

Chapter 9. MANAGEMENT CONTROLS, AUDIT, AND EVALUATION

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Management controls, auditing, and evaluation are processes and mechanisms that are designed to assure that budgeting is linked to the real world of program operations. Without these links, there would be considerable risk that decisions would be based on flawed information, that resources are mismanaged, and that the decisions would be ignored by the operating organization. Thus, this chapter focuses on the ways in which governments, with the help of these processes and mechanisms:

- assure implementation of budgetary and other policy decisions;
- avoid improper use of funds and detect and correct instances of such improper use;
- assess the efficiency of operations and seek ways of improving that efficiency;
- obtain reliable reporting of financial and other data concerning the execution of budgetary decisions; and
- gather information about program operations and results that can be used to adjust future policy decisions and budgets.

The three concepts—management control, and internal audit, external audit, and evaluation, are not self-evident, and other words are sometimes used to describe them. Let us therefore start by pointing out some important characteristics. Management control is used here to describe all the policies and procedures put in place by a government or by the managers in the various entities of the government, to ensure the proper and effective functioning of the overall government or the individual entity. A synonym often used for management control is internal control. Internal audit, in turn, has the key function of reporting to the senior management (the minister, board, or head of an agency, etc.) on the functioning of the management control systems, and recommending ways for improvement.

External audit is, in most countries entrusted to a separate organization connected to or at the same level as the legislature (the Parliament). These organizations, the Supreme Audit Institutions (SAIs), are independent from the government and have the mandate to audit or

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investigate most aspects of the government's activities and to report their findings to the legislature and, often, to the general public.

A. MANAGEMENT CONTROL

The term "evaluation" means a systematic effort to identify and measure the effects of government policies and programs. It implies the use of scientific methods to increase the reliability of findings by systematically isolating the policy or program effects from other factors and influences that might have caused or contributed to those effects.

1. Objectives of management control

Management controls are the heart of budget and policy implementation. The European Court of Auditors in its 1998 publication *European Implementing Guidelines for the INTOSAI Auditing Standards (draft)*, defines management controls as all the policies and procedures conceived and put in place by an entity's management to ensure:

- the economical, efficient, and effective achievement of the entity's objectives;
- adherence to external rules (laws, regulations,...) and to management policies;
- the safeguarding of assets and information;
- the prevention and detection of fraud and error; and
- the quality of accounting records and the timely production of reliable financial and management information.

Management controls can include a wide variety of mechanisms designed to assure that budgetary and other policy decisions are executed properly; that resources are used appropriately; that waste, fraud, and mismanagement are minimized if not entirely avoided; and that reliable and timely information is obtained, maintained, and used for decision making. While certain elements are common to most management control systems, no single set of control devices is appropriate for all entities in all circumstances.

Management controls are essential in managing any organization, whether it is part of government or it is a privately owned business. In a government ministry or agency, for example, it does little good to enact laws or regulations, to develop budgets, or to establish

administrative policies, if there can be no assurance that they will be properly implemented. For example, the Kingdom of Tonga undertook a systematic assessment of government management controls. It found frequent problems involving incomplete or non-existent documents and records, lack of separation of duties, and inadequate training and supervision of staff.

However, management must also assure that the systems of controls do not conflict with the overall management philosophy of the entity. For example, in many countries, emphasis is now given to allowing discretion to managers and holding them accountable for results, rather than for strict adherence to detailed rules and procedures. This approach can be easily vitiated by systems of management control that put undue reliance on detailed procedural safeguards or on multiple levels of supervisory review of decisions. Conversely, where public integrity and/or fiscal discipline is the major concern of management philosophy, management control systems that allow discretion without sufficient accountability can be problematic. In general, therefore, management controls should be carefully balanced, taking into consideration the related risks and the costs and benefits of the safeguards to be introduced.

Management must also recognize that circumstances change. Controls that were needed and effective at one time may be rendered unnecessary or ineffective by changes in the nature of operations or in the external environment. It is essential that management periodically examine its systems of management control, modify those systems as necessary to assure that they remain effective, and eliminate or alter controls that are no longer needed or have become unnecessarily burdensome. In countries that are seeking to establish or strengthen their management controls, a high priority in most transition and developing countries, it may be useful to have a formal requirement that government organizations perform a periodic assessment of their systems of control and report any material deficiencies that are found. The organization's internal and external auditors can be of great assistance in making such an assessment and in suggesting ways of overcoming weaknesses that are disclosed.

For an organization's internal audit unit, a continuing assessment of management controls should be one of its highest priorities. The external auditor can also play an important

role in helping management build and maintain effective control systems. Any audit that is intended to render an opinion on the reliability of an entity's financial statements or other reports must include an assessment of the control systems. Such an audit will pay special attention to the controls that govern the recording and processing of data that are included in the statements. In many cases, however, the assessment will include the controls that are meant to assure compliance with applicable laws and regulations. In such an assessment, the auditor will not only examine the controls themselves, but will also conduct such tests as the auditor deems necessary to assure that the controls are operating properly.

Other audits can also be useful in strengthening management controls. Any irregularity, whether or not found during the course of an audit, should be seen as evidence of a possible failure of the relevant control system. Such irregularities should be examined carefully by both the auditor and management to determine whether or not a strengthening of controls is warranted. For example, New Zealand has a firm commitment to effective management controls. For example, each year the Chief Executives and Chief Financial Officers of operating units sign a Statement of Responsibility covering the management controls of their entities. Nevertheless, problems still come to light, including weak documentation of purchases, irregularities in the use of credit cards, irregularities in the employment of consultants, and the failure to fully test changes in accounting systems before implementation.

The International Organization of Supreme Audit Institutions (INTOSAI) has developed standards for management controls as a framework for countries to use in designing and developing their systems of management control and as a guide for auditors in assessing those controls. Following the practices of the accounting profession, the original wording of these standards uses the term "internal controls". In this chapter, however, the term "management control" which is deemed to be more descriptive and less likely to be misunderstood by the readers, is used. The wording of the standards has been modified accordingly.

The general standards are as follows:

- Management control structures exist to provide reasonable assurance that the general objectives of the organization will be accomplished. (This obviously assumes that the objectives are clear—which is not always the case.)
- Managers and employees are to maintain and demonstrate a positive and supportive attitude toward management controls at all times. (Of course, this is only possible if there is a consensus that controls are efficient and effective to begin with.)
- Specific control objectives are to be identified or developed for each ministry/department/agency activity and are to be appropriate, comprehensive, reasonable, and integrated into the overall organizational objectives.
- Managers are to monitor their operations continuously and take prompt, responsive action on all findings of irregular, uneconomical, inefficient, or ineffective operations.

The detailed standards are as follows:

- The management control structure and all transactions and significant events are to be clearly documented, and the documentation is to be readily available for examination.
- Transactions and significant events are to be recorded promptly and classified properly.
- Transactions and significant events are to be authorized and executed only by persons acting within the scope of their authority.
- The same person should not hold key duties and responsibilities in more than one of these areas: authorizing, processing, recording, and reviewing transactions and events.
- Competent supervision is to be provided to ensure that management control objectives are achieved.
- Access to resources and records is to be limited to authorized individuals who are accountable for their custody or use. To ensure accountability, the resources are to be periodically compared with the recorded amounts to determine whether the two agree. The vulnerability of the asset should determine the frequency of the comparison.

