

Translation of Guidelines on Performance Audit Risk Analyses  
Issued in Finnish 29 May 2007



**Guidelines**

**PERFORMANCE AUDIT  
RISK ANALYSES**



## 1 Objectives of risk analyses

The objective of risk analyses is to form an overall picture of risks and problem areas in sectoral and cross-sectoral activities, using consistent procedures. The result is a prioritized proposal for audit topics together with detailed reasonings. To ensure that risk analyses are concise and clear, the results are presented in table form. This makes it easier to compare topics and discuss risk factors.

The purpose of these guidelines is to support risk analyses and steer reporting.

## 2 Criteria for focusing audits

The focusing of audits is guided by the National Audit Office's strategy. Since important decisions regarding the focusing of audits are made on the basis of risk analysis, the strategy also guides risk analyses. The strategy defines permanent audit areas in which audits are to be conducted annually, strategic theme areas in annual reporting to Parliament and general criteria for focusing audit activities. These criteria are used in selecting audit topics and in defining permanent audit areas and strategic theme areas in annual reporting to Parliament.

The criteria for focusing audits that are defined in the strategy are:

1. The financial significance of the matter and the associated financial risk. In evaluating financial significance and risk, attention should also be paid to the longer term.
2. The possibility to produce useful information that
  - has considerable significance for decision-making concerning the state's financial management or
  - ensures the correctness and quality of the state's financial management, the reporting of true and fair information and compliance with the budget
  - promotes the economy, efficiency and effectiveness of financial management and activities that fall within the scope of external audit.

The financial significance of the matter means its impact on the state economy: the state's income, expenses, assets or commitments. The matter can have a direct or indirect impact on the state economy. Including a topic in the audit plan when the impact on the state economy is indirect requires a reasonable assumption that there is a linkage between the topic

and the state economy. Topics are prioritized according to their significance for the state economy.

In addition to the financial significance of the matter, the need to conduct an audit is influenced by observed problems or risks. Risk means any undesirable event, factor or problem that could have a negative impact on the state's financial management or performance. Lost opportunities to achieve objectives can also be regarded as risks. Financial risk depends on two things: (1) the probability of something with a negative impact on performance occurring and (2) the consequences of a negative impact on performance and the state economy. Risk is evaluated using the perspectives derived from the performance audit effectiveness model (see Performance Audit Manual).

#### *Strategic theme areas and themes*

In addition to the general criteria for focusing audits that were mentioned above, risk analyses should take into account the theme areas and themes that have been included in the National Audit Office's strategy.

The reasonings that are given for topics in risk analyses should explain how a topic is connected to strategic theme areas or particular themes.

### **3 The risk analysis process**

Risk analyses are conducted in five stages:

1. The financial significance of the matter is examined and risks are identified in financially significant areas.
2. Identified risks/problem areas are analysed and classified.
3. The functions to be audited are outlined.
4. Reasonings are prepared for prioritizing topics.
5. A risk analysis report is prepared.

Stages of risk analysis are presented in figure in Appendix 1. The administrative sector groups can agree on practical working methods themselves.

#### **3.1 Stage 1: Examining the financial significance of the matter and identifying risks**

In the first stage the sector group has to identify the areas, topics and functions that have considerable significance for the state economy. The

impact on state finances is evaluated in money terms, using the state budget, the report on the final central government accounts (and the Netra online reporting service) and ministries' budget proposals (framework proposals). The calculations that are used in preparing budget proposals show pressures on spending. Evaluating the financial significance of a matter can take place by comparing performance or financial indicators with other functions or organizations or the administrative sector's total expenditure.

The administrative sectors / ministries define and group functions differently, and groupings can vary considerably in the budget and the final central government accounts, for instance. One basis for defining the function to be audited can be the Government Rules of Procedure, which detail ministries' tasks. Risk analyses should follow the grouping that is used in the administrative sector. (The Ministry of Trade and Industry groups activities according to policy areas, for example.) The starting point can also be a functional entity based on legislation or a service or financing system. Appropriation blocks or areas of responsibility may be so large (as in the case of grants administered by the Ministry of Social Affairs and Health or the Ministry of Education) that it is necessary to break them down into smaller units. Functional entities can also be areas that the sector group will propose as a topic.

