

# State Audit & PUBLIC ACCOUNTABILITY

PART 1



## The Changing Role of the National Audit Office in Public Accountability



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### EXECUTIVE SUMMARY

The purpose of the paper is to gain insight into the changing role of the National Audit Office (NAO) in public accountability with the backdrop of the legal amendments that instituted the Office. The paper seeks to analyse the strength of the Office's legal mandate, evaluate the understandability of NAO reports as well as discuss the Office's bearing on public policy.

The discussion draws upon semi-structured interviews conducted with three NAO Officers and thirteen main users of NAO reports, consisting of Public Accounts Committee (PAC) Members, Opinion Makers and Public Officials. The analysis takes stock of relevant PAC transcripts and of visits made to PAC meetings.

### INTRODUCTION

'Accountability', as applied in the public sector, takes a different form from its application in the private sector (Ingstrup & Crookall, 1998). Public accountability is wider in extent and not limited to the internal accountability of public officials towards their ministerial chain of command (Bovens, 2007; Ingstrup & Crookall, 1998). This wide accountability setup exposes public officers to answer directly to the citizen (Bovens, 2007; Mulgan, 2002). As suggested earlier by Normanton (1966) the discharge of public accountability requires statutory rights to inspect and inquire public officials. State auditors are entrusted with these rights to bypass the internal ministerial chain of governments and to prevent any distortions from reaching public fora.

The Maltese National Audit Office had been established as a separate and independent Supreme Audit Institution (SAI) following the legislative amendments that took place on July 25, 1997. Its predecessor, the Department of Audit, fell within the ambit of the Ministry of Finance. The old legislative framework is a far cry from the one presently in vigour. The amendments redefined the Maltese State Audit because the Auditor General is a parliamentary appointed institution. Indeed, the Office has now been operating autonomously under its Constitutional vest for more than a decade. In view of this relatively new role, some questions crop up. What is the legal mandate of the Maltese NAO vis-à-vis the ideal of 'public accountability'? Departing from the premise that the NAO is a watchdog and not a bloodhound, is its alarm-call clearly discernible? Is its legal empowerment giving actionable information? What are the main users' perceptions of state audit reports? Does the standard of reporting give clear information about the use or misuse of public funds? With regards to the learning dimension, how do audit results and recommendations affect public policy?

#### *The Regulatory Setup*

The Constitution of Malta (1964) describes the appointment and the functions of the Auditor General and the Deputy Auditor General. The President of Malta appoints the Officers in conjunction with a resolution from Parliament, which has to be supported by at least a two-thirds majority. The core mandate of the NAO is the financial and regularity audit of the accounts of the Government of Malta and all bodies making use of the Government's funds. The Office is also empowered to audit the economy, efficiency

and effectiveness of Government departments and entities. These are also known as Value For Money (VFM) audits or performance audits.

The NAO’s primary audience is the Parliament of Malta, and the Public Accounts Committee is the organ where the NAO’s output is discussed. Special audits, inquiries and investigations are made on the Auditor General’s own initiative or requested by either the Minister of Finance or the PAC (Auditor General and National Audit Office Act, 1997). In addition to its main functions, the NAO appoints private auditors for local Government, and reports upon the results of these audits in its Annual Audit Report.

THE REMIT OF THE NATIONAL AUDIT OFFICE

The framework used for discussing the legal mandate of the Maltese NAO poses four questions that seek to define its scope: *when* and *how* can the NAO execute its powers? *What* are the criteria by which the NAO can conduct its audits and investigations? *Where* can the NAO establish jurisdiction? Figure 1 illustrates the framework used for discussing the research findings.

Questions (1) and (2) are perhaps the simplest to answer. The NAO can audit and investigate activities undertaken by the Government, either on its own initiative or when requested by the PAC or the Minister of Finance. These enquiries would mandate specific terms of reference by which the Auditor General would be obliged to adhere. The NAO can then avail of its statutory powers including the power to administer oaths and the power to sequester public files and databases. Research findings suggest that questions (3) and (4) are the most unclear in defining the strength of the NAO mandate.