2. Prerequisites for effective management controls

Management controls are the responsibility of the leadership of an organization. Therefore, establishing and maintain effective management controls, the top leadership of the organization must, first of all, be committed to the effective management of the entity and to the creation and effective use of mechanisms that will assure its ability to exercise its management responsibilities. The leadership must also demonstrate personal integrity and professionalism. Only if that commitment and example are in place will it be possible to establish and maintain an effective system of controls.

Because of the importance of management controls in assuring the effective control of public funds and the proper execution of the budget, the central budget office (typically, the Ministry of Finance) in many governments plays an active role in strengthening the management controls of the operating units.

If the leadership of an organization is committed to effective management, the next requirement is a careful and thorough assessment of the risks facing the organization and an identification of useful controls to manage those risks. In a complex organization, this can be a difficult task and one for which the leadership of the entity may wish to seek expert assistance. Internal and external auditors are frequently the source of this assistance. They may be able to identify risks of which the management was unaware and to suggest control procedures that can minimize those risks. Whatever assistance is obtained, however, it is essential that the leadership of the entity remain involved throughout the process and especially in the decisions about the control arrangements to be put in place. The controls that are implemented must be ones that the management will use, even when they create some inconvenience in day-to-day operations, and must be used throughout the entity.

The controls must therefore be cost-effective. They must not be so detailed and onerous as to paralyze the organization. And the cost of the control systems must not be out of proportion to the risks they are intended to avoid. This point is stated briefly, but is extremely important: "red tape" is an ever-present risk, and the temptation is usually present to introduce new controls even when there is no need for them.

3. Types of management controls

Because management controls must be designed for the particular circumstances of a particular entity; there is no universally applicable list of controls. However, it is possible to describe categories of controls and the circumstances in which they might be appropriate.

- *Financial reporting.* All organizations must operate within their budgets. Those budgets may be relatively fixed, as with an appropriation from the legislature, or they may be flexible, as in a commercial activity that generates income. In either case, it is essential that management receive a timely, reliable flow of information about its financial status and that management initiate prompt corrective action when the accounting data indicate a significant deviation from the budget. Thus the financial accounting system is a vital part of any structure of management controls. To assure that the accounting system produces timely and reliable data, management should require that the system be audited at regular intervals.
- *Performance monitoring.* Organizations exist to accomplish certain activities. Management's first responsibility is to assure that those activities are achieved. To this end, it is essential that management track the performance of the organization against its stated goals. This requires that management describe the goals in measurable terms (clients served, units of output delivered, etc.) and establish a reliable and timely reporting system to keep itself informed of progress against the stated goals. To assure the reliability of the data, it is desirable that the performance reporting system be linked to the financial accounting system and that it be audited (including appropriate tests of the reporting procedures) at regular intervals. Management should also establish its performance expectations with respect to the outputs being measured and should initiate corrective action if the reported results deviate materially from the expectations.
- *Effective communications.* In modern organizations, managers recognize that subordinates and front-line workers perform better if they have a clear understanding of the mission and goals of the organization and the purpose being

served by the activities they are asked to perform. In such an organization, the channels of communication are part of the management control system. For example, managers should communicate their performance expectations to subordinates, who should then define the expectations for their components of the organization that are needed to accomplish the overall goals of the organization. It is important that communications flow upward as well as downward. When management sets clear goals and expectations, workers can often suggest ways of achieving greater efficiency in the attainment of those goals. Management should pay careful attention to such suggestions, as front-line workers are often aware of procedural inefficiencies that escape the notice of senior managers.

In addition to assuring that the output goals of the organization are achieved, however, managers are also responsible for assuring that the resources available to the organization are protected against improper use. A variety of management controls might be used for this purpose:

- *Physical controls.* These would include the security procedures that are intended to control access. For example, it may be desirable to control who will have access to inventories of items that have high value or might be easily pilfered and sold. It may also be necessary to control the access to particular rooms or buildings where accounting and other records are stored. This may be accomplished by locked doors, the keys to which are held only by authorized persons, or may warrant full-time protection by a security force, which permits entry only to those on an approved list.
- *Accounting controls.* These would include the procedures by which transactions are required to be recorded in the accounting system. For example, there might be a requirement that all cash receipts be deposited daily. The person who collects the cash might be required to provide a written receipt to the payer and to file a copy with the accounting clerk. The person who deposits the cash in the bank would be required to file a copy of the bank receipt with the accounting clerk. Accounting controls also include the internal procedures within the accounting systems that are intended to detect and report any anomalies. In this example, the accounting clerk

might be required to reconcile the two reports of cash collections and to report any discrepancies. Another typical accounting control would apply to expenditures, which would be compared with the budget or other authorization. Expenditures that depart from the expected pattern would be reported while expenditures that exceed the maximum authorized amount would be blocked.

- *Process controls.* These are the procedures that are designed to assure that actions are taken only with proper authorization. For example, the issuance of a purchase order or the approval of a contract, especially one above some minimum threshold, might require documentation from the requesting official, review by a purchasing clerk, and approval by a supervisor. Unusually large purchases might require approval from a higher official. Payments to contractors might require documentation in the form of the original purchase order, a voucher from the contractor describing the goods and services provided, and a certification from the receiving official that the goods and services were received. Elsewhere payments above a certain amount might require review and approval by a higher authority. In the People's Republic of China, personnel standards are an important part of the management control system. Applicants for a post undergo rigorous examination and must receive a "Certificate for the Post" before assuming the position.
- *Procurement controls.* These have been discussed in some detail (see Chapter 5).
- *Separation of duties.* This is both a control measure and an indispensable element of many control systems. The central feature is that, with to "risky" events or transactions, at least two people should be involved to minimize respect the risk of improper actions. In the previous example concerning the handling of cash receipts, one person collects the cash, another makes the bank deposits, and a third reconciles the cash receipt documents and enters the data in the accounting records. Separation of duties in this way is properly an essential element of almost every financial control system, but its use can be overdone. If carried to extremes, it can severely degrade the efficiency of an organization and impair its ability to accomplish its mission.

- *Internal audit.* Internal auditing can be defined as an independent appraisal activity established within an organization as a service to the organization. It is a managerial control, which functions by measuring and assessing the effectiveness of other controls. Any government organization should include an internal audit unit. The role of the internal audit organization is very different from that of the external auditor, although the two should cooperate wherever possible. The external auditor is independent of the organization and reports to an external overseer of the organization. The internal auditor, on the other hand, is part of the organization and is typically responsible to the top management of the organization, although there are some circumstances, such as evidence of high-level corruption, that warrant reporting the facts to an outside authority. Managers should use their internal audit units primarily to perform a continuing assessment of the control systems and as a source of recommendations for improving the effectiveness of those systems. In addition, however, the internal audit unit can be used to examine apparent irregularities. Its findings can serve both as evidence of the need to strengthen the control systems and as a basis for determining what action may be appropriate against those who caused the irregularity.

There are many other types of management controls discussed in the literature. Those who are interested in a more exhaustive discussion of the topic might start with the previously mentioned *European Guidelines* document.

4. Limitations of management control systems

No system of controls can be an absolute guarantee against the risk of wrongdoing or honest error. Any system that attempted to reach that goal, especially in a complex organization, would impose costs far out of proportion to the risks and create rigidities for the organization. Thus the proper goal of the control system should be to provide “reasonable assurance” that improprieties will not occur or that if they occur, they will be revealed and will be reported to the appropriate authorities. With this in mind, managers should be aware of certain risks involved in building and maintaining management control systems.