Evaluating the financial significance (direct or indirect) determines the functions/policies that are ministries' core functions and thus important objectives in the administrative sector. Risks may also involve cross-sectoral functional entities. Core functions and focuses in the administrative sector are expressed in ministries' operational and financial plans and strategies.

A matter may have little direct financial significance, but the indirect financial significance may be substantial. In this case the linkage to state finances must be carefully argued in the risk analysis. In identifying linkages, the effectiveness model outlined in the performance audit manual should be used.

In identifying financial significance and risks, an important role is played by the monitoring that takes place in the sector groups, auditors' experience and cooperation between performance auditors and financial auditors. Audit work and monitoring reveal potential or existing problems that have significance for the achievement of objectives in the administrative sector. In identifying risks auditors can use the effectiveness model and the audit perspectives derived from it, on the basis of which the types of risks mentioned in Appendix 3 have been formulated. Interviews that are conducted in the administrative sector can also help reveal financial significance and risks. Interviews can be used to

obtain the ministry's views concerning observed risks in the administrative sector and the ministry's reaction to possible risks. In this case financial auditors' findings with regard to risk management in the administrative sector should also be utilized. The observations of previous performance audits and follow-up reports should be considered as well.

### 3.2 Stage 2: Analysing and classifying risks

The second stage is the detailed analysis of financially significant matters and potential risk factors. In this stage the matters to which attention has been drawn in identifying financial significance and risks are classified according to type of risk (Appendix 3). Types of risk have been formulated on the basis of performance audit perspectives, and the appended table (Form 1) is used to classify risks.

A risk factor means any undesirable occurrence, event or matter that could have a negative impact on the state's financial management. This includes all the functions in which state funds have been used to achieve certain objectives. A risk is any undesirable event, factor or problem that has a negative impact on the achievement of objectives. Lost opportunities can also be regarded as risks. This includes opportunities to improve operational performance and policy effectiveness. Risk analysis seeks to determine the probability of negative impacts and their impact.

The table starts with the administrative sector and the particular subsector, policy area, function or cross-sectoral function, depending on the administrative sector, the structure of the budget or the grouping used in the field. In the space marked Risk/problem area the auditor should indicate the potential topic area to which attention has been drawn in identifying financial significance and risk. This is analysed according to type of risk. Different types of risk are listed on the left side of the table. These are defined in Appendix 3, which also contains questions that can be used for this purpose. Determining types of risk makes it possible to evaluate tentatively what parts of the effectiveness model risks concern. Multiple risk factors may be identified and these should be evaluated on a scale of 1–3, with 1 signifying low risk, 2 moderate risk and 3 high risk. The purpose is to evaluate the probability of potential risks or problem areas and their impacts from the perspective of different types of risks.

*Evaluating the probability of a risk:* The probability of a risk materializing is evaluated on a scale of 1–3, with 1 signifying low probability, 2 moderate probability and 3 high probability. The evaluation is based on the group's opinion concerning the likelihood of the occurrence of an undesirable event or problem.

*Evaluating the impact of a risk:* In evaluating the impact of an occurrence or state of affairs on the achievement of objectives in an organization, for example, it is necessary to get an idea of the significance of the impact. In some cases direct impacts can be evaluated in money terms. It is not always possible to use quantitative indicators, however, in which case qualitative evaluations of the significance of impacts must be made. This may concern risks or problems involving performance, for instance. Impacts are evaluated on a scale of 1–3, with 1 signifying low significance, 2 moderate significance and 3 considerable significance.

It may not always be possible to evaluate every risk or problem area on a scale of 1–3 (for example because of insufficient data). In this case the box should be marked NA (Not assessable). If this is done, points should not be added up. It is still possible to draw conclusions concerning overall risks in a potential topic area, however.

### 3.3 Stage 3: Outlining and prioritizing topics

The third stage in risk analysis is to place the topics in an administrative sector in order of importance, based on overall risk. This is done in a separate summary table (Form 2).

The summary table presents types of risks, key problems or risks, the probability of risks, the impacts of risks, the direct significance for the state economy (€ or NA) and the indirect significance for the state economy (yes or NA). About five key risks should be included in the summary table. These should be listed in order of importance, as evaluated by the administrative sector group.

