



National Audit Office

Peer Review

10 December 2013

Swedish National Audit Office

Peer Review Report

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Summary

1 The Swedish National Audit Office (SNAO) constitutes one of the major elements of the parliamentary control system within the Swedish Government. The SNAO carries out two main audit functions, Performance Audit and Financial Audit¹.

2 The SNAO asked the UK National Audit Office (NAOUK) to lead a Peer Review, examining its approach to delivering audit outputs, in autumn 2011. The NAOUK, in turn, asked the Finnish National Audit Office (NAOF) to assist with the Peer Review.

3 The Peer Review team was led by Nick Bateson; and consisted of Rebecca Sheeran, Steve Mirfin, Lewis Knights and Matt Kay from the NAOUK; and Visa Paaanen and Arto Seppovaara from the NAOF.

4 The Peer Review was carried out in accordance with the Memorandum of Understanding that was signed by the SNAO, NAOUK and NAOF in spring 2012; and sought to answer the question:

- Considering national legislation, international standards and internal regulation, is the SNAO's audit quality control system appropriate, well-functioning and well managed, creating the prerequisites for high quality audits?

5 The Peer Review focussed on assessing the organisational approach to delivering Performance and Financial audits across the SNAO; and compliance of the Performance Audit and Financial Audit work streams with the SNAO's quality processes and International Standards².

Peer Review Conclusion

6 **The SNAO is a high quality Supreme Audit Institution that is well managed and controlled.** The SNAO has a good understanding of its governing International Standards for Supreme Audit Institutions for Performance Audit and applies them consistently to produce high quality outputs. However, the SNAO needs to invest in its Financial Audit practice to generate the maximum possible value from this work stream and demonstrate that it complies fully with International Standards on Auditing, as detailed in International Standards for Supreme Audit Institutions.

¹ The SNAO also carries our International Development Cooperation work. Due to the nature of International Development Cooperation work it is outside of the scope of this Peer Review.

² A detailed methodology is set out in Section 5.

Overall findings

7 The overall findings of the Peer Review are as follows:

On the organisational approach to ensuring quality Performance and Financial Audits

- **The Auditors General manage the SNAO effectively.** The SNAO has three Auditors General, which is an unusual leadership structure for a Supreme Audit Institution. This structure is designed to provide diversity in the approach to the delivery of the SNAO's work. While we found some differences in the approach to Performance Audits that are carried out for each Auditor General, this did not affect their quality (paragraphs 2.3 to 2.9).
- **The SNAO's strategy is clear and understood by its staff, but it needs to develop its strategic approach to Performance and Financial Audits further to demonstrate that it is covering the financial risks faced by the Swedish Government sufficiently.** The focus of the risk analysis for Performance Audits and the current Financial Audit approach implies a risk that the SNAO is not covering Swedish Government finances sufficiently (paragraphs 2.10 to 2.14).
- **The culture of the SNAO assists in ensuring high quality audit work.** Staff are committed, work well together and are open to challenge and new approaches to the delivery of work. This helps to generate a culture of continual improvement, which is a key factor in an effective quality control system. However, the SNAO needs to ensure that Financial Audit has a sufficiently high profile within the organisation to gain the most value from the on-going development of the work stream (paragraphs 2.15 to 2.21).
- **The SNAO's current delivery capacity is likely to be insufficient for the future needs of the organisation.** The investment in Financial Audit methodology and practice that is required to enable the SNAO to demonstrate compliance with International Standards will cause delivery tensions for the SNAO. This presents a significant challenge to the Auditors General in the short to medium term (paragraphs 2.22 to 2.25).

On Performance Audit

- **The SNAO's Performance Audit Function meets the demands of International Standards.** The SNAO can continue to focus on maximising the influence of its Performance Audits across the Swedish Government system, rather than on compliance with the International Standards (paragraphs 3.5 to 3.7).
- **There is a need for greater consistency in the SNAO's documentation approach to individual Performance Audits.** We found differences in the approach to documentation and control of information within individual

Performance Audit files (paragraphs 3.8 to 3.9).

- **The SNAO has the opportunity to further improve its Performance Audit methodology and increase the efficiency of the approach.** The SNAO's approach to identifying audit topics is complex and involves multiple processes. The SNAO's Performance Audit Handbook would benefit from greater clarity and more consistency (paragraphs 3.10 to 3.15).

On Financial Audit

- **The SNAO needs to demonstrate clearly that its Financial Audit methodology is fully compliant with International Standards.** The SNAO started implementing International Standards on Auditing in its 2011 audit cycle and has made substantial progress since then. We found good practice in the SNAO's understanding of its clients; approach to designing responses to identified audit risks and communication with audit clients. However, we also found that the SNAO needs to develop its policies to translate the requirements of the Standards into a fully consistent audit approach; improve the focus and rigour of its risk assessment processes; enhance its approach to materiality; and gather more detailed evidence to support its Financial Audit opinions (paragraphs 4.4 to 4.11).
- **The SNAO should seek to generate greater impact from its Financial Audit practice.** The SNAO's current audit approach does not focus sufficiently on the areas of greatest financial risk within the system or within individual organisations. This reduces its impact and also affects the SNAO's ability to draw all relevant conclusions on the overall state of financial controls across the Swedish Government (paragraphs 4.12 to 4.16).
- **The SNAO's approach to auditing Performance Reports and Controls Statements needs to be revised.** Currently the true and fair opinion that covers these elements is not supported sufficiently by the audit work that is carried out. The SNAO is working with its audit clients and stakeholders to address this issue (paragraphs 4.20 to 4.22).
- **The SNAO's current Financial Audit approach assumes a very high level of reporting accuracy across the Swedish Government sector, equivalent to best practice in financial control.** The SNAO's current Financial Audit approach needs to test this assumption more robustly. This can be achieved by reducing the inconsistencies in the identification of audit risks and addressing the gaps in its core assessment and audit of controls, balances and transactions (4.26 to 4.30).
- **The SNAO needs to invest in its Financial Audit documentation package.** Its current package, 'The Tool', is a barrier to the effective implementation of International Standards. The SNAO has the opportunity to use its upcoming investment in a new package to accelerate its development of its audit methodology significantly (paragraphs 2.26 to 2.28).