- *Design flaws.* It has been stressed that management control systems must be designed for the specific organization, operations, and environment in which they will function, after careful consideration of the risks involved in that particular situation. Managers are sometimes tempted to shortcut the design process, such as by adopting the control systems designed for another organization. This can be dangerous. A flawed design may leave the impression of safety but may overlook important risks in one part of an operation while creating unnecessary inefficiencies in another.
- *Poor implementation.* The best-designed system will achieve its goal only if it is implemented properly. Managers and supervisors at all levels must be vigilant to assure that everyone complies with applicable control procedures. Even more importantly, the required procedures must be ones that workers will be comfortable using at all times, and which they will not be tempted to ignore when the procedures become inconvenient or in times of pressure and stress. Meeting this criterion is one of the key considerations in the design of effective control systems. Managers should also plan ahead for alternative arrangements that might need to be put in place in the event an emergency requires bypassing the regular procedures.
- *Poor response to reported anomalies.* Control systems are designed to call attention to events that depart from normal expectations. For the systems to remain effective, it is essential that supervisors and managers respond properly to such alerts. The triggering event should be investigated promptly to determine if an irregularity was involved. If so, corrective action should be initiated. Failure to respond effectively to reports of anomalies will quickly undermine the effectiveness of the control system. This should also be a factor in the design of control systems. Care should be taken to avoid making the systems so sensitive that they yield frequent "false alarms". If this happens too frequently, valid alarms might be ignored.
- *Collusion.* Any system of controls can be defeated if a sufficient number of dishonest key individuals conspire to subvert them and are able to falsify the relevant documents. A sufficiently complex set of controls can make it difficult to

assemble the needed number of conspirators, but at a potentially great cost in organizational inefficiency. Conspiracies of this sort usually come to light when they are observed (and reported) by someone who is not a party to the conspiracy, or when there is a falling out among the conspirators. They may also be detected during a routine audit if substantial amounts of funds are involved or if the conspirators are not sufficiently careful in falsifying the documents.

- *Wrongdoing by top managers.* Management controls are designed to help control the organization on behalf of its management, not to control the top managers themselves. The managers can easily circumvent the control systems, bypassing the controls directly or instructing or authorizing others to do so. There are many examples of dishonest top managers evading the control systems to commit various forms of fraud and abuse. In a large organization, however, such activities are usually noticed by subordinates. Thus, the best protection against wrongdoing by top managers may be an environment of openness, in which workers are encouraged to report evidence of irregularities, confident that they will not be punished for being disloyal to their superiors. Such openness in an organization becomes part of the control environment.

Management controls are an essential part of the structure and operations of any organization. The larger and more complex the organization and its activities, the more care must be given to the design of the control systems. But control systems are effective only if they are installed, maintained, and used by competent, dedicated managers. Systems can support such managers, but they cannot substitute for them.

B. EXTERNAL AUDIT

The Lima Declaration of Guidelines on Auditing Precepts, published by INTOSAI, opens with the following statement:

"The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust. Audit is not an end in itself but an indispensable part of a regulatory system whose aim

is to reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent—or at least render more difficult—such breaches."

Effective auditing can contribute in several important ways to the management of a government's finances. It can:

- Detect irregularities involving the misuse of public funds and identify related weaknesses in management controls that may imperil the integrity of the organization and the effective implementation of budgetary and other policy decisions;
- Determine the reliability of reports on budget execution and other financial data;
- Identify instances and patterns of waste and inefficiency that, if corrected, will permit more economical use of available budget resources;
- Provide reliable data about program results as a basis for future adjustments in budget allocations.

This discussion focuses primarily on the role of the organizations that are responsible for auditing the government as a whole. They have many different names but, collectively, these organizations refer to themselves as Supreme Audit Institutions or simply SAIs. In most English-speaking countries, Commonwealth member states, and Scandinavian countries, the SAIs are National Audit Offices headed by an independent, sole head, the Auditor General. The General Accounting Office in the U.S., the National Audit Office in the U.K., the Office of the Comptroller and Auditor General in India, and the Rigsrevisionen in Denmark are examples of this type of SAI. In most Latin countries the SAIs are Courts of Audit (or Courts of Accounts), headed by a collegiate of court members, who normally enjoy the same status as conventional judges. The Cour des Comptes in France, the Corte dei Conti in Italy, the Tribunal de Cuentas in Spain, and the majority of SAIs in South America are examples of this type of SAI. There are however several variations of these two SAI models. The German, the Austrian, the Dutch, and several central and eastern European Courts of Audit combine characteristics of both

models. The SAI of the European Union, the European Court of Auditors, is also shaped along these lines.

While this section focuses on the SAI, much of the discussion is also applicable to other audit organizations, such as the audit units of government ministries and commercial auditors who may be hired under contract to perform audits of government entities. Throughout, the reader should keep in mind that even the most rigorous audit provisions are not always safe. In Japan, for example, constitution provides the foundation for that country's government management control systems by requiring annual audited statements of State revenues and expenditures. This is reinforced by statutory requirements governing the accounting activities of ministries and agencies and, for example, by the mandatory separation of contracting and disbursement functions. Even so, failures can occur. For example, Japan's Board of Audit found significant overpayments of health subsidies that arose, in part, because municipal officials did not understand the requirements of the health subsidy system.

1. Prerequisites for effective auditing

The International Organization of Supreme Audit Institutions (INTOSAI) has promulgated standards for the audit of government organizations and operations. These standards, or national standards that are equally or more rigorous, have been adopted by government audit organizations around the world, including virtually all SAIs. Anyone who is interested in the auditing function in government is encouraged to obtain a copy of the standards from the INTOSAI Secretariat in Vienna. Among the most important of these standards are those dealing with the following matters:

a. Independence

The independence of the auditing organization is essential to assure that its work will not be biased by any relationship it might have to the entity being audited. This is also necessary for internal audit, whereby the entity responsible must not be part of the finance or treasury function of the ministry concerned, but report directly to the senior manager overseeing financial transactions. In the Lima Declaration, INTOSAI made the following statements about the independence of the SAI:

Section 5. Independence of Supreme Audit Institutions

- 1. Supreme Audit Institutions can fulfill their tasks objectively and effectively only if they are independent of the audited entity and are protected against outside influence.*

- 2. Although state institutions cannot be absolutely independent because they are part of the state as a whole, the Supreme Audit Institutions shall have the functional and organizational independence required to fulfill their tasks.*

Independence is typically accomplished by creating the SAI as an organization apart from the government. Often, the SAI is responsible only to the national legislature. This is the arrangement in the United Kingdom, most of the countries that are members of the Commonwealth, several other countries of the European Union and the United States, in all of which the SAI reports to the legislature. Another way of securing independence from the auditee, the government, is to make the appointment of the Auditor General or the members of Courts of Audit dependent on approval by the legislature. Auditor Generals are normally appointed either by the legislature or by the legislature together with the government. As an exception, the appointments of the Auditor General in Sweden and Finland rest with the executive. Members of Courts of Audit and/or the President of Courts of Audit are in some countries appointed by the legislature or the legislature together with the government. This is the case in Spain, Germany, and the Netherlands. In other countries, such as Italy, France and Portugal, appointments rest with the executive. Here the independence is safeguarded through the independent and indissoluble status of the Court members.