### 3.4 Stage 4: Reasonings for audit topics

In the fourth stage of risk analysis the administrative sector group summarizes the reasonings for the most important audit topic proposals. Reasonings evaluate the linkage to the National Audit Office's strategic theme areas and audit themes and present tentative audit perspectives.

Reasonings are given on Form 3 for each topic in the summary form. Perspectives that were not discussed in Stage 2 can also be presented. These can include timeliness, feasibility, the availability of audit resources and Parliament's possible interest in a topic, for instance. Reasonings for audit topics are summarized later on in a separate memorandum.

### 3.5 Stage 5: Risk analysis report

The final stage is the drafting of a risk analysis report. This contains a summary (2–3 pages) of the risk analysis and the description of key risks in the administrative sector that has been formed on this basis. The completed risk analysis forms, summary form, reasonings forms and a list of audit activities in the administrative sector during the past 5 years are appended to the report.

### 3.6 Appendices to the guidelines

Appendix 1: Risk analysis in the form of a process chart

Appendix 2: Background material used in risk analyses

Appendix 3: Types of risks and performance audit perspectives

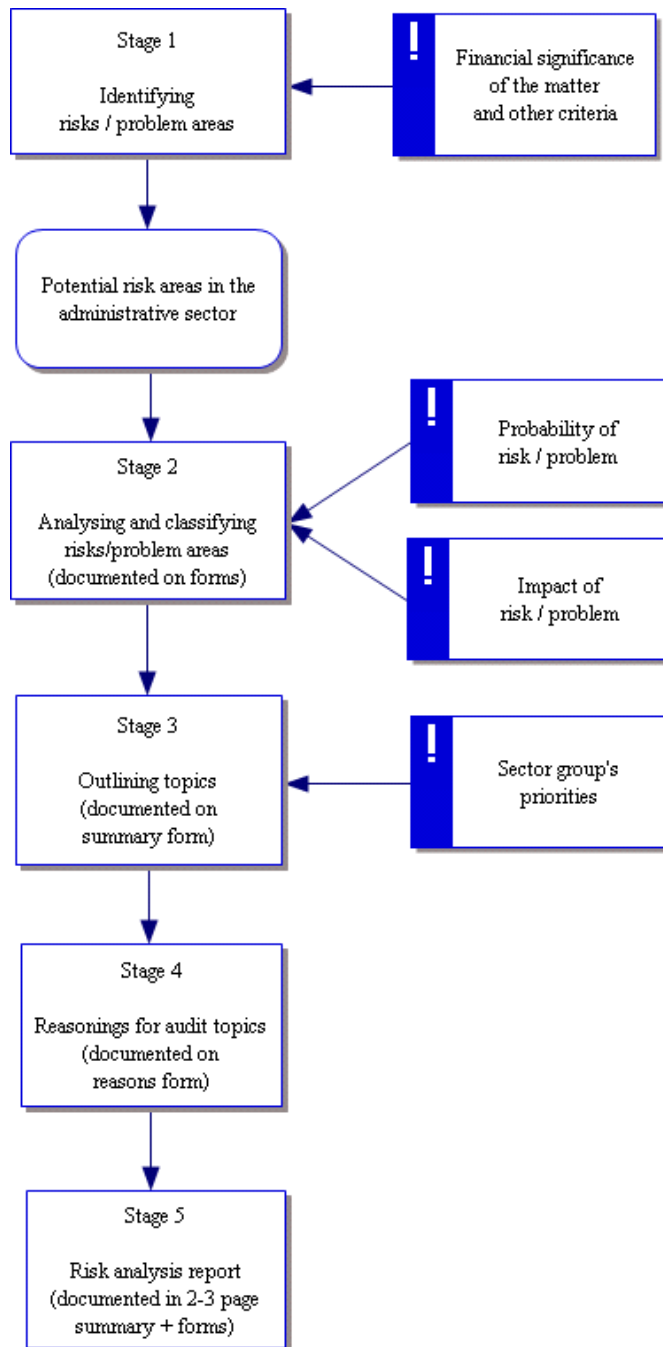
Appendix 4: National Audit Office's strategic theme areas and audit themes in 2007–2012

Form 1: Risks/problem areas in the administrative sector classified according to probability, impact and type of risk