*What to Audit: Criteria for fulfilling Audit Mandates*

The core function of the Maltese NAO is the

annual financial and compliance audit of financial statements issued by the Treasury. The criteria by which the NAO carries out this function are prescribed by the Financial Administration and Audit Act 1962 (FAAA) and its subsidiary regulations. The FAAA, being the “*mamma*” of these regulations, defines the public officials that are responsible for ensuring that regulations are adhered to (Standing Committee on Public Accounts, 2006a: p. 9). Any audit engagement, investigation or inquiry that uses such criteria will inevitably adopt a rules-based approach that aims to provide assurance on the legality of financial reports. By elimination, any other mandate has the shaky task of determining ‘good governance’ in terms of the economy, efficiency and effectiveness of policy programmes or through ad hoc investigations.

*Where to Audit: Ownership versus Control*

Public accountability weaknesses may arise where state auditors do not have a legal authority on the annual financial audit of public entities (ASOSAI, 1989; Bottomley, 2000). This weakness had been predicted by Normanton (1966), who pointed out the tendency of state auditors to narrowly focus on the accounts of bodies under treasury control. He also added that there is “*no practical reason why state audit should not examine and draw useful conclusions from the accounts of bodies which spend public moneys under other systems of regulation, or indeed without any system at all*” (Normanton, 1966: p. 373).

One PAC Member drew attention to an apparent legal anomaly which might prevent the Maltese State Auditor from accessing information pertaining to entities in which the Government has a non-majority shareholding. In fact, the legal mandate gives the Maltese NAO the power to inquire into and report on “*the operations of companies or other entities in which the Government of Malta owns not less than 51 per cent of the shares*” (Auditor General and National Audit Office Act, 1997: Schedule 1

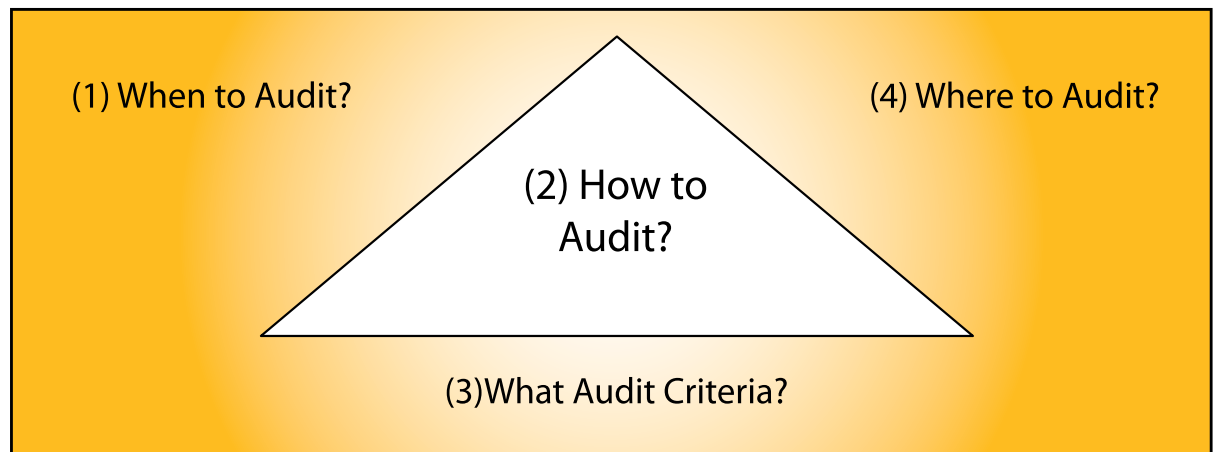


Figure 1 Framework for analysing the NAO’s Mandate

s9(a)(iv)). One might agree or disagree with the respondent's suggestion to expand the remit of the Auditor General to include entities in which the Government has a minority interest. That may very well be a philosophical debate that transcends this discussion.

What the response willingly or unwillingly points out is that the Law falls short of distinguishing between 'majority ownership' and 'public control'. And this is a crux in public accountability. Any government may be able to control an entity even if it has a substantial, minority ownership. In other words, if accountability implies controllability, the respondent's proposition gains much more relevance.