It is essential that the institutional independence of the SAI be genuine. The constitutional or statutory basis for the organization should be clear. The SAI should have its own budget. It should have statutory authority to determine the scope of audits, to obtain any documents and records relevant to the audit, and to exercise its judgment as to the audit results to be reported.

Not only must the organization be independent, the individual auditors must also be with respect to the audits on which they are working. This matter is usually handled through internal regulations promulgated by the SAI, but may also be covered in various laws, including those that are generally applicable to the civil service. For example, it may be appropriate to have laws and regulations requiring that an individual auditor not be an investor in an entity that might be affected by the results of the audit. Such potential conflicts of interest arise more often than one might suspect. If the SAI is auditing the operations of a government computer system, the auditors on that assignment should not own shares of stock in any computer firm that might benefit from the results of the audit, such as a firm that might compete to supply replacement computer equipment.

Other requirements may be imposed to avoid any likelihood that the audit work will be (or might appear to be) subject to improper influence. Auditors may be prohibited from active participation in political parties. They may be prohibited from auditing an entity in which a close relative by blood or marriage holds a position of responsibility. Rules to avoid such conflicts of interest are often inconvenient, but the independence of the auditor is central to an SAI's credibility and the inconveniences must be tolerated.

b. Professional skills

Auditing is a profession that encompasses a wide range of technical skills, mirroring the types of audits and auditees that the SAI may be required to face. Few, if any, auditors possess the entire range of skills that may be needed by an SAI. For each individual audit, however, it is essential that the audit team, as a whole, possesses the knowledge and skills required for that particular audit. If the SAI is auditing the financial statements of an entity, the audit team must include (and preferably be led by) a fully qualified financial auditor. In most countries, this ability is evidenced by some type of certification, usually one that is issued following completion of a course of study and successful completion of a related examination. There may also be a required period of practical experience. If the SAI is auditing a government computer system (or an activity that is highly dependent on computer support) the audit team should include individuals who are knowledgeable about computers and experienced in auditing such systems. This, too, may be evidenced by a special certification of competence.

From time to time, an SAI will encounter a situation in which it must carry out an audit for which no one on the permanent staff has the requisite knowledge and skills. When such situations arise, the SAI must be able to obtain the needed skills elsewhere. The most common solution is to hire consultants who can help plan and guide the audit and interpret the data resulting from the audit work. In other circumstances, the SAI may contract a private firm to carry out all or some part of an audit for which it lacks the necessary resources or specialized skills.

Such consultants and contractors can be an important supplement to the SAI's own staff, but great care must be taken in using them. The outside expert or firm may perform the work, but the SAI remains responsible for the results. Thus the SAI should require the experts and contractors to adhere to the same standards of objectivity and independence, including avoidance of conflicts of interest, which the SAI's own staff is subject. In addition, the SAI should maintain sufficient oversight of the work performed by others, to confirm that it was done competently before approving any findings based on that work. In some circumstances, the SAI may need to seek advice from other experts in assessing the quality and reliability of a contractor's work.

Using the work of others as a basis for reaching audit conclusions is the subject of much discussion among auditors. The previously mentioned *European Guidelines* document addresses this issue at some length. It is also the topic of a study published in 1994 by the International Federation of Accountants entitled "Using the work of other auditors: A public sector perspective".

2. Types of audits

Many different kinds of work are subsumed under the term "auditing". Most SAIs are authorized to perform any of these activities, but they may be required to perform certain audits. The SAI must develop a strategic plan that will allow it to carry out any mandatory audits while also using its available resources in a cost-effective way on other types of audits.

a. Ex-ante audit

In this type of auditing, also called “pre-audit” or “a priori auditing”, individual transactions are examined for propriety before they are completed. That is, a payment may not be made until the auditor has approved the related voucher after examining the supporting documents. Centralized ex-ante auditing by the SAI is still practiced in many places. In other countries, however, such audits are viewed as being an element of the management control structure, and therefore are a responsibility of management, not of the SAI. In these countries, ex-ante auditing by the SAI has been largely abolished, with the SAI focusing instead on the reliability of the measures taken by each ministry to avoid improper payments and other transactions.

b. Regularity audits

This form of government auditing involves checking individual transactions after the fact, to assure that the appropriate authorizations and documentation are present. The focus is on determining the legal propriety of the individual transaction.

An SAI that does a substantial amount of regularity auditing needs to decide its strategy for such work. It might decide, as others have, to delegate that responsibility to the ministries. However, this may not be a practical solution in a country where management controls in government entities are weak and unreliable. In that situation, the SAI may, for the time being, be the only institution capable of detecting and halting irregularities. If that is the case, the SAI should carefully consider how its regularity auditing resources can be used with greatest cost-effectiveness.

Few, if any, SAIs have enough staff resources to examine every transaction in every unit of government. It would be wise for an SAI, preferably in cooperation with the Ministry of Finance and the internal audit units of the operating organizations, to use its available auditing resources as part of a coordinated strategy for strengthening the management controls that can prevent irregularities and other sources of waste of budget resources, rather than in an ultimately futile effort to detect and correct every regularity that may occur. By the strategic use of regularity audits, the SAI can identify the control weaknesses that permitted the irregularities to occur and demonstrate the consequences of failing to correct those

weaknesses. The Ministry of Finance or other central management agency can then use this information within the Government to emphasize the necessity of improving controls and, in particular, of strengthening the internal audit units that are an essential element in building and maintaining effective control structures.

There are several ways of implementing such a strategy. One approach would be to concentrate on areas where frequent irregularities are known to occur. In some countries, this might include such matters as wage- and salary-setting procedures or cash disbursements for routine supply purchases. The individual irregularities in such areas may be small but their total amount may be large. Furthermore, they may create a climate of tolerance which, over time, can weaken the integrity of the entire organization.

Another approach would be to focus on specific areas of government activity, where there is judged to be high risk of major irregularities. In many countries, for example, SAIs have come to recognize the risks associated with large procurements and have concentrated substantial resources on audits of such procurements in an effort to strengthen the procurement system. Thus, process audits (or management audits) are needed, as discussed later, in “value-for-money” audits.

The real purpose of a strategic approach to regularity auditing should be to strengthen the systems to prevent irregularities, not just to detect past errors, although that will also occur. Most SAIs have found the practice of routinely auditing individual transactions to be a very inefficient way of seeking better management of state resources. Identifying individual errors and transgressions may (or may not) result in correcting that particular error, but experience shows that, unless regularity auditing is part of a broader strategy to overcome the sources of irregularities, detecting an irregularity is unlikely to prevent the same error from arising the next day or the next year.

c. Financial audit

As used here, the term “financial audit” implies more than is described in the foregoing section on regularity audits. Many SAIs are required to perform annual audits of the State budget or other government financial reports. The objective of such an audit should be to

determine the reliability of the data in the report. For example, the audit report may be required to be completed before the legislature can accept the financial report.

The nominal objective of such an audit is to render an opinion as to whether the reader of the statement or report can be reasonably sure that the information contained in the report is correct. To render such an opinion, however, the auditor must go far beyond an examination of the statements and reports and of summary documents that supposedly support those statements. The auditor must also examine the accounting and other systems that are used to compile the data and the accounting and other controls that are intended to assure the proper reporting of transactions. A relatively small sample of various types of individual transactions is often examined as a way of testing the effectiveness of the accounting systems and controls. Thus, the true focus of such an audit is the reliability of the systems and management controls underlying the statements and reports.

