on a periodic basis and include a process of feedback from citizens on the issues of the Office reports, with the aim to improve the recommendations and to increase the degree of their acceptance and adoption.

(iii) SAI Management Use of Assessment Results

As mentioned above, the Auditor General initiated the self-assessment exercise primarily aiming to identify opportunities to strengthen the performance of the Office relative to the ISSAIs and establish a baseline against which future performance can be measured. Following the submission of the draft report to the Auditor General, the findings and recommendations included therein have been diligently considered and discussed with middle and higher management levels, and corrective action has been designed and implemented for many weaknesses that came forward from the assessment exercise. The Office management is still in the process of studying potential remedial action to be taken to address all performance areas that have received low scores. Furthermore, the peer review currently in progress helps to assess the effectiveness of action already taken with a view of improving the Office's performance.