#### *The Audit Jurisdiction of the State Auditor*

How should one go about assessing the adequacy of the NAO's legal mandate? The legitimacy of the NAO's role in public accountability depends on *what* is being audited and *where* it is being audited. It is inadequate to assess the legal remit of state auditors solely on the basis of *where* they can establish jurisdiction. The NAO's role in Governmental departments is undisputed not only because these offices are part of the Government but also because there are objective and enforceable criteria, such as financial regulations, that make these places auditable.

But where separate legal entities are involved, legal interpretations of the NAO's legitimate role may easily conflict. The PAC investigation on the Voice of the Mediterranean radio station can be brought to bear weight. In this atypical case the NAO had been requested to investigate the financial compliance and 'good governance' of the entity's operations. It transpired that the NAO could not undertake a financial and compliance investigation because the entity's constitution did not specify its abidance with financial and public procurement regulations as one of its objects (Standing Committee on Public Accounts, 2006a). In other words, there were no criteria by which the NAO could objectively investigate the financial conduct of the station. What remained was the elusive task of determining good governance via the VFM route.

The NAO is not empowered to conduct the annual financial audit of separate legal entities. However, it is empowered to inquire and report upon any issue pertaining to the entity; this gives it a very wide remit because the terms of reference may very well include a variety of issues. Notwithstanding this, if the NAO is requested to inquire on financial and compliance issues on an ad hoc basis, it may only fulfil that mandate if public regulations are enforceable either by the entity's memorandum and articles or by statute.

#### *Enforcement and Execution*

Audit mandates in most democratic states do not confer the power to punish or sanction auditees (Friedberg, 1987; Normanton, 1966). One possible reason was given by Mulgan (1997), who argued that the restriction does not prevent state auditors from calling public managers to give their account. In other words, the power to call to account is sufficient to render the state auditor's role in public accountability.

But how far should state auditors go in combating administrative irregularities and public mismanagement? Interview respondents pointed out the distinction between serious irregularities and administrative shortcomings. A serious irregularity refers to the outright breach of laws and regulations governing a public office, department or other entity. Administrative shortcomings refer to weaknesses in the internal controls of the department or entity.

The Maltese Auditor General has the power to recommend the imposition of penalties on responsible individuals who do not comply with public regulations (Auditor General and National Audit Office Act, 1997). This is a tool which the NAO has hitherto not utilised because as one NAO Officer put it "*there may be legal difficulties in practising it, especially in light of the fact that the Office does not have a legal background*". In addition, one Opinion Maker indicated that although the NAO's powers are adequate, "*they are not personalised*", in that they fail to ensure that corrective action is taken on, or by, the responsible individuals.

In the case of administrative shortcomings, this power is not so clear because deficiencies of this sort do not always lead to an outright breach of laws and regulations. However, one is inclined to favour the recommendation of a penalty if administrative shortcomings seem to recur without due consideration from the auditees, as has been outlined by respondents.

Although this legal tool has never been used by the Office it is unclear whether penalties have ever been called for, or whether the NAO has opted out purely out of expediency. What is clear is that there are legal difficulties in proposing penalties. For this reason, some of the claims that the NAO is not structured to bite the responsible parties gain even more weight.

In reality, pinpointing the culprit may not always be possible. The NAO might not feel confident enough to point its finger because it lacks the legal background to do so. The bottom line is that the only legal tool, available to the NAO to pressure the executive into taking remedial action, is obviated by

the legal difficulties in implementing it.

*Lacuna in the Reporting Line*

As pointed out by Borge (1999), state audit oversight is practised on three main levels:

- i. The Office reports suspicions to other investigative bodies, and collaborates to determine whether suspicions have valid grounds for prosecution;
- ii. The Office notifies suspicions to the appropriate authorities, such as ministers;
- iii. Suspicions are notified only to the head of department or body being audited.