Form 2: Summary of topic areas in the administrative sector

Form 3: Reasonings for audit topics

**Appendix 1: Risk analysis in the form of a process chart.**



## Appendix 2: Background material used in risk analyses.

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Budget proposal for the administrative sector (plus calculations showing pressures on spending), annual budget and supplementary budgets

Government Programme and the Government's policy programmes

Health and Social Services Programme

Stability Programme for Finland

Operational and financial plans for the administrative sector

Framework proposals

Strategies and sectoral plans for the administrative sector

Report on the final central government accounts

Ministry's opinion concerning financial statements

Ministry's internal control and risk management documentation

Administrative sector's annual reports

Audit reports issued by the National Audit Office

Ministries' internal audit reports for units

Final central government accounts and central accounting data

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Administrative sector's performance plan

Administrative sector's performance agreements and cost budgeting

Own contacts in the administrative sector and control data in the administrative sector

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Other information such as:

Government resolutions and policies

Legislative reforms and proposals concerning the administrative sector

Authorizations to conclude agreements

Budget breakdown

Complaints

EU documents

Studies and evaluations

Parliament's opinions

Report of the Chancellor of Justice

Report of the Parliamentary Ombudsman

Report of the Parliamentary State Auditors

Publications and statistics

Special reports

Government Strategy Document

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### **Appendix 3: Types of risks and performance audit perspectives.**

Problem areas identified in risk analysis can be approached using performance audit's audit perspectives, to which risks involving external factors have been added. Below are some questions that can be used to outline potential risks.

1) **Risks involving external factors:** This includes climate change, natural disasters, international crises, worldwide pandemics (such as bird flu), globalization, unreliable governments, corruption, weak courts (for example in development cooperation).

2) **Risks involving need and objective:** Is there a risk that social needs regarding activities and inputs have changed but administration has not reacted to this change? Has the setting of objectives for inputs been based on social needs expressed by Parliament or derived from its decisions?

3) **Risks involving actors and financing:** Are there problems in the dimensioning of financing? Does the financing system encourage economy and efficiency? Do activities receive funds from more than one source? Does financing include large amounts of government grants, state aids or EU funding?

4) **Risks involving steering and operations (managing and steering risks, operational risks, personnel and competence risks, information risks, reporting risks):** Do management and management instruments function properly? Are activities complex? Are activities fragmented? Have organizational changes taken place in activities? Have there been significant legislative reforms or development projects affecting activities? Are large amounts of charges collected in the administrative sector? Are activities managed in such a way that objectives can be achieved? Have supporting functions such as procurement, IT, real estate and human resource matters been organized properly? Are large procurements being made in the administrative sector? Have problems been observed in operational processes? Have there been problems in supervising and monitoring activities? Has true and fair information been reported to the supervising authority? Are there any gaps in reporting?

5) **Risks involving outputs:** Are outputs in line with objectives?

6) **Risks involving impacts:** Have activities achieved the desired impacts on customers? Have impacts on customers been achieved efficiently? Have activities had the desired social impacts? Have social impacts been achieved efficiently? Have activities had unwanted impacts? What is the financial significance of unwanted impacts? Have problems arisen in measuring impacts?

7) **Risks involving the achievement of objectives and input-output relations:** Have performance problems arisen? Has the achievement of objectives been efficient in relation to resources? Have problems arisen in achieving objectives? Have activities been economical, efficient, productive and cost-effective? Has administration been able to measure economy, efficiency and cost-effectiveness sufficiently? Can administration influence the achievement of objectives (for example with regard to activities financed with transferable funds).

8) **Risks involving transparency and accountability:** Have irregularities been observed in activities? Has administration complied with the budget? Have errors and shortcomings been observed in activities? Have the setting of objectives, financing, activities and outputs been presented transparently? Has adequate and high-standard performance information been produced? Are activities transparent for citizens? Have activities been criticized?

