

NAOD LEGAL-CRITICAL AUDIT POLICY

I. Introduction and summary

1. The legal-critical audit has a central position in the audit work of the NAOD because the ever-increasing state regulation of the units subject to audit makes it necessary to prioritise the Parliament's (Folketinget) supervision of the lawfulness of the transactions encompassed by the state accounts and due process protection of individual rights at the same time.

The purpose of the policy is to ensure high-quality, consistent performance of and reporting on the legal-critical audit. The policy should also be viewed against the background of the working group's report on legal-critical audits.

The legal-critical audit must be seen in conjunction with the mission and the visions, targets and strategies established by the NAOD for its overall audit. The legal-critical audit forms part of both the financial audit and the performance audit.

2. Paragraph II.A of the NAOD's legal-critical audit policy opens with a clarification of the concept of "legal-critical audit" on the basis of the Auditor General's Act and the generally accepted standards for good public auditing practice at any time.

Paragraph II.B briefly describes who (the units) and what (the object) are comprised by the legal-critical audit, whereas paragraphs II.C and D specify the contents of the legal-critical audit (the verification). Finally, paragraph II.E defines the limits of the NAOD's authority in connection with legal-critical audits.

Paragraph III deals with the planning process, which must reflect, as usual, the objective and scope of the audit. Paragraph III.A gives a brief account of the materiality and risk concepts in legal-critical audits on the basis of the existing auditing practice.

Paragraph IV deals with the implementation of the legal-critical audit, which in principle takes place in the same manner as financial audits and performance audits. It also refers to a number of forms which the legal-critical audit may take.

Paragraph V explains that the reporting on the audit to the audited unit always takes place according to best practice and that the legal terminology is complied with and used in the correct context.

Finally, paragraph VI explains that the quality assurance complies with the NAOD's quality assurance standards and is performed on an ongoing basis as well as subsequently, if necessary as an external quality assurance with the involvement of legal experts.

II. Legal-critical audits

A. Clarification of concepts

3. A legal-critical audit examines whether the activities (transactions) carried out are authorised by legislation, including whether the audited unit has the necessary authority and legal competence to effect the transaction.

The control of the audited unit's compliance with acts and provisions comprises not only the application of acts but also a verification of whether the intentions of the Parliament have been fulfilled as expressed in the legislation and related legislative material, including regard for due process protection of individual rights.

4. The NAOD audit constitutes an entity of which the legal-critical audit is a part. The legal-critical audit interacts with, overlaps and supplements financial audits and performance audits. It is thus an element of the standards considered generally accepted standards for good public auditing practice at any time.

5. "Good Public Auditing Practise – guidelines" ["God offentlig revisionssskik (GOR) – en vejledning"] apply, but do not specifically define the concept of legal-critical audits:

"... in connection with a financial audit, the auditor verifies ... that the transactions encompassed by the accounts comply with ... acts, other regulations, agreements entered into and usual practice (legal-critical audit)."

It further appears under the objective of the financial audit that "... a particular feature of "good public auditing practise" is the extent of the legal-critical audit as a result of the special appropriation rules and the extensive statutory prescription relating to public bodies."

6. On the basis of section 3 of the Auditor General's Act, the concept of the legal-critical audit can be based on the following general definition:

Verification of whether transactions encompassed by the financial reporting comply with acts, other regulations, agreements entered into and usual practice.

Furthermore, the concept can be derived from section 6(1) of the Auditor General's Act:

“The review of accounts mentioned in sections 4 and 5 shall especially ascertain ... that the conditions for contributions etc. have been fulfilled, that the funds have been spent according to the regulations...”

B. Units and objects verified?

7. The units subject to verification are stated in the Auditor General's Act, that is, the institutions, etc., presenting the accounts audited by the NAOD according to section 2 of the Auditor General's Act or whose accounts are reviewed by the NAOD according to section 4. Accordingly, the legal-critical audit is based on the overall external and internal sphere of activity of these units, with special focus on legislative and contractual issues.

The transactions encompassed by the accounts and results of the audited unit are the object of the verification.

In addition to units mentioned in the Auditor General's Act, other units subject to verification may be mentioned in other legislative or special contractual bases conferring auditing authority on the NAOD.

C. What is verification and when is it made?

8. The legal-critical audit in the financial audit is typically performed as a verification of the audited unit's compliance with appropriation rules/conditions, accounting rules, rules for entering into commitments and internal authority rules. Furthermore, it must be assessed whether the transactions made are generally unwarranted. In addition, the auditor must decide which elements to include in the verification in each individual audit situation.