Recommendations

8 At the organisational level, the SNAO should:

- **Engage with its staff and stakeholders to ensure it understands fully the areas of greatest financial risk within the Swedish Government system.**
This should cover the nature of the organisations that operate within the system; the control environment within these organisations; the inherent materiality and complexity of particular transactions streams and balances; and the level of public interest. Once this is complete the SNAO should review Performance Audit work plans and its Financial Audit approach to ensure that it is systematically covering the areas of greatest risk.
- **Invest in its Financial Audit approach, staff training and IT infrastructure to facilitate full compliance with International Standards and generate improvements in its ability to identify and audit financial risks and controls.** This investment will require a significant increase in its Financial Audit capacity in the short term, but will increase the SNAO's knowledge of its audited bodies and improve the value of its audits.

9 With regard to Performance Audit, the SNAO should:

- **Promote consistency in the application of its Performance Audit documentation approach.** This will ensure there is a common understanding of the required documentation standards within all Performance Audits.
- **Drive further improvements in its Performance Audit practice.** This will help to continue the process of enhancing the Performance Audit practice and the overall effectiveness of the work stream.
- **Review its Performance Audit Handbook with the aim of generating efficiencies in the audit process.** This should focus initially on the planning and pre-study phases; and introducing a clearer separation between the identification of audit topics and assessment of the areas of interest within them.

10 With regard to Financial Audit, the SNAO should:

- **Focus, within each audit, on articulating carefully the financial statement risks that exist and how to test them most effectively via controls testing, analysis supported by corroborative enquiry, predictive testing and detailed testing.** This will help to target the Financial Audit effort into the areas of greatest significance and will enable the SNAO to use its Financial Audit practice to assess the operation of financial controls across the Swedish Government system effectively.
- **Continue to review its application of its Financial Audit methodology to ensure that it is demonstrating compliance with International Standards.** This should cover its documentation of audited entities' operations, control systems and financial position; approach to materiality; structure of its audit

opinion; and approach to testing individual transaction streams and balances.

- **Develop policies that translate International Standards into a consistent approach to delivering its Financial Audits** This should specify the SNAO's approach to controls work, analytical work, predictive testing and detailed testing.
- **Continue its drive to revise the approach to auditing Performance Reports and Controls Statements.** There is currently a gap between the work that is done on these areas and the audit opinion that is granted which needs to be closed. This provides the opportunities for generating efficiencies in the audit approach which can offset some of the investment that is needed.

Introduction

Swedish National Audit Office operational context

Functions of the Swedish National Audit Office

1.1 The Swedish National Audit (SNAO) has been in place in its current form and structure since 2003 and constitutes one of the major elements of the parliamentary control system within the Swedish Government.

1.2 The SNAO is led by three Auditors General appointed by the Riksdag. The Auditors General: Claes Norgren, Jan Landahl and Gudrun Antemar³, are jointly responsible for the work of the SNAO. Claes Norgren is appointed by the Riksdag as the Auditor General with responsibility for the administrative management of the office.

1.3 The main task and focus of the SNAO in its current form is to ensure effective use of resources and administration within the Swedish Government. It has a mandate that enables it to conduct independent audits of central government activities. The SNAO has three key operational functions, Performance Audit, Financial Audit and International Development Cooperation⁴, which are currently managed as separate work streams.

Performance Audit

1.4 Performance Audit is designed to scrutinise central Government activities and submit recommendations to increase the efficiency and quality of these activities. The SNAO carried out 27 Performance Audits during 2012 and plans to deliver up to 30 reports during 2013.

Financial Audit

1.5 Financial Audit involves the audit of financial reports that are produced by the State; Government Offices and agencies under the Riksdag and the Government; the Riksdag administration; and the Palace Administration. The aim of Financial Audit is to provide an opinion as to whether these financial reports present a true and fair view of the activities of each organisation that is subject to audit. In 2012, the SNAO carried out 251 Financial Audits and aims to deliver the same number during 2013.

³ Gudrun Antemar left the SNAO on 14 October, but was in post during the fieldwork for the Peer Review.

⁴ Due to the nature of International Development Cooperation work, which is developmental and is not designed to provide assurance to the Riksdag on the operations of the Swedish administration, it is outside the scope of this report.

International Development Cooperation

The SNAO's International Development Cooperation work contributes to good administration in partner countries by strengthening parliamentary control and the capacity of Supreme Audit Institutions to perform audits. The SNAO is engaged in International Development Cooperation in Africa, Asia and Europe.

The scope of the Peer Review

1.6 The SNAO asked the NAOUK to lead the Peer Review in autumn of 2011. The scope of the Peer Review was agreed in spring 2012 in the Memorandum of Understanding, which was signed by the SNAO, NAOUK and NAOF. To supplement the Memorandum, we produced a Peer Review Strategy, which was agreed in January 2013.

1.7 The Peer Review approach was designed to answer the following question, specified in the Memorandum of Understanding:

- Considering national legislation, international standards and internal regulation, is the SNAO's audit quality control system appropriate, well-functioning and well managed, creating the prerequisites for high quality audits?