SAs have taken various approaches to satisfying such requirements, some more successful than others. One technique is to examine a few of the transactions that are included in the report, relying on the auditor's judgment in selecting those transactions. If no errors or irregularities are found in the selected transactions, the report is considered accurate and that conclusion is reflected in the audit report. This approach can also be valid for assessing the efficiency and policy compliance of nonfinancial transactions.

Users of financial data in the finance ministry, the legislature, and elsewhere should view an audit conducted in this manner with considerable skepticism. There is no valid statistical basis for assuming that a judgment sample of this sort is representative of the entire body of transactions included in the financial report, even if the sample was drawn by an experienced auditor. Thus, one can have little confidence in conclusions reached about the overall report on the basis of having audited a judgment sample of transactions.

An alternative is to examine a sample of transactions that is statistically representative of the entire body of transactions. Such an audit demands the assistance of skilled statisticians, who should also be involved in interpreting the results. If a sample audit is performed properly, the user can have relatively high confidence in the results.

In some countries, the auditing of government financial reports employs a basically different approach, modeled on the techniques used in auditing the financial statements of commercial enterprises. This type of audit has been found to be particularly useful in strengthening the management of state resources.

Some SAIs may need to outsource some of their financial statement audit work because of their limited audit resources. However, each SAI must determine how best to meet its responsibilities in this area. It needs to make a strategic judgment as to the extent of outsourcing required and how it will assure itself that applicable standards will be followed, if the work is to be done by others. In any event, the SAI must equip itself with staff who are sufficiently skilled in this type of auditing to assess the quality of the work, even if that work is to be outsourced.

d. Value-for-money audits

This type of audit has become increasingly common among SAIs. A value-for-money (VFM) audit examines an entire entity, activity or program to suggest ways of improving the efficiency of those operations. The VFM auditor searches for areas of waste and mismanagement which, if eliminated, would permit the same purposes to be achieved at less expense, and for areas where the same resources, used differently, would produce greater value for the same cost. This type of auditing can make a major contribution to increasing the efficiency of government. Audit reports with useful recommendations in this area are typically quite popular with those who are trying to deal with difficult budgetary problems, such as ministries of finance and committees of Parliament with budget responsibilities. However, value-for-money auditing is quite different from regularity auditing and financial statement auditing. It requires the ability to analyze operations in a way that is more often associated with the profession of management consulting than with traditional auditing. SAIs wishing to begin this sort of auditing must make a strategic decision about how much they are prepared to invest in training to build a staff with competence in this work.

e. Other work

Some SAIs have gone beyond the traditional VFM focus on economy and efficiency to the performance of program evaluations. The boundary between VFM auditing and program evaluation is fuzzy. In general, however, VFM audits focus on efficiency (cost per unit of output) while program evaluations focus on outputs (amounts accomplished) or outcomes (program effects on society). As discussed in the next part of this chapter, program evaluations involve a careful effort, based on scientific methods, to measure the actual direct accomplishments or effects of a program in terms of its stated objectives. For a variety of reasons, SAIs rarely perform the most advanced types of program evaluations, such as social experiments. However, they may be called upon to examine the validity of such experiments and, if they have the required skills, they may be asked to perform time-series evaluations and case studies. This area, too, requires skills that are quite different from traditional auditing. For example, effective program evaluations often require staff with the capability to perform sophisticated statistical analyses. Building a staff with these capabilities will require a considerable investment in training.

As the SAI's stature and credibility grows, it may be asked to perform other tasks, outside the traditional realm of auditing. For example, an SAI with a strong field organization may be asked to assemble information that is relevant to the debate on major policy questions without performing any analysis of that data. Or, because of its expertise in assessing the management and operations of organizations, the SAI may be asked to advise the government in restructuring its ministries and agencies. Or, because of demonstrated expertise in a particular area of policy, the SAI may be asked for its advice on policy questions that go well beyond its audit and evaluation work. Requests of this sort are most likely to arise if the SAI has developed an especially close working relationship with the Government or Parliament.

A relationship of this sort is usually highly desirable, as it is a valuable way of focusing attention on important findings and recommendations, and thus of gaining corrective action on problems that the SAI has uncovered. However, such a relationship must also be handled with great care.

If the SAI becomes too close to the Parliament, the members of Parliament may be tempted to treat the SAI as a "staff agency", without adequate regard for the SAI's

independence, and may seek to impose tasks that unduly burden the SAI with nonaudit duties and that may undermine the SAI's credibility with regard to its primary responsibilities. The same risks are involved in the relationship with government, especially the Ministry of Finance (MOF). The SAI and the MOF should cooperate wherever possible, as the MOF can play a key role in implementing SAI recommendations. However, the SAI should carefully preserve its independence from the MOF and must avoid being seen as its agent or surrogate. Finally, despite the great temptation to speak out on matters on which the SAI may, in fact, have considerable expertise, the SAI must avoid offering opinions and advice that are not the direct outgrowth of work it has performed, lest it be seen as only one among a chorus of voices on controversial policy questions.

Because of the potential diversity of the tasks that an SAI may undertake, it is essential that careful thought be given to relative priorities. The highest priority should usually be assigned to building and maintaining the integrity of the public financial systems, especially in places where the risk of corruption is high. In countries where management controls are of limited reliability, as is typically the case in transition and developing countries, this suggests an emphasis on regularity and financial statement audits as part of a strategic effort to strengthen controls. VFM audits and, especially, program evaluations should normally have somewhat lower priority until basic problems in management controls and financial reporting have been overcome.

3. Reporting audit results

Requirements for the distribution of audit reports are often specified in the laws establishing an SAI and specifying its authority and responsibilities. In many countries, all audit results are required to be reported to the Parliament. The reports may be forwarded individually, or may be provided in a summary report at specified intervals, perhaps annually, or both. Often, reports to the Parliament are automatically delivered to a single committee with responsibility for overseeing the work of the SAI, such as a Public Accounts Committee. Typically, however, requirements such as these describe only the minimum permissible distribution of audit reports. Most SAIs have considerable discretion to distribute additional copies of their reports as they deem appropriate.

The general rule for distributing audit reports should be to provide copies to those with an interest in the topic and especially to those who should act on the findings and recommendations contained in the report. For example, the entity that was audited should always be informed of the results and the Ministry of Finance (or other central budget office) should be routinely informed of reports that have implications for budget allocations or the management of budget resources. If the audit shows the need for new or revised legislation, the SAI should bring this to the attention of the parliamentary committees that would consider such legislation and the ministry that would be responsible for proposing or implementing it.

The SAI and other auditors should also recognize that, in a democracy, the general public has a legitimate interest in the results of audits of public entities and of the use of public funds. In many countries, all SAI audit reports are made available to the public unless they must be restricted for national security reasons. Auditors should also recognize the role played by the media in informing the public about government operations and should take steps to assure that media representatives are aware of significant audit reports. A competent and proactive media is critical for the effective administration of audit results, as the public at large is most unlikely to be interested or directly competent to interpret the audits.

4. Gaining action on audit results

1. Some SAIs are empowered to order corrective actions of certain kinds when irregularities are found during an audit. When an overpayment is discovered, for example, these SAIs may issue an enforceable order to recover the excess payment. However, this authority is usually available only with respect to matters of regularity and many SAIs lack such authority even in these matters.