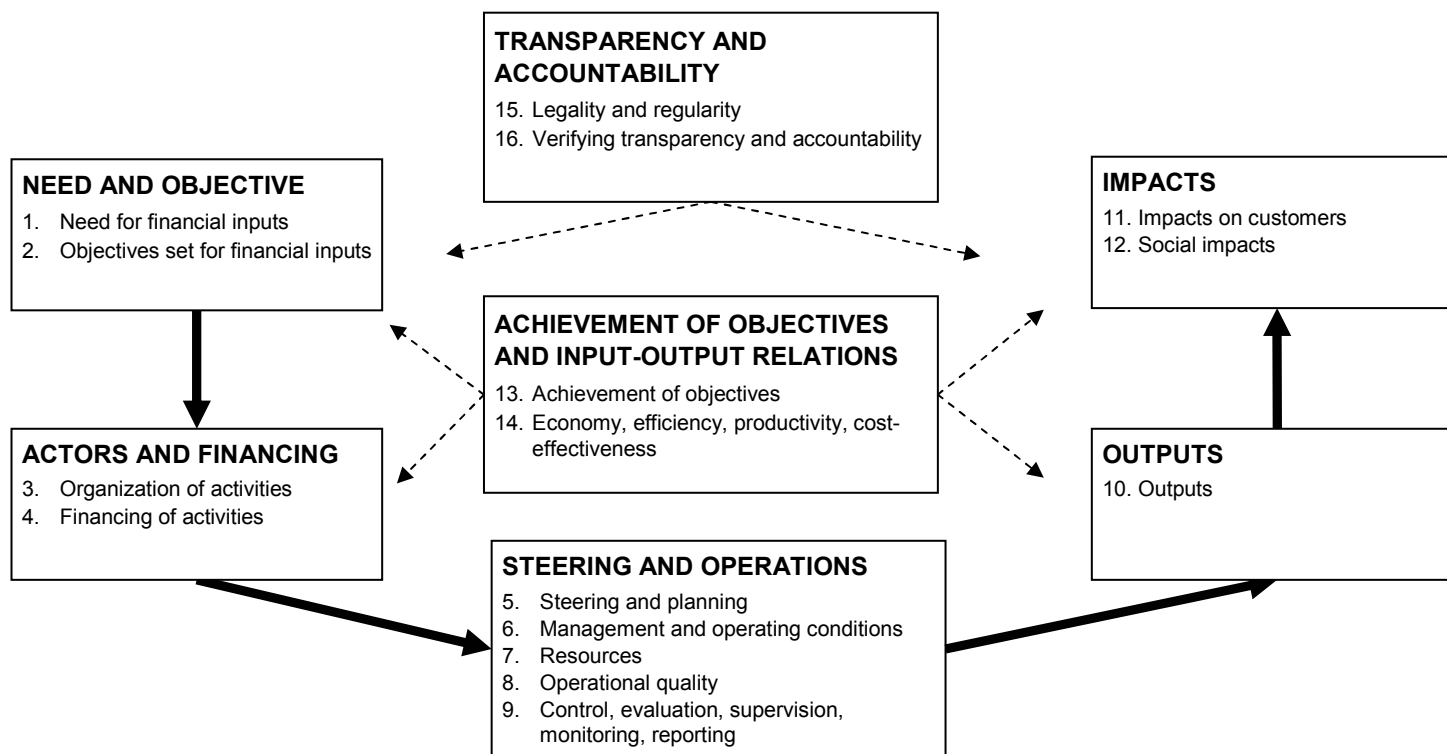


FIGURE. Performance audit perspectives derived from the effectiveness model.

## **Appendix 4: National Audit Office's strategic theme areas and audit themes in 2007–2012**

### **The optimal focusing and timeliness of audit activities**

The National Audit Office has limited resources at its disposal. It must therefore focus resources correctly. In order to do this it must have a comprehensive management and planning system that

- identifies key changes in the operating environment and expectations with regard to the National Audit Office and reacts to them
- defines strategic criteria for focusing activities, audit areas and audit perspectives
- schedules and focuses audits effectively.

In order to ensure the proper focusing of audit activities:

- general criteria are approved for focusing audit activities (1)
- permanent annual audit areas are defined (2) and
- theme areas for the entire strategy period and annual themes for reporting to Parliament are defined (3 and 4).

#### **1. General criteria for focusing audit activities**

The following general criteria are used in focusing audit activities and in defining permanent audit areas and annual themes for reporting to Parliament:

- The economic significance of the matter and the associated economical risk for the state economy. In evaluating economic significance and risk, attention is also paid to the medium and longer term.
- Audits should produce useful information that
  - has considerable significance for decision-making concerning the state's financial management or
  - ensures the correctness and quality of the state's financial management, the correctness and adequacy of reported information and compliance with the state budget or
  - promotes the effectiveness of the state's financial management and activities and the production of information falls within the scope of external audit.