1.8 To address this question, we assessed

- The overall strategic management of the SNAO; its capability and resources; and the quality control procedures in place across the organisation.
- The methodologies applied to the Performance Audit and Financial Audit work streams to assess whether they are compliant with International Standards.
- A sample of three Performance Audits and three Financial Audits to test compliance with the SNAO's procedures and International Standards, the evidence collected to support each audit and whether the reporting in each case was appropriate.

1.9 The detailed methodology we applied to carry out the Peer Review is set out in more detail in section five of this report.

1.10 This report details the findings in three sections covering the organisational approach to ensuring quality across the SNAO; Performance Audit; and Financial Audit. The Financial Audit section of the report is more detailed than the Performance Audit section. In general, we had more findings on the application of standards Financial Audit than Performance Audit. This is due to three factors, the recent reviews of the SNAO's Performance Audit work stream; the current status of the SNAO's implementation of International Standards in Financial Audit; and the relative scope and complexity of the Financial Audit standards in comparison to Performance Audit framework, which meant that our work on Financial Audit had a more technical and compliance focus.

Organisational approach to ensuring quality

2.1 A well designed system of internal quality control starts from the top of the organisation and flows down through the systems, processes and controls that are in place throughout the work streams that are carried out.

2.2 To assess the overarching quality control framework in place at the SNAO, we examined:

- the role of the Auditors General;
- the clarity of the strategy in place in the SNAO, which acts as the framework for Performance Audit and Financial Audit;
- the management structures within the SNAO and their impact on Performance Audit and Financial Audit;
- culture and staffing of the SNAO; and
- the resources of the SNAO and whether they support audit delivery.

The role of the Auditors General

2.3 The SNAO's leadership structure is unusual for a Supreme Audit Institution. The SNAO has three Auditors General appointed by the Riksdag. The Auditors General are jointly responsible for the strategic direction and management of the organisation, but have a duty to determine independently what is to be audited, how audits are to be conducted and what conclusions are to be drawn within their specific areas of responsibility.

2.4 This structure is designed to ensure a diversity of views at the top of the organisation to feed into the approach to delivering work. Most other comparable Supreme Audit Institutions do not have this structure. They have one appointed Auditor General, responsible to Parliament for the scope of the audits and the conclusions, supported by senior managers that have functional responsibility for the delivery of work and are accountable to the Auditor General.

2.5 The SNAO's leadership structure succeeds in providing different views at the top of the organisation. It ensures a variety of different perspectives on the areas of significance to the SNAO and approaches to the delivery of work. However, there is the potential for this structure to result in inconsistencies in the scope of the audits that are carried out and the methodologies that are applied. This is particularly the case in Performance Audit where there is greater freedom in the topics that are chosen, the

work that is carried out and the nature of the outputs that are produced. Financial Audit follows a structured process and is less judgemental. Therefore, there is less scope for significant divergence in the approach to Financial Audits carried out under each Auditor General.

2.6 To address this risk, the Auditors General have used the SNAO's work on Strategic Intelligence⁵ to agree ten areas of focus within the Performance Audit work stream, called Audit Strategies, which are presented in the SNAO's Annual Audit Plan⁶. These cover the following areas:

- public finances;
- infrastructure on new terms;
- defence capabilities;
- sustainable development - climate;
- the Government in the market;
- employment and integration;
- Government healthcare initiatives;
- Government initiatives in the field of education;
- robust pensions; and
- citizens and the administration.

2.7 These strategies help to ensure that the Auditors General agree on the overall direction of the organisation. However, there remains the possibility that the individual Auditors General could adopt different approaches to the delivery of work within them.

2.8 We assessed this by comparing the processes that are applied to Performance Audit in each of the Auditors General's areas of responsibilities. We found that there was some divergence in the approach taken by teams, particularly in documentation as detailed in section three of this report, but we were able to conclude that this did not impact upon the quality of the work that was carried out significantly.

2.9 We also assessed the operational effectiveness of the SNAO's senior management structure and the ways in which the Auditors General work with SNAO staff. We found that that the Auditors General work well within the restrictions of the structure they are required to operate, engage effectively with staff and have the appropriate tools with which to manage the organisation. Overall, we found the SNAO

⁵ Strategic Intelligence is the SNAO's approach to identifying the wider events in the Swedish Government of significance.

⁶ Reference: Swedish National Audit Office Annual Audit Plan.

to be a well-managed and controlled organisation and that the current management structure, though unusual, does not impact upon quality.

The SNAO's strategy

2.10 The SNAO's overall strategy is set out in its Strategic Plan 2012-2015 and is updated annually. The strategy provides a clear articulation of the vision for the SNAO, which is to contribute to the sound use of public resources and effective and efficient public administration⁷. Flowing from this strategic vision are the SNAO's stated objectives of ensuring that the public has confidence that it will identify areas of deficiency in the delivery of central government; and that its audits will deliver improvements in public services.

2.11 During our work, we found that this strategy was understood by SNAO staff. We also found that the SNAO, through its strategic intelligence and planning processes, has a clear view of the influences on the Swedish Government system and the pressures within it. However, our review of the contents of the Strategic Plan and the Annual Audit Plan found that the SNAO has not taken the step of articulating the financial risks within the system and the impact on government spending. For example, we found that the Audit Strategies, detailed in paragraph 2.6 above, and the audit topics selected within them are focussed on wider issues within the Swedish Government. This is a sensible approach that ensures that the SNAO engages with wider issues of relevance to the Swedish Government and produces Performance Audit products covering them. However, the links to issues related to Government finances could be more explicit within the SNAO's Audit Strategies and selected audit topics to demonstrate its thinking in this area clearly.