Another important distinction is that between serious irregularities and fraudulent activities. While the former is of an administrative nature, the latter translates into a criminal offence. Despite the distinction, the provisions set out in the Auditor General and National Audit Office Act (1997) provide for the same reporting line, as illustrated in Figure 2. The Auditor General is obliged to give notice of any serious irregularity or fraudulent activity to the responsible Minister.

It is debatable whether this is the ideal kind of arrangement since the system relies on the bona fide follow up of the Minister in charge. The setup is unlike that which is in place at the Internal Audit Investigations Department (IAID), which resides

within the Office of the Prime Minister and has two reporting lines in place. The IAID Director is legally bound to report any fraudulent or criminal activity to the Attorney General. As one Public Official stated, “we are speaking of the Supreme Audit Institution here, and if the IAID has more legal leverage than the NAO, then there’s a serious problem”.

Indeed, follow-ups of fraudulent and criminal activities resulting from NAO findings do not have any history. Two Public Officials and one Opinion Maker drew a comparison between the NAO and the IAID. Interestingly, the respondents perceived the IAID to be more effective in capturing illicit activities because it has “*mani in pasta*” in Government. The respondents could recall actual prosecutions against suspects as a result of IAID investigations but could not associate the NAO with similar proceedings. That being said, the subtle suggestion was that the NAO is in a “*straitjacket*” as it is “*not structured to bite*”; its genetic makeup precludes it from doing so.

As things stand, one can reasonably argue that there exists an institutional lacuna between the NAO and other Maltese institutions. Is there some kind of vacancy between the NAO and other law enforcement institutions? Is this gap associated only with the NAO, or is it part of a wider disconnection between the ‘checks and balances’ of the State?