For the most part, auditors are authorized only to report what they have found. They must rely on others to correct the reported problems. This is especially true with respect to matters on which modern auditing tends to concentrate, the adequacy of management controls and the economy, efficiency, and effectiveness of programs and operations. Some SAIs are empowered to issue binding directives, but this is typically limited to recovering funds that have been misspent. If the problem is more complicated than this, solving it may require action by the Parliament, the government, a line ministry, or an operating agency. Typically, the auditor

cannot force any of these to act. However, the auditor bears considerable responsibility for encouraging an appropriate response to audit findings and for facilitating needed corrective action. There are several things an auditor should do to meet this responsibility:

- *Clear findings.* General observations that “money was wasted in program X” are not helpful. Auditors must state as clearly and specifically as possible the nature of the problems they find and the consequences of those problems. Which management controls were absent or failed and how much money was wasted or misappropriated because of that failure? Which specific policies or procedures caused the observed inefficiencies and what was the effect of the inefficiency? It is the auditor's responsibility to assure that the reader of the audit report can easily grasp the nature of the problem and the importance of correcting it.
- *Convincing evidence.* The evidence supporting the findings must be relevant and credible and must be presented in a clear and persuasive fashion in the report.
- *Cost-effective recommendations.* If an auditor identifies a problem, it is incumbent upon him to suggest a reasonable solution for that problem. As with findings, general remarks about solutions are not helpful. If there was a failure of controls, the audit report should specify the actions needed to prevent a recurrence. If changes are needed in laws, regulations, or administrative procedures to achieve greater efficiency or effectiveness, these should be described with as much precision as possible. It is also essential that the recommended corrective actions be legally and administratively feasible and that the costs of implementing them not be disproportionate to the problem. The goal should be to convince the reader of the wisdom of correcting the problem.
- *Effective communications strategy.* The best-written audit report serves no purpose unless its contents are made known to those who can act on its findings and recommendations. The auditor should think carefully about who needs to read the report and how best to assure that they give it the attention it deserves. Merely sending the report to someone may not be sufficient. Parliamentarians and government officials are busy people and typically receive far more written material

than they can find time to read. A brief, well-written executive summary accompanying the report can help, as can follow-up conversations with the official or with key members of his staff. It is often useful to work with others, such as officials of the Ministry of Finance, who may be in a position to encourage appropriate action. In addition, if the media gives attention to a report, this can be a helpful stimulus to corrective action.

In many cases, audit units issue “audit observations”. These are based on evidence and advise the auditee that corrective action is needed (specifying the nature of the corrections). The auditee has the opportunity to make changes before the final audit report is written the audit report would then contain information on the audit observations and on actions taken or not taken on them. As stressed in the discussion on accountability in chapter 1 dialogue is often more effective than faultfinding, and is far more constructive for institutional capacity building. Box 30 illustrates the variety of useful audit findings.

Box 30
Some Examples of Concrete Audit Findings

Audit can uncover not only financial irregularities, but deviation from moving or performance issues:

- Japanese auditors found improprieties in the House Purchasing Loan Program, which was designed to facilitate home ownership. Several borrowers rented out the houses they had purchased, violating program requirements. Most of the improperly borrowed funds were recouped.
- New Zealand auditors examined the procedures used to prevent and detect improper payments for medical and pharmaceutical services. They found that existing procedures detected some irregularities and probably deterred others. However, some types of transactions, representing considerable risk to the funds because of high estimates of probable irregularities, were not adequately covered by existing procedures. The auditors recommended procedural improvements to reduce this risk.
- Indian auditors found that machinery for a state enterprise was purchased at an unnecessarily high price, that installation of the machinery was delayed beyond the warranty period, that defects subsequently developed and that the machinery was lying unused.
- Hong Kong, China auditors examined the status of General Post Office facilities occupying a very valuable waterfront site. They concluded that considerable savings could be realized by relocating the facility. Such relocation, however, was severely delayed by lack of proper planning and coordination and by unnecessarily restrictive specifications for the new site.
- In an assessment of the new drug evaluation and approval process. Australian auditors found that there had been great improvement in the speed with which drug applications were approved. At the same time, improvements were needed in the reporting of adverse reactions to drugs.
- In auditing the execution of the State budget, auditors of the People’s Republic of China found that some departments violated standards and laws in managing their finances, that some financial reports were untruthful, and that some entities failed to collect or surrender

5. Limitations of audit

Reasonable assurance. The audit profession has strengths, but there are limitations as well. No reasonable auditing procedure can be sure of finding every error or irregularity. The prevention and detection of errors and irregularities is, first and foremost, the responsibility of management, not the auditor. If problems are discovered later, the auditor should be held responsible only for conducting a proper audit in accordance with auditing standards. It is in the nature of auditing that some mistakes, only minor ones, it is hoped, will escape the auditor's attention.

For example, in auditing the financial statements of an entity, the auditor can provide only "reasonable assurance" that the statements are reliable. Neither the auditor nor the reader of the audit report should believe that such an opinion is an absolute guarantee that there are no material errors in the statements. The limitations discussed in the management controls section of this paper apply to audits, as well. If there is collusion among key individuals in the entity, or if there is an intentional effort on the part of the top managers deliberately conceal facts, there can be no absolute assurance that the auditor will detect the resulting distortion of the truth. Thus, the phrase "reasonable assurance" in an audit opinion must be taken seriously by the reader, and it is the SAls responsibility to stress this point.

Access to data and records. Auditors can audit only that which they can observe. If the management of an entity maintains secret records involving matters that are material to the audit, to which the auditor is not permitted access, the audit will have no credibility and should not proceed. In government auditing, these cases arise most frequently with regard to agencies involved in national security activities. However, auditors may also encounter situations in which access is restricted or denied in an apparent attempt to avoid disclosure of illegal, corrupt, or politically embarrassing activities. In these circumstances, the auditors should report the facts to others, such as the Parliament, who may be able to facilitate the required access or take other appropriate action.

C. EVALUATION

Evaluation is the key function that connects the past to the future—that feeds lessons from actual experiences back into the programming and decisions for future actions. It is the element that “closes the circuit” and permits progress to be made.¹ Of course, it is only one such element. To quote from Petrei (1998, p. 393):

“Evaluation should not be understood as an alternative or substitute for other techniques that promote spending efficiency. Rather, it is one of several complementary practices that should be mutually reinforcing. The evaluation of a program or project requires the comparison of results with what was anticipated in the program design. If project or program goals are stated clearly, their evaluation is significantly easier. For that reason, performance indicators are especially useful for evaluation tasks. A program with well-defined mileposts that establish the scope of certain goals, is much better able to have a complete evaluation, using those mileposts as anchors for a more detailed examination of the achievements. As noted, the conceptualization of goals themselves will indicate how far an evaluation can go.”

1. Objectives of evaluation

The goal of program evaluation is to improve decision-making and resource allocation by providing reliable data about the effects of policies and programs. For this reason, program evaluations of high quality should be encouraged, valued, and used by those responsible for managing the budget and other policymaking processes.

There are a number of circumstances in which those making budget decisions will want to know the effects of a government program. In an environment of limited budget resources, it is important to consider the likely effects of a potentially expensive policy change before deciding to implement it. For example, will early childhood education, or smaller class sizes, or longer school terms have the greatest likelihood of improving the educational attainment of children from families living in poverty?