2.12 This gap in financial analysis of the whole of system is also reflected in the approach that the SNAO takes to its audits. In our sample of Performance Audits we found that only one of the three audits could be directly linked to Government Finances. In addition, in our sample of Financial Audits we found a lack of consideration of the relative financial risks individual organisations represent, due to the complexity of the transactions or the relative quality of controls that are in place. This translated into similar audit approaches being taken in each entity.

2.13 Swedish Government activities are generally well controlled, have a history of transparency and accountability and are not subject to a particularly marked risk of fraud, manipulation or financial mismanagement. However, there are areas of weakness in any financial system. Overall, we have concluded that there is a need for greater focus within the SNAO's strategy on ensuring that it is gathering sufficient evidence over the use of public funds within the areas of greatest financial risk in the Swedish Government system. This is particularly significant for the SNAO in Financial Audit as it could be exposed to potentially significant reputational damage if significant

⁷ Reference SNAO Strategic Plan 2012-15.

fraud or mismanagement of funds was uncovered in an area of the Swedish Government that had been given a clean audit opinion.

2.14 To address this, the SNAO needs to work with its stakeholders to explicitly consider and document its assessment of the areas of Government finances that represent greatest risk and ensure that it addresses them appropriately. The SNAO should then ensure that it tests these areas systematically through its Performance and Financial Audits and revises its assumptions accordingly depending on the results of this testing. This is a key step in ensuring that it can demonstrate that it provides sufficient assurance on financial risk within its broader audit mandate.

Management structure

2.15 In January 2013, the Auditors General introduced a revised structure to the SNAO that separated Performance Audit and Financial Audit into two management areas. This structure was introduced to professionalise the Performance Audit and Financial Audit work streams and ensure they are both given sufficient resources.

2.16 This management structure has the benefits of ensuring that the Performance and Financial Audit communities have distinct identities and that the accountability for them is clear. However, there is a risk in this structure that Financial Audit is not given sufficiently high priority within the SNAO. This arises because of the Auditors General's responsibilities for presenting Performance Audit reports to the Riksdag, which means that Performance Audit requires a greater proportion of their time and engagement.

2.17 As the findings in the Financial Audit section below show, the SNAO needs to increase its investment in its Financial Audit work stream to ensure it gets best value from the work that is done; demonstrates compliance with the requirements on International Standards on Auditing; and is delivering the work consistently across the organisation. The returns on this investment will be greater impact from Financial Audit and more effective identification of systemic issues and risks that are of concern. These returns will only be maximised if Financial Audit is given sufficient time and consideration by the Auditors General and senior management. Therefore, the Auditors General need to consider the level of engagement they need to have in this process, while maintaining their necessary focus on Performance Audit.

Culture and staffing

2.18 Two key aspects of an effective system of quality control are the culture of the organisation⁸ and that the effectiveness of the Human Resources processes that ensure that there is sufficient high quality staff within the organisation with the competence, capability and commitment to deliver⁹. To test these aspects we

⁸ ISQC1 paragraph 18, ISSAI 40 paragraph 6 (a)

⁹ ISQC1 paragraph 29, ISSAI 40 paragraph 6 (d)

assessed the tone established by the Auditors General at the top of the organisation and whether this is transferred to its staff; and the quality, commitment and engagement of the staff that work on the audits within the sample.

2.19 It is clear from our work that the Auditors General have established a culture within the organisation that facilitates high quality work. This is shown through:

- The openness throughout the organisation, with particular reference to the flat management structure and the clarity, frequency and tone of the communications within audit teams and up and down the grades.
- The continued learning within the organisation as demonstrated by the practice of seeking regular external opinions on the quality and impact of work; the hot and cold review processes; and the willingness within the teams subject to the Peer Review to develop from the experience.
- The level of awareness of the areas for improvement within the SNAO's audit approach across the organisation.

2.20 The SNAO has a range of very highly qualified and committed staff to draw upon and a culture of training and developing its staff. On the Performance Audit side, the quality of the research, development and management skills is high. However, as detailed previously, there is a need for additional focus on holding organisations to account via assessment of financial analysis and risk.

2.21 On the Financial Audit side, we found Financial Audit staff to be well informed of the organisations they are auditing; have effective working relationships; and be committed to improving their skills and experience. This will stand the Financial Audit work stream in good stead as it continues to progress its implementation of International Standards. However, investment is needed to ensure that all Financial Audit staff have a consistent understanding of the requirements of International Standards, and that they can apply them effectively. This is demonstrated by the improvements in the methodology and its application that are set out in section four of this report.

Resources

2.22 In order to achieve high quality work, any audit institution needs to have sufficient resources. We found that the level of capacity the SNAO has to succeed in its strategy may not be sufficient for its future development.

2.23 The SNAO's operating cost for 2012 was SEK360,942k, of which some SEK152,482k relates to Performance Audit and SEK141,370k relates to Financial Audit, with the remainder related to International Development Co-operation¹⁰ and

¹⁰ International Development Co-operation work is funded separately from domestic Financial and Performance Audit work by the Riksdag

central administration. The SNAO operates to a fixed budget and the Auditors General are responsible for allocating the resources between the SNAO's main work priorities.

2.24 As the findings in section four of this report show, the SNAO needs to invest in its Financial Audit work stream in the short term. This will require investment in Financial Audit training, staff development and IT infrastructure; together with an increase in the basic level of assurance that is needed on all financial audits to demonstrate full compliance with International Standards.