9. In connection with performance audit examinations, the scope and depth of the legal-critical audit will often be more extensive than in the financial audit.

The legal-critical audit in a performance audit examination frequently covers a considerable number of issues in addition to the legislation, etc., for whose administration the examined unit is responsible. It is thus verified whether the transactions reflect the implementation of specific agreements concluded and usual practice in this connection and whether the funding authorities' purpose specification can be comprised herein (appropriation condition).

10. In principle, a legal-critical audit may range from assessing whether any of a given unit's activities can be considered unconstitutional to establishing the existence of the proper authorities and ensuring that the authority concerned is not attempting to regulate the legal status of citizens by means of a guideline. This means that the NAOD safeguards both the Parliament's need for control of the state administration and due process protection of individual rights.

When the exercise of authority is not involved, the purpose of the legal-critical audit will often be to ascertain whether agreements between the audited unit and other parties comply with appropriation conditions and whether they are in accordance with law and customary practice.

11. The verification is always made a posteriori, that is, after the audited unit has made the transactions.

D. Elements of the verification?

12. Acts and other regulations include binding regulations, both national law, including the Appropriation Act and the Act embodying Supplementary Estimates, ministerial orders and decrees; and international rules of law, including EU acts and bilateral agreements with other countries. Binding regulations also include the Budget Code, government circulars and administrative guidelines regulating the conduct of the administration.

A number of interpretative contributions attach to this material, such as explanatory notes, committee reports, resolutions made by the Parliament and parliamentary debates. When working with this material, other binding "regulations" may occasionally be found, for example, when the act authorises the minister to lay down detailed rules on a given subject. Normally the minister decides, in accordance with the objective of the act, etc., the contents of these administrative provisions, but there are cases where the relevant parliamentary committee has decided how the rules should be drafted. Such a parliamentary committee decision constitutes a binding stipulation for the minister. Another example could be that in an agenda, the Parliament decides how the act is to be understood in cases where uncertainty has attached to the understanding of a substantive act. Such a parliamentary resolution will also be a binding stipulation for the minister.

13. Agreements and common usage, including legal decisions, form part of the legal-critical audit especially pertaining to property. In addition, there is customary practice, for example, various types of usage and legal custom that as a general rule apply alongside the act when the act is silent, but not contrary to the act.

Customary practice also includes (legal) standards which are a kind of legal rules that do not bind the application of the law through carefully drafted directions but are limited to providing the courts with a moral or social standard which must be given content and substance according to

the conception of the law at any given time. Typical (legal) standards are the “generally accepted administrative standards” and “good public auditing practise.”

14. A central element of the legal-critical audit relates to the lack of authority and possible misunderstandings/misinterpretations on the part of the administration in relation to authority issues, including the compliance of the transactions with appropriation conditions.

E. Authority of the NAOD

15. In the legal-critical audit, the NAOD has authority to

- draw the Parliament’s attention to an act which – according to its objectives – is malfunctioning or insufficient,
- draw the Parliament’s attention, for example, to the lack of necessary provisions, such as actual authority enabling the minister to administer the act in an appropriate manner,
- suggest interpretative contributions or recommend that the administration attempt to clarify interpretation difficulties,
- examine and assess whether the unit examined (typically the minister and/or government officials) acted according to the applicable norm for expedient administration (reasonable man standards) in force at any time, which may have been laid down by the Public Accounts Committee,
- criticise a minister if the minister has failed to apply existing authorisations in the legislation, providing such implementation is relevant to the audit, and
- point out that the minister failed to fulfil his obligation of initiative, for example, to introduce bills/amendments in the ministerial field to remedy deficiencies in the set of rules.

16. The assessment of the minister’s role or criticism of the minister’s handling of tasks should take into consideration the response options open to the minister.

17. The NAOD’s legal-critical audit has clear limitations. Thus, on the basis of a legal-critical audit performed, the NAOD **cannot**

- criticise the Parliament or decisions made by committees of the Parliament,
- examine and establish whether ministers are politically or legally responsible (according to the Act on Accountability of Ministers),

- examine and establish whether criminal offences have been committed,
- examine and establish whether employees are “guilty of something” in a broad sense in cases of violation of the public servants legislation or other sets of rules.
- examine and establish whether ministers and/or public servants are liable for damages in relation to the public (the state, county and municipality), contracting parties, creditors or citizens,
- examine and establish whether natural or legal persons are generally liable for damages to the public,
- comment, assess and report on parts of the audit which have been heard at the courts, complaints commissions, etc., or if the minister in question has initiated legal inquiries and/or investigative surveys regarding issues covered by the audit or
- determine what is applicable law or practice as this is a right solely owing to the courts.