Once a program has been operating for some period of time, policymakers may want to know whether or not its affects are commensurate with its cost. For example, does participation in a job-training program actually increase the number of previously unemployed individuals who find employment? Does a profit-motivated clinic or hospital deliver services more efficiently than a free, government-operated institution?

The objective of program evaluation is to provide reasonably reliable answers to questions such as these.

2. Prerequisites for an effective evaluation

Evaluations are useful only in an environment in which decisions will be based on analysis rather than ideology, and in which cost-effectiveness is an important goal. This may seem obvious, but in every country there are certain topics which, at a particular time, are not susceptible to analytically based decision processes. These topics are matters of faith or ideology and it would be pointless to raise questions about them, no matter how well-founded in logic and analysis.

Thus, evaluations must be part of a wider performance management framework in which there is a systematic search for ways to make government programs as effective and efficient as possible.

For evaluations to be effective, there must be cooperation among the key participants in the evaluation process. Those who request the evaluation must work with those who perform the evaluation and those who will be affected by the results.

The *requester* must define clearly the question to which he wants an answer and the time frame within which the answer is needed. The requester may be the Parliament or one of its committees, a ministry, a budget office, or the managers of a program. However, in reality, many evaluations are done not in response to a request but to fulfill a management commitment and the evaluators must rely on their own judgement in determining what to evaluate.

The *evaluator* must define clearly the process and resources that will be needed to obtain the answer and must set forth the limitations on his ability to assure the reliability of the answer, in the light of any time and resource constraints imposed by the requester. The evaluator may be part of the analytical staff of a ministry or, an audit organization, or an outside contractor. Whoever fulfills this role must have the technical and managerial skills necessary to plan and implement the evaluation successfully. An evaluation involving staff examining data at multiple sites, for example, can be a huge managerial task. Moreover, evaluation of complex programs often relies heavily on sophisticated techniques of statistical analysis, without which reliable findings cannot be developed.

The intended *user* of the evaluation (who may or may not also be the requester or a stakeholder, or both) must be involved in planning the evaluation to assure that the results will be relevant to the user's decision process.

The views of *stakeholders* (those with an interest in the outcome of the evaluation, such as those operating a program under examination) must be considered in defining the question and planning the evaluation, as they are typically expected to supply data to the evaluator and often play a major role in interpreting the results and in implementing any recommendations that emerge from the evaluation. Stakeholders often are the people with the best understanding of the "real" world of the program. If they are actively involved in the evaluation, they can provide important assistance in planning and implementation. However, stakeholders sometimes feel that their interests are threatened by an evaluation. If they become actively opposed, they can sometimes sabotage the project.

If these participants in the evaluation do not come to an agreement, it is sometimes very difficult to carry out an effective evaluation plan.

3. Types of evaluation

Evaluators have developed a variety of techniques for assessing the effects of programs. Each method has both strengths and limitations. None is perfect and none is appropriate for all situations. For discussion purposes, they are grouped here into three broad categories, although each category contains numerous variations.

a. *Experimental design*

A true experimental design is modeled on the work of laboratory scientists. In such an experiment, the scientist attempts to hold everything constant except for the one variable that is the subject of the experiment. If the experiment is successfully constructed, the observed effects can be determined with high confidence to have been the result of changing the single variable. In program evaluation, this method is usually found in the assessment of social welfare programs. The strongest designs involve randomly assigning people to two groups. This randomization is intended to make the two groups as similar as possible in all respects. One of the groups, called the "experimental group" or the "treatment group" participates in the program of policy under examination. The other, called the "control group" does not participate. In a properly constructed experiment, the differences in outcomes between the two groups can be attributed to the effects of the program or policy.

An evaluation based on a strong experimental design has the advantage of producing results in which there should be a high degree of confidence. Unfortunately, it is often very difficult to obtain such reliable results. Full comparability of control and treatment groups can be hard to achieve and differences may later come to light that contaminate the results. For example, one group may later be found to have a higher proportion of people with certain cultural characteristics, such that they respond differently to the treatment. Another problem is how to decide who is in the treatment group and who is not.

In addition, a true experimental design can be quite expensive in terms of both resources and time. The experimental approach works best when both groups are relatively large, so that potentially small statistical differences in outcomes can be confidently attributed to the program rather than to random chance, and when the two groups can be observed over an extended period, so that delayed effects have time to emerge. The cost of the evaluation thus tends to increase, because of the increase in the cost of the benefits being provided to

the treatment group as well as the costs of collecting data and managing the evaluation project.

Developing countries, by contrast, these evaluations need to be built into a project. Project officers would have to decide that they want to test the form of an experimental evaluation. This does not happen often for a variety of reasons: no time, no interests, no control. Experimental evaluation can not be done ex-post. Even evaluating a project while it is ongoing is difficult, because treatment groups would have been chosen in a way that may not allow easy construction of a control group.

b. Time-series analysis

This technique involves the analysis of time-series data in a search for changes in the trend lines that may be attributed to a policy or program under examination.

For example, in response to budgetary constraints, those financing a public health clinic may plan an increase in the fees charged to people visiting the clinic. Because of the obvious political sensitivity of such a change in policy health, ministry officials (or officials of the Ministry of Finance) may want to determine the effect of that increase. The evaluator may start by examining administrative data on clinic visits before and after the increase in fees. He might well observe that, after the fees are increased, the number of patients visiting the clinic on an average day drops by a significant percentage. It would be reasonable to conclude initially that the increased fees were at least partially responsible for the decline in visits, on the premise that some potential patients were discouraged from using the clinic because of the higher costs.

In addition, however, other important questions would need to be considered before the evaluation could be considered complete. Did other factors affect clinic usage at the same time as the increase in fees? This careful search for other possible explanations is a vital part of any evaluation. Without it, time-series data alone is quite unreliable as a basis for reaching conclusions about effects. Just because two events occur one after the other, does not necessarily mean that the earlier event caused the later event. To reach this conclusion, the evaluator must have both a logical basis for thinking that the two events would be related (in

this case, the long-standing economic principle that higher prices reduce consumption) as well as the ability to rule out other competing explanations. More effectively, and certainly more logically, the evaluator should solicit feedback from the people who were affected by the change—which is normal practice in a good evaluation, as noted earlier.

A second important question that most evaluators would want to answer relates to the people who did not seek service at the clinic. Were they individuals who would probably not have gained materially from that service? Or were they people who later became even more seriously ill because of the lack of treatment? This apparently difficult question can be answered in small communities by feedback from the local health centers, and in larger communities by appropriate random surveying of the entire population.

High-quality time-series analysis depends heavily on the availability of reliable baseline data. That is, to assess the results of a change in a policy or program, the evaluator needs sufficient and relevant data about the situation that existed before the change (see the extensive discussion in chapter 15). This makes it almost essential that the evaluation be planned, and implementation begin, before the change in policy is implemented. It is very difficult, and sometimes impossible, to reconstruct important elements of the baseline later.

c. Case studies

This evaluation technique involves the systematic examination of a particular operation in an attempt to identify what causes the results that have been attributed to that operation. For example, a country may have a large number of offices providing social welfare services. Ostensibly, those offices are identical in terms of staffing, services provided, etc. However, a few of those offices may have reported consistently superior operating efficiency or greater output than the others. The responsible ministry (or the central budget office) might wish to know why those offices are superior, in the hope of saving budget resources by replicating this performance in other offices.