2.25 This investment should result in savings and efficiencies in the medium term as the changes become embedded and the SNAO becomes more streamlined at the delivery of Financial Audit. However, due to the fixed budget the SNAO operates within, without an increase in the capacity of the organisation, the Auditors General will need to identify significant operational efficiencies. These tensions and prioritisation decisions present a significant challenge for the Auditors General in the near term.

IT infrastructure

2.26 One of the key planks of infrastructure for any audit institution is the documentation package that it uses to demonstrate compliance with its internal process and procedures; and collate and evaluate the evidence it has gathered in support of its audit opinions. This is again particularly important for Financial Audit, as the documentation package is the primary mechanism by which compliance with International Standards can be demonstrated.

2.27 The SNAO has historically used an internally developed package called 'The Tool' to document its Financial Audit processes. This package was sufficient for its purposes prior to the introduction of International Standards. However, this implementation has required a number of additions, modifications and adjustments to The Tool to enable the SNAO to demonstrate that it is working within the guidelines. Following our review of the sample of Financial Audits, it is clear that the SNAO needs to invest in a revised documentation package, which will provide the consistency it now needs in its documentation of Financial Audits.

2.28 The Financial Audit teams we engaged with were frustrated with the rigidity of The Tool and our review of audit documentation demonstrated that there was a need to revisit the standard templates the SNAO issues to support its Financial Audit teams. This will help the SNAO to ensure that the revisions to its methodology to support the implementation of International Standards are linked through to its documentation system to facilitate efficient and effective audit. The SNAO is addressing this and is seeking an appropriate IT solution. To gain the maximum benefit from this process it needs to be aligned with improvements in its audit methodology, detailed in section four of this report.

Performance Audit

3.1 The objective of Performance Audit in the SNAO is to promote the optimum return on resources within the Swedish Government, having regard to the public interest.

3.2 The SNAO has agreed the following objectives for Performance Audit¹¹:

- the focus of each audit should be relevant and interesting;
- the audit must be of a high standard; and
- the audit must achieve a high standard of efficiency and effectiveness.

3.3 To assess whether the SNAO's approach to Performance Audit produces high quality outputs, under a suitable internal control system, we covered the following areas via a sample of three audits:

- Compliance of the SNAO's Performance Audit Handbook, methodological framework and processes with International Standards for Supreme Audit Institutions.
- The quality and consistency of the documentation in support of the findings and conclusions for each Performance Audit.
- The efficiency of the approach to Performance Audit.

3.4 In addition, we also identified improvements that could be made to the overall Performance Audit approach within the SNAO.

Compliance with ISSAIs

3.5 The primary purpose of the Peer Review, with reference to Performance Audit, was to assess the appropriateness of the SNAO's internal quality review processes and compliance with International Standards. In the case of Performance Audit, the applicable standards are the International Standards for Supreme Audit Institutions (ISSAIs).

3.6 In our review, we were able to conclude that the SNAO meets the requirements of the ISSAI standards. As a result, the SNAO can afford to focus on generating maximum influence across the Swedish Government from its Performance Audits rather than compliance with ISSAIs.

¹¹ SNAO Annual Report 2012 page 16

3.7 We were particularly impressed by the SNAO's approach to collecting the opinions of external experts on its work. The Peer Review is one indication of this, but we found that the SNAO commissions external reviews and studies of its Performance Audit reports on a regular basis. The information that the SNAO has collected on its own work has provided a good basis for the development of the Performance Audit function. This openness to external input and drive to improve will stand the organisation in good stead for increasing its influence across the Swedish Government into the future.

3.8 We found one particular issue with regard to the ISSAIs that the SNAO should address, which is the uniformity of the SNAO's approach to documentation of its Performance Audits. Documenting audit observations in electronic workspaces, which is the approach that is encouraged in the ISSAIs and is documented in the SNAO's Performance Audit Handbook, is best practice from the perspective of quality assurance. However, we found that the guidelines in the SNAO's Performance Audit Handbook are not always adhered to. The documentation of observations followed different approaches in individual audits, rather than following the standard structure that is set out in the Handbook.

3.9 Though we did not find any particular deficiencies in the documentation of audit observations in our sample, the lack of consistency in the collation of findings suggests that the level of control that is exercised by the SNAO over the audit teams' approach to documentation should be enhanced. This is a common problem in Performance Audit and can be addressed simply by enforcing the controls over documentation standards and focussing performance auditors' attention on the need for a consistent approach via training.

Areas for improvement in the Performance Audit work stream

Identifying Performance Audit topics

3.10 As set out in section two, the SNAO uses its strategic intelligence process to identify the areas of overall focus within Performance Audit work stream, called Audit Strategies. These are set out in the SNAO's strategy and annual audit plan¹². These Audit Strategies are then used as the framework upon which the SNAO selects individual audit topics. This is sensible approach that ensures that the SNAO engages with the wider issues in the Swedish Government and produces audits of relevance to address them.

3.11 However, the selection of individual audit topics from within the Audit Strategies is complicated and could be streamlined while maintaining its quality. The selection of individual audit topics is based around a risk analysis process, which divides an

¹² Swedish National Audit Office Annual Audit Plan 2012-13.

individual audit proposal into separate processes and then determines within each process how well it lends itself to an audit. This is a comprehensive and extensive exercise, which involves multiple stages and results, in many cases, in all of the essential facts being known before an audit proceeds.