The limitations do not prevent the NAOD from examining the areas mentioned above in connection with the examination of other matters. In that case, the NAOD will merely describe the actual circumstances because the purpose of the NAOD’s examination is not to take an actual stance in the situations mentioned above.

18. In case of doubt as to what is applicable law or practice, the NAOD’s verification will point this out and recommend that the audited unit clarify such doubt.

In certain cases the NAOD may point out that the audited unit ought to have clarified the issue before making the transaction, in particular when the matter concerns appropriation rules.

In other cases the NAOD recommends that the audited unit subsequently clarify doubt as to the scope of applicable law, for example, by approaching the Ministry of Justice or awaiting the outcome of legal proceedings/arbitration proceedings. However, in some of these cases the NAOD has to mention the fact that a matter of dispute ought to have been clarified before the transaction was made, for example in the Danish Competition Authority regarding tenders,

The NAOD policy for legal-critical audits

- The overall purpose of the NAOD’s legal-critical audit is to verify, on the basis of the material presented or provided, whether transactions encompassed by the financial reporting comply with acts and other regulations, agreements entered into and usual practice.
- The legal-critical audit is performed in compliance with the concept of good public auditing practise, which include the assumptions and conditions on which the performance and the contents of the audit of the state accounts are based.
- The legal-critical audit contributes to fulfilling the NAOD’s mission and the visions, targets and strategies for the audit work.

III. Planning the audit

19. The NAOD's planning determines the objective and scope of the legal-critical audit to ensure that a high-quality audit is performed in an economical, productive and efficient manner.

The planning of the audit is intended to ensure such coverage of the accounts as will support a proper conclusion of whether the underlying transactions in the accounts are legal and agreements are customary.

The legal-critical aspect forms part of the planning of both the financial audit and performance audit examinations. As regards the latter, "Procedures, etc., governing legal-critical audits in preliminary examinations" have been drawn up.

Knowledge of the audited unit and their legal bases are important elements in the detailed planning of the legal-critical audit. This also includes knowledge of the appropriation situation of the audited unit, the practical conditions under which they operate and management control. Insight into the budgets, accounting systems and internal control systems of the audited unit is a particular requirement.

The NAOD's legal-critical audit is among other things planned to ascertain whether the management of the audited unit has established procedures and internal controls that help ensure lawful administration and whether management carries out efficient supervision hereof.

A. Materiality and risk

20. The auditor's deliberations regarding materiality and risk are an important element of planning a legal-critical audit.

The concepts of materiality and risk are not unambiguous, but may vary according to the context in which they appear. The NAOD's existing practice in this area has shown that the following overall definition can be used:

- Materiality in a legal-critical context relates to the number of persons/institutions affected by the rules. Moreover, the amount involved, the nature of the case or information, or the context in which it appears, are taken into account. Finally, the weight the members of the Public Accounts Committee attaches to the case is also important.
- Risk in a legal-critical context means the likelihood of violation/disregard of applicable rules and thus of incorrect accounts. Examples of risk indicators may be complicated or unclear legislation and use of estimate.

Planning the NAOD legal-critical audit

- The NAOD's Legal-critical audit is planned so as to ensure the performance of a high-quality audit in a financial, efficient and effective manner.
- Knowledge of the audited unit and their legal bases are an important prerequisite in planning the legal-critical audit, and the procedures and internal controls of the audited unit are also taken into account.
- The scope of the legal-critical audit is planned on the basis of considerations regarding legal risk and materiality.

IV. Implementation of the audit

21. When performing the audit, efforts should be made to ensure that the audited unit experiences the legal-critical audit as a meaningful contribution to clarifying the legal basis for the audited unit's decisions and proposing possible improvements.