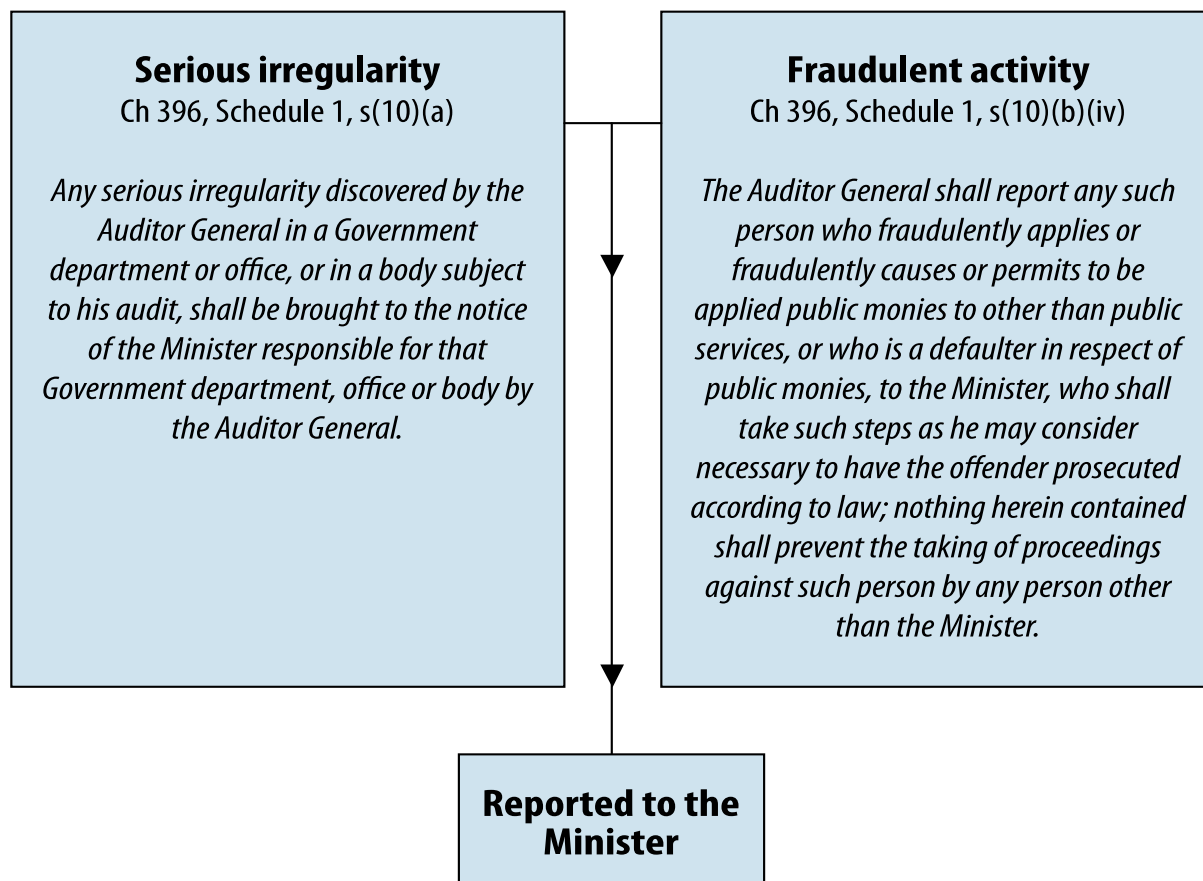


Figure 2 NAO Reporting Line of Irregular and Fraudulent Activities (Auditor General and National Audit Office Act, 1997)



## REPORTING AND COMMUNICATION

*The Public Accounts Committee*

The effectiveness of audit reports should be measured in terms of the mark they leave on their readers. Mifsud Bonnici (2007) had pointed out that, despite their frequency, NAO reports in Malta seldom attract the exposure that is required to spark public debate. But this is something depending on the effectiveness of the PAC itself. According to Hedger and Blick (2008) PACs in many developing countries lack the administrative personnel and research facilities which are necessary for analysing audit reports. The PAC's capacity is important because *"that which strengthens the effectiveness of the PAC strengthens that of the Supreme Audit Institution, and vice versa"* (Hedger & Blick, 2008: p. 34), otherwise described as a relationship based on "symbiosis" (Wang & Rakner, 2005: p. 22).

Users of NAO reports were asked to express their opinion on the clarity and understandability of NAO reports. Perceptions of audit reports were very positive. Respondents were quick to point out that the reports are clear and objective. Audit findings are backed by factual and accurate evidence, making NAO reports very reliable. According to respondents, other institutions governing the State should be able to take action on the reports presented by the NAO.

The PAC, however an avenue to public accountability, may ironically be one of the reasons why NAO reports may not be fulfilling their intended results. The PAC represents the teeth of the Maltese NAO as it can publicly expose managers and pressure the executive into taking action. Therefore, a discussion on the effectiveness of the NAO as an institution should revolve around the PAC's use of the State Auditor's reports.

It appears that the teeth need some good sharpening. Respondents expressed their doubts about some of the members' preparedness to Committee meetings. One Opinion Maker stated that the passive attitudes of a number of parliamentary members leave much to be desired, and that *"blank faces let you down"*. The lack of time and back-up resources was seen as impinging on the members' preparedness to Committee meetings, thereby affecting the quality of the scrutiny that is made on Public Officials.

Research findings show that the PAC in Malta lacks the necessary resources. What is lacking might be a bit of both technical knowhow and time resources. This should also be seen in light of the fact that the Maltese NAO is churning out more reports. The issue ties in neatly with the claim that the Annual Audit Report is not being scrutinised as deserved, because other reports are stealing the show. As one respondent put it:

*"As a result of the lack of resources, the analysis of the Annual Audit Report has become the run of the mill in PAC meetings. Appropriate expertise, at this level of scrutiny, is a sine qua non in public accountability."*

Furthermore, the Maltese system does not ensure a level playing field for the State Auditor. Indeed, the PAC tends to fall into the temptation of criticising the NAO's methodology, rather than limit the discussion to the audit findings. Five respondents recalled instances when *"the PAC's scrutiny actually turned on the NAO"*. It is true that the NAO is the working hand of the PAC. But the Office is also vested with a Constitutional role and the system should ensure that it is treated as such.

*Part 2 of this feature will be published in the summer 2012 issue of the Accountant.*



## About the authors

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