3.12 This process could be simplified by provide a clearer break between the analysis required to select Performance Audit topics within an Audit Strategy and the planning of work in individual selected topics. This would increase efficiency by enabling audits to be put forward for approval by the Auditors General on either a six monthly or yearly cycle. This would have the benefit of providing a clearer more cyclical planning horizon for the SNAO; and a more focussed risk assessment process on individual pre-selected topics adding efficiencies to the process. Redesigning this approach would provide the opportunity for the SNAO to identify reductions in the overall cost of its planning cycle.

The Performance Audit Handbook

3.13 The SNAO has a long tradition in the field of Performance Audit, which is clear from the Performance Audit Handbook. The Handbook has evolved in an environment in which audits have been conducted over an extended period. Therefore, as expected, we found that the guidelines are generally effective and provide the Performance Audit work stream with useful technical guidance, facilitating high quality audit outputs. However, this incremental development of the Performance Audit Handbook has resulted in a lack of consistency and overly complex processes in some areas, particularly in the planning cycle, as identified above.

3.14 One particular area of the Handbook that would benefit from revision is the working definition of Performance Audit. Having a common understanding of the definition of Performance Audit helps to ensure that the work stream is coherent and that the approach to identifying, assessing and reporting on audit areas is consistent. This is particularly important for the SNAO because it is introducing a revised quality assurance process for Performance Audits, based on colleague reviews. This increases the number of individuals involved in the quality assurance process, which will create a broader range of opinions on what constitutes an effective Performance Audit

3.15 During our work we found a lack of clarity in the detailed description of Performance Audit in the SNAO's Performance Audit Handbook, setting out its unique features and how it differs from other research based activities. The SNAO can address this by consulting with its staff and stakeholders to ensure that there is a common understanding of the value that Performance Audit can have in the Swedish Government, in comparison to the wider ranging research that is done on Government functions. This common definition should then be included in the Performance Audit Handbook to aid understanding and provide a clear point of reference for the selection of audit topics, design of audit approaches and assessment of the quality of the outputs.

Financial Audit

4.1 The objective of Financial Audit in the SNAO is to submit auditor's reports on the annual reports of auditees covered by the Act on Audit of State Activities in accordance with generally accepted auditing standards and in a timely manner.

4.2 The SNAO has established the following objectives for the Financial Audit work stream¹³:

- the focus must be relevant and interesting;
- the audit must be of a high standard; and
- the audit must achieve a high standard of efficiency and effectiveness.

4.3 To assess whether the SNAO produces high quality Financial Audits, we covered the following:

- Compliance of the SNAO's Financial Audit Handbook and methodological framework with International Standards.
- The approach to generating sufficient information on audited organisations' activities, control frameworks and financial position to identify audit risks.
- The design of appropriate responses to the identified audit risks.
- The consistency of the audit approach to significant areas of the audit.
- The approach to communicating the findings of the audit with clients.

Compliance with International Standards on Auditing

4.4 The primary purpose of the Peer Review, with reference to the Financial Audit work stream, was to assess the appropriateness of the SNAO's internal quality review processes and compliance with International Standards. In the case of Financial Audit, the applicable standards are International Standards on Auditing (ISAs), as detailed in International Standards for Supreme Audit Institutions¹⁴. ISAs are the recognised best practice standards for the delivery of high quality financial audits.

¹³ SNAO Annual Report 2012 page 10.

¹⁴ The ISSAI framework specifies that SAIs should carry out financial audit under relevant recognised guidance.

4.5 To test compliance with the ISA framework, we reviewed the overarching methodology that is applied to financial audit in the SNAO and is documented in the Financial Audit Handbook; the guidance that translates the Handbook into an applicable audit framework; and compliance with this methodology in three audit files.

4.6 The SNAO started its process of implementing ISAs for its 2011 audit cycle and has made substantial progress since then. During our work we found some areas of good practice in the SNAO's audit approach, in particular audit teams':

- understanding of the nature of the organisations they are responsible for auditing and the issues they are facing;
- understanding of the nature of the business risks audit bodies are facing and, in many cases work to address the risks that have been identified; and
- work on the financial statements overall, including an examination of the data that is used to produce them and the way they are organised to produce financial statements.

4.7 However, there are some areas where the SNAO needs to enhance its approach to Financial Audit to demonstrate compliance with the ISA framework. These are set out in detail in the sections below.

4.8 During the Peer Review, we were encouraged by the SNAO's willingness to open itself up to the Peer Review; and knowledge of the areas of its Financial Audit approach that need to be improved to ensure that it can show full compliance with the ISAs. However, the input that is needed to do this is significant and will involve:

- Investment in the Financial Audit policies that translates the theoretical ISAs and the Financial Audit Handbook to an applicable SNAO audit approach. This investment will enable the Handbook to form the basis of a consistent, well understood assurance process that is followed by all Financial Audit teams.
- Introduction of a revised financial audit documentation package that translates the SNAO's audit methodology and application policies to practical steps for teams, see section 2 for further details.
- Greater focus on testing the detailed financial statements transactions and balances within the audit approach, which will increase the overall level of work that is done on each audit.
- Revisiting, with consultation, the SNAO's assessment of materiality in financial audit to ensure that audited bodies, Parliament and other stakeholders understand the impact of materiality in the context of the SNAO's audit and are comfortable with the thresholds applied.
- Revising the SNAO's current approach to auditing the Performance Report and Controls Statement.
- Training for financial audit staff on ISAs and the changes to the SNAO's audit

approach.

4.9 The level of input that is required in these areas will require an investment in Financial Audit in the short to medium term. The actual level of input that is required is difficult to quantify via an external review and will need to be determined by the SNAO and the Auditors General, in consultation with its stakeholders.