In this situation, the most effective approach would often be a detailed case study comparison of one of the "superior" offices with one or more of the others. As with any evaluation, the most difficult task is to determine the cause of the reported superior results,

and to do so with a high level of confidence. This means searching for possible explanations and either ruling them out or describing logically how they may have caused the observed effect. This is a particular challenge for case studies because there are typically many differences between the "superior" offices and the control group. That makes it very difficult to rule out any of the differences to settle on the particular set of differences that account for the differing results. Thus, while case studies often yield highly useful information, particularly about ways of improving operating efficiency, they typically provide relatively low confidence levels in the attribution of results to particular causes.

4. Conclusions

The goal of evaluation is to provide decision makers with information that they need to decide whether to continue or change a policy or program, by measuring the effects of government policies and programs and to ascribe those effects with confidence to the policy or program under examination. There is a variety of ways of answering evaluative questions. Each has its strengths and limitations and the choice among them should not be considered a purely technical question. Successful evaluations require agreement among the affected parties, especially between the evaluator and the requester, as to the question being examined, the resources (both money and time) available to answer the question, the evaluation method that will be used in the light of the resources that are available, and the level of confidence that one can expect to have in the answer.

D. KEY POINTS AND DIRECTIONS FOR REFORM

1. Key points

Management controls, (also called "internal controls") are the policies and procedures put in place by the managers of an entity to ensure the proper and effective operation of the entity. There are many kinds of management controls. Developing an effective system of controls requires, first, a careful assessment of the risks facing the organization. Policies and procedures can then be selected to control those risks effectively and at reasonable costs.

Management controls are a basic responsibility of any manager. To be effective, the management control system must have the strong support of the entity's leadership. Policies and procedures must be observed consistently throughout the organization. Irregularities revealed by the control system must bring prompt and effective corrective action. To assure continued effectiveness, both the risks facing the organization and the control system, itself, must be reassessed frequently.

No system of controls can provide an absolute guarantee against the occurrence of fraud, abuse, inefficiency, and human error. However, a well-designed system of controls can give reasonable assurance that significant irregularities will be detected. At the same time, even well-designed controls can be defeated by collusion, especially if that collusion involves senior executives who have the power to disarm or bypass the control system. As stressed earlier, effective accountability requires appropriate external feedback and "voice".

Internal audit is part of an organization's management control structure. It performs audits of lower level units on behalf of the top management of the entity. Some of its most important functions are to test the management controls themselves and to assist management in assessing risks and in developing more cost-effective controls.

External audit of the government is typically performed by a separate organization, the SAI, which usually reports its findings to the legislature and/or the public, as well as to the audited entity itself. SAIs may perform several types of audits, including ex ante audits, compliance/regularity audits, financial (assurance) audits and value-for-money (efficiency) audits. The appropriate audit emphasis depends on the particular circumstances of each country. Weak or non-existent management controls in government organizations may require the SAI to conduct extensive auditing of individual transactions in an ex ante or compliance/regularity mode. However, this is an inefficient use of audit resources. An SAI in these circumstances should work with the legislature and the Ministry of Finance to implement a coherent strategy for building effective systems of management control.

The credibility of external audit requires that the SAI and its staff be independent of the governmental units being audited and have unrestricted access to required information. This independence is typically set forth in the legal provisions establishing the SAI. The SAI must

guard this independence zealously but, at the same time, its effectiveness depends on maintaining a professional, cooperative relationship with the legislature, the government and the entities being audited.

There are several organizational models of SAI designed to reinforce independence while also providing effective management of the SAI as an organization. Most are variations of the “office” model, headed by an Auditor General reporting to the legislature (typical of Commonwealth countries) or of the “court” model, in which the auditors have the status of law court judges (as for example in France and Italy). Combinations of these two basic models are also seen in some countries.

To be effective, the SAI’s audit staff must possess the professional skills required by the audits being performed. For an SAI to move from ex ante and regularity audits to financial assurance and value-for-money audits will require extensive training or the hiring of new professional cadres to perform these more complex audits.

The SAI, especially one pursuing strategic objectives such as improved management controls or undertaking more advanced types of audits, needs an effective means of communicating audit results and a sound approach for encouraging appropriate corrective action.

No audit, however thorough, can provide absolute assurance of detecting every irregularity or error. An audit can give only reasonable assurance that any material errors will be found and reported. Even this level of assurance that any material errors will be found and reported. Even this level of assurance can be given only if the auditors have access to all needed records and the audit was performed in accordance with generally accepted auditing standards.

Program evaluation is a systematic effort to identify and measure the effects of government policies and programs. The more sophisticated forms of evaluation, experimental design and time series analysis, involve the collection and statistical analysis of large volumes of data to isolate reliably the effects of the program from other factors that might have caused

these effects (“impact evaluations”). Case studies provide less reliable information about causation but have proven useful in identifying ways of improving efficiency.

For an evaluation to succeed, there must be clear agreement on the question being examined and the data required to provide a reliable answer. Those performing the evaluation must have the professional skills and resources needed to collect and analyze the data. The evaluator often must depend heavily on the cooperation of operating units to gain needed access and to collect needed data. Program evaluation itself, like value-for-money audit, must show that it is cost-effective relative to the improvements to be identified or the progress expected.

2. Directions for reform

The several elements that can contribute to the integrity, efficiency, and effectiveness of government organizations and programs, must be instituted by the government; they do not come into existence because one wishes them to. Some of the key considerations involved in the development effective management controls, auditing, and program evaluation are as follows.

A government that is convinced of the need to build or strengthen its control and analysis capabilities needs to define a strategy for accomplishing these goals and to establish responsibility for doing so. In most countries, there are two institutions that should play critical roles in this process, the Ministry of Finance and the Supreme Audit Institution. Typically, the MOF, because of its central position in managing the government's finances and its authority over the state budget, has unusual influence over the line ministries with regard to their control structures, especially their accounting systems and procedures. The SAI, because of its special expertise in auditing, is usually a reliable source of advice and technical assistance in defining the steps that need to be taken. Ideally, the strategy should be the outgrowth of consultation and cooperation between these two institutions. Implementation of the strategy, involving the actions that must be taken by the line ministries, should be the responsibility of the ministers and senior civil servants in those ministries, under the leadership of the MOF and external oversight by the SAI.

It is not possible to develop all the needed institutions and procedures at one time. Thus, it is necessary to set priorities. In almost all countries, and especially in developing and transition economies, the highest priority should be placed on assuring the reliability of the financial systems and the integrity and security of the controls over transactions. This translates into placing first emphasis on building reliable management control structures and effective internal audit units in the ministries and on assuring the effectiveness of the SAI as the external auditor. Only when these structures are in reasonably satisfactory condition is it worthwhile to focus on the efficiency and effectiveness of operations.

Countries need not be dependent exclusively on their own knowledge and experience in the development of effective management controls, auditing and program evaluation. Technical assistance is available in all these areas from multilateral institutions, donor nations and professional organizations. The assistance can take the form of providing relevant documents, formal training and temporary secondment of experts, as well as financial support. Donors, whether bilateral or multilateral, are typically committed to helping developing and transition countries build their management controls and auditing capacity as a way of helping assure the effective use of donated funds. SAIs and MOFs in developed countries are often prepared to provide technical advice and assistance to their counterparts in developing and transition countries because of their professional commitment to the importance of sound financial management in all countries.

¹ The experience of Australia, among developed countries, and Costa Rica, among developing countries, has been particularly positive.