22. The audit procedures and results hereof typically take the following forms:

- A review of the substantive set of rules and related legislative material, followed by an assessment of whether the transactions comply with these rules, etc.
- An assessment of the compliance of the transactions with appropriation and accounting rules.
- A review and assessment of the compliance of the transactions with civil law contracts and agreements.
- An assessment of the compliance of the transactions with (legal) customary practise and (legal) standards.
- An assessment of whether the information given to the Parliament and/or its committees is correct, timely and adequate.
- A thorough analysis of the expediency of the regulatory basis examined and related legislative material, followed by an assessment of whether the rules function as intended.
- Criticism of the issue of deficient, delayed or inadequate administrative rules or if no rules have been issued at all, and of failure to enforce rules.
- More fundamental comments aimed at a broad group of recipients, for example, other ministries in a similar situation.
- Reference to citizens'/users' claim for due process protection of individual rights.
- A description of applicable legal rules without further comment.

23. With respect to the analysis of the expediency of the regulatory basis examined, it is noted that the concept of “expedient regulatory basis” means rules (whether legal provisions or administratively established rules) that the audit finds are

- suitable for achieving the objective of the act,
- easy to apply in the daily administration of the act and
- comprehensible for the users of the act.

24. In special cases, the outcome of a legal-critical audit may be that the NAOD criticises the legislative basis. However, the criticism is not levelled directly at the Parliament as the legislative authority but at the minister who introduced a bill whose legislative material was inadequate, for example, if the explanatory notes were based on insufficiently clear or substantiated assumptions. Over a period of years, the NAOD has gradually started making a more detailed assessment of the legislative basis as a whole, a development the Public Accounts Committee has accepted.

25. The limits of the legal-critical audit are the focus of dynamic adaptation to changing conditions in society. Therefore, legal-critical issues must be assessed in relation to social changes and to the overall requirements to the NAOD’s products.

26. The documentation relating to the legal-critical audit should describe the audit procedures and the results in order to enable a precise verification.

Implementation of the NAOD’s legal-critical audit

- The audit must be implemented on the basis of the planned audit procedures and reflect the deliberations regarding the expected results.
- The NAOD’s implementation of the audit must ensure the provision of sufficiently relevant and reliable audit evidence.

V. Reporting and communication

27. The NAOD’s communication with the audited unit takes place as part of a reporting chain. The chain starts with communication in connection with planning and implementing the financial audit products and the individual performance audit examination. The final element of the reporting chain comprises an overall reporting of the performance plus the results of the legal-critical audit in the report on the audit of the state accounts and/or in relevant paragraphs of reports or memorandums to the Public Accounts Committee.

The NAOD's reporting to both the audited unit and the Public Accounts Committee must be balanced and in compliance with best practice for reporting of the legal-critical audit. Accordingly, the reporting must differentiate between material and immaterial issues.

Moreover, the wording of the reporting must be in line legal terminology. This means that legal expressions must be used correctly and in the correct context. Similarly, legal arguments must be reproduced loyally and in their entirety. As regards the understanding and impact of the reporting, the NAOD must stringently apply the legal system of concepts to prevent readers from misunderstanding the substance of the concepts.

Reporting on the NAOD's legal-critical audit

- The NAOD's reporting on the outcome of the legal-critical audit must be credible, current and understandable.
- Communication of the audit results takes place through dialogue with the audited unit and must be useful to management and the ministry concerned.
- The NAOD must stringently apply the legal system of concepts to prevent readers from misunderstanding the substance of the concepts.

VI. Quality assurance of the legal-critical audit performed

28. The purpose of both ongoing and subsequent quality assurance is to ensure compliance with the NAOD's internal quality standards. This helps to develop the legal-critical element of the products and thus eliminate inexpediency in planning and implementation.

29. Ongoing quality assurance ensures that the legal-critical audit is planned, implemented and documented expediently and that sufficient audit evidence is available. The legal-critical audit must thus have been performed in compliance with the guidelines stipulated in this policy paper. This means, in particular:

- That the audit is carried out with due respect for the limitations applying to the NAOD's authority in this area.
- That the audit is planned based on an understanding of the audited unit's legislative basis and on which legal issues are material and important.
- That the correct legal terminology is used and that legal arguments are reproduced loyally and in their entirety.

30. Subsequent quality assurance takes place through an annual internal quality assurance of the financial audit products and, as regards performance audit examinations, an external quality assurance involving a panel of external evaluators with legal experts.

Quality assurance of the NAOD's legal-critical audit

- Quality assurance forms part of the ongoing audit process to ensure that audit products are implemented according to the professional standards laid down in the audit policy, including the availability of audit evidence.
- The NAOD subsequently verifies the quality of the legal-critical audit work performed, if necessary with external assistance, in order to ensure consistent focus on uniform and adequate audit performance.