4.10 The return on this investment will be greater confidence in the SNAO's Financial Audit work stream; enhanced assurance for the Swedish Parliament that the financial risks within the Swedish Government system are being addressed at a level of accuracy they are comfortable with; and, in the mid-term, a more focussed, efficient and consistent Financial Audit approach.

4.11 In addition to ISA compliance, we also assessed the SNAO's quality framework for Financial Audit, with reference to International Standard on Quality Control 1 and International Standard for Supreme Audit Institutions 40. Except for the enhancements in knowledge and training required to evidence full compliance with ISAs, we were able to conclude that the SNAO complies with the requirements of the quality control standards. It has a quality control process that focusses on ensuring key audit judgements are assessed appropriately; there is sufficient review of audit work at the time it is completed and subsequently via cold reviews; and that it has appropriate calibre of staff and management in place to conduct good quality audit.

Identification of audit risks

Understanding of the audited body and its controls

4.12 ISAs require Financial Audit teams to assess and document audit risks via a programme of work to examine the inherent, control and financial risks that each audited body faces in order to ensure that the audit is focussed on the areas of greatest potential for error.

4.13 In our examination of the SNAO's Financial Audit methodology and its application we found that the audit teams we met were highly aware of the issues each audited entity was facing and the impact on their business, which was helped by the stability of the audit teams and the experience of senior staff. However, we found gaps in the documentation of this assessment and also in the understanding of the nature of audit risk and, therefore, the relevance of the issues that teams were identifying to the audit.

4.14 On the documentation side, we found a need for more:

- documentation of the controls that are in place within organisations that are relevant to the audit, such as the processes for making payments, receiving income or managing fixed assets, and the impact these controls processes have on the risk of error in the financial statements; and
- assessment at the planning stage of the changes in each organisations financial performance or position and impact on the audit risk assessment.

4.15 On the understanding of risks, we found some areas of judgement in the audit files that should, in our view, have been identified as audit risks. For example the process required to assess the level of non-payment of tax, which requires difficult evaluation of estimates with numerous inputs. We also found a number of the areas that were being identified as audit risks that did not, in our view, meet this definition. For example in two of our audit files payroll was identified as a risk area due to its size, when in fact payroll in most organisations is one of the best controlled processes and is unlikely, therefore, to result in a material error.

4.16 In conclusion, therefore, in our view the SNAO is focussing too much on some areas of risk and insufficiently covering others. Improving teams' abilities to identify audit risks will benefit the SNAO as a whole by increasing its ability to make an accurate assessment of the status of financial control across the Swedish Government's finances via its annual engagement with some 250 audited bodies.

Assessment of materiality

4.17 ISAs require audit teams to assess materiality on the basis of the level of interest in the financial statements; and to consider areas of the audited accounts that need to be subject to lower materiality due to their particular characteristics or the level of interest in them. Auditors are also required to assess the key driver of financial statements and base their materiality on this factor.

4.18 Currently, the SNAO's approach steers teams towards a particular method of assessment of materiality by value - a combined percentage of the balance sheet and operating results of each entity. In assessing materiality, audit teams need to consider independently what is important for each audited entity, including the nature and context of the transactions and balances within the financial statements. For example, some organisations such as pension funds are dominated by the scale of their liabilities, and others are dominated by the level of expenditure they incur, such as those that pay out benefits. During our work, we did not find evidence of this assessment. All the audits we reviewed used a combined assessment of the balance sheet and operating results despite the audited bodies having different characteristics.

4.19 The assessment of materiality is a key step in the audit risk assessment. This process provides a threshold by which audit teams can assess the significance of the risks they identify against a framework for grading the level of assurance that is required on each individual area. Therefore, the SNAOs need to ensure that this is carried out appropriately across its audit portfolio and includes assessment of the applicable context for each audited organisation when setting materiality. The SNAO also needs to ensure that its stakeholders are comfortable with the levels of numerical materiality it is selecting, as this effectively provides an indication of the levels of error that can be tolerated within a set of financial statements before the opinion is modified.

Audit of the Performance Report and Controls Statement

4.20 Currently the SNAO's audit opinions provide a true and fair view over the full annual report that is produced by their clients. This covers the financial statements,

but also the narrative element at the start of the document which constitutes the Performance Report and the Controls Statement.

4.21 In our opinion, this overarching true and fair opinion provides a perception of a level of confidence in the accuracy of the Performance Report and Controls Statement that is not supported clearly by the work that is carried out by the SNAO. The narrative statements that are provided in each of these documents do not lend themselves to the provision of true and fair opinion¹⁵. Therefore, in our view there is a gap between the level of assurance the SNAO is providing via its audit opinion and the work that is being done to support it.

4.22 The SNAO is aware of this gap and is seeking to close it by agreeing a reduction in the scope of the work that it does on these areas with its audited bodies; and a clarified audit opinion template. We encourage this and the SNAO should seek to conclude it as soon as possible. Clarifying the scope of this work has the potential to offset some of the costs of investment that will be required in other areas of the SNAO's Financial Audit methodology.

Designing responses to audit risks

4.23 Once the risk assessment has been completed, ISAs require appropriate responses to be designed to test these risks, which should cover the controls that are in place to address them and substantive detailed testing to gather evidence as to whether they have resulted in material error.

4.24 In our review of a sample of financial audits, we found that the SNAO was addressing the audit risks it had identified appropriately in most areas. We found evidence that the impact of the risks is being articulated at an appropriate level¹⁶; with documentation of the controls that are in place to address these risks; and testing of the controls where appropriate. However, we did find a need to carry out more substantive detailed testing to address the risks, which is linked to the need to develop clearer policies to translate ISAs to an operational audit framework that is applied across the SNAO's audits, as detailed in the following section.

4.25 For the audit risks that the audit teams identified that relate to the Performance Report or Controls Statement, greater clarity in the testing approach to these areas is required. This is inevitable given the nature of these statements and issues that are identified within them, but supports our view that this is an area that the SNAO needs to focus on.

¹⁵ The ISA framework covers the scope of the work that is required on this section in ISA720, which only requires a review of this additional information for consistency with the financial statements and the audit team's overall understanding of the entity that is being audited.

¹⁶ ISAs require audit risks to be assessed at the assertion level and this was done in most cases.

Consistency of audit approach to significant audit areas

4.26 ISAs require all areas that are significant to the financial statements to be covered by a combination of controls testing and/or substantive testing to gain sufficient appropriate assurance. In our review of the SNAO's audit methodology and sample of audits, we found that the SNAO does not have clearly articulated policies for implementing this assurance.

4.27 ISAs provide a number of options for delivering this assurance as follows:

- Controls testing - which covers an appropriate sample of controls across the financial year in question.
- Substantive analytical procedures - whereby a model of an audit area is built up via a range of inputs and assumptions to predict an outcome.
- Substantive tests of detail - which includes detailed testing of the recorded transactions to underlying evidence.
- Comparative analytical procedures - which compare prior year outturn to the current figures supported by evidence.

4.28 In our review of files we found that the SNAO uses tests of control to evidence their operation over particular audit risks and in some specific areas carries out substantive tests of detail to cover these risks. For the areas that are not subject to significant audit risk, however, the SNAO's assurance is based more or less entirely on comparative work. This level of evidence provides comfort that significant movements of concern in the financial statements are reviewed. However, except for in organisations that have the strongest financial control framework, this needs to be supplemented by either detailed evidence to confirm the movements are supported; additional substantive analytical work; or tests of detail to be fully ISA compliant.

4.29 There are very few entities within the UK government sector and relatively few organisations in the UK private sector where a controls testing approach supplemented by comparative work only is adopted and judged to be compliant with ISAs. Where such an approach is adopted, the controls testing that supports the comparative work is very extensive and, in general, based on the operation and testing of robust IT based controls. In effect, therefore, the SNAO's current audit approach assumes that the financial control processes of all organisations within the Swedish Government sector complies with best practice.

4.30 Within the scope of the Peer Review we cannot make an assessment of whether this judgement is appropriate. The Swedish Government system is generally recognised as among the best in the world; is highly integrated and well financed; and the control framework is boosted by the culture of openness and transparency within the Swedish system. In addition, the system does not have some of the operational complexities that impact on Financial Audit in the UK, such as multiple complex IT

systems and processes, a legacy of under investment in financial processes and systems and complex consolidation processes. However, the SNAO's audit approach would benefit from a careful assessment of the appropriateness of this assumption; whether it is appropriate across all organisations in the sector; and whether it is testing it sufficiently to ensure that it is valid. This will become increasingly important as the Swedish system changes over time and the level of resources that are available reduces, creating increased tensions within the system and greater potential for error.

Communication with audited bodies

4.31 ISAs require effective communication on the areas of focus for the audit, the overall audit approach and the errors that are found between the audit team and the management of the organisation being audited.

4.32 The SNAO has interpreted this requirement by requiring audit teams to have a documented meeting with the senior management of the organisation that is being audited at the start and end of the audit process, without the need for a formal written output. This provides the benefit of requiring teams to prepare a coherent and concise conclusion on the audit that can be verbally presented to management. We would encourage this general approach. However, the lack of a formal written output means that the SNAO needs to ensure that it covers all of the requirements of ISAs¹⁷ and that they are documented.

4.33 Overall, however, we found that the communication with senior management within the audited entities was appropriate in our sample of audits and that the culture of effective face to face discussion of the audit was a positive aspect of the SNAO's approach to financial audit.

¹⁷ International Standards on Auditing require audit teams to communicate their: assessment of independence; assessment of the risks identified during the audit including in relation to fraud, and the errors and adjustment that are identified during audit work.

Methodology

5.1 The methodology we applied to the Peer Review, following ISSAI 5600 Peer Review Guideline.

Organisational approach to ensuring quality

5.2 The principle behind a detailed review of the effectiveness of the SNAO's whole of office procedures is to establish the effectiveness of the overall framework for ensuring high quality audits that is in place. This principle is established in International Standard on Quality Control¹ and ISSAI 40, which focusses on the importance of establishing effective leadership responsibilities and oversight to ensure high quality outputs.

5.3 In the context of the SNAO this our work included reviews of:

- the structure and management of the SNAO;
- the SNAO's overall strategy and coverage of the Swedish Government system;
- the overall systems for ensuring quality across the SNAO and within the Performance Audit and Financial Audit practices;
- human resources procedures; and
- the resources that are in place to deliver audits across the SNAO.

5.4 In carrying out our review of the SNAO's whole of office procedures we assessed the adequacy of the policies in place in each of these areas and, through our sample work across the financial and performance audit work-streams, sought evidence in support of their operational effectiveness.

Financial audit sampling

5.5 Our review of a sample of three financial audits aimed to provide substantive evidence of the operation of the SNAO's quality control procedures for financial audit, assessed the compliance of the SNAO with International Standards on Auditing, and evaluate the sufficiency and appropriateness of the evidence gathered in each assignment to support the audit opinion.

Performance audit sampling

5.6 We reviewed a sample of three of the SNAO's performance audits. As the framework for performance audit is more fluid, these reviews focused on the compliance of each project with the key aspects of the SNAO's quality processes, the appropriateness of the approach to gathering evidence, and the robustness of evidence to support the overall conclusions.