## 2. Permanent audit areas

Permanent audit areas are those in which audits are conducted annually. The perspective and scope of audits is revised in the annual plan.

Permanent audit areas include:

### *A) The state's financial statements*

The state's financial statements are audited annually and the audit report is reported to Parliament in connection with a separate audit report dealing with the report on state's financial statements.

### *B) The report on state's financial statements*

The report on the state's financial statements is audited annually in the manner that some specific part of the report is always targeted for auditing.

A separate audit report is submitted to Parliament on audit of the report on the state's financial statements and the actual financial statements each year.

In its audit of the report on the state's financial statements the National Audit Office selects a particular administrative sector or a cross-sectoral matter and investigates goal-setting system, the functioning of the steering system, the information basis and risk management related to the steering system.

In connection with the audit of the report on the state's financial statements, the National Audit Office monitors the information basis of the state's financial management and financial policy decision-making as well as the functioning and effects of financial policy instruments (such as budget frameworks). The National Audit Office selects from this entity a particular focus area defined more closely in its annual operational plan.

### *C) Financial audits of Government offices and agencies*

The National Audit Office issues annually financial audit reports on all the Government offices and agencies that are required according to the State Budget Act (423/1988) and the State Budget Decree (1243/1992) to prepare financial statements that should include both calculations on financial statements and an annual activity report. Financial audit reports can also be issued on Government offices agencies for which a ministry has approved performance goals as prescribed in the State Budget Act.

***D) Annually started performance audits***

Each year the National Audit Office will carry out performance audits according to the strategical theme areas and themes so as to cover different administrative sectors and cross-sectoral operational and steering systems adequately during the six-year strategy period. Audits are based on the audited area's economic significance and risk.

***E) State funds, state enterprises and state-controlled companies***

The National Audit Office audits those state funds annually that have been legally prescribed to be audited by the Office. It also conducts at least one performance audit focusing on state funds, state enterprises or state-controlled companies each year.

***F) EU-funds***

The National Audit Office applies the same allocation criteria in the performance and financial audits of EU funds as it applies to national state funds. Control measures, audits and key audit observations concerning EU funds are summarized in a separate section of the National Audit Office's annual report on its functions to Parliament.

**3. The National Audit Office's strategic theme areas**

According to the National Audit Office's strategy, in selecting audit topics and approaches, special emphasis will be placed on the following themes:

- productivity, economic efficiency and service ability in central government and other public activities. Attention will be paid to the balance between efficiency and the need to keep costs under control and between the quality of public service production and effectiveness, for example.
- finance policy based on reliable information and tax and payment policy as part of the state's financial management
- effective and competitive infrastructure and expertise and innovation systems
- quality legislation, which from the viewpoint of financial decision-making is based on a correct picture of the effectiveness and impacts of regulation
- the management of environmental risks and environmental change from an economic viewpoint
- good management of state activities and state property

- an efficient and effective European Union, taking advantage of the possibilities it offers at the national level.

#### **4. Theme areas and annual reporting on themes to Parliament**

Audit activities will be planned and reporting to Parliament will take place according to the theme areas in the National Audit Office's strategic focuses and the annual themes derived from them. The National Audit Office will submit separate reports to Parliament on annual themes or summarize findings in its annual report on its functions to Parliament.

Audits regarding annual themes will be started so that reporting can take place according to the timetable given below.

Audits regarding annual themes will mainly be performance audits. Theme areas and annual themes will also be taken into consideration in focusing financial audits.

Annual themes are as follows:

**A) *Productivity, economic efficiency as well as effectiveness and service ability***

- services for children and young people (2007)
- productivity programme (2009)
- occupational health care (2010)

**B) *Fiscal policy based on reliable information including tax and payment policy***

- performance information in the report on the state's financial statements and financial reporting to Parliament
- tax subsidies (2007)
- effectiveness of the tax administration (2010)
- functioning of the framework procedure (2010)

**C) *Effective and competitive infrastructure and expertise and innovation systems***

- research and development (2008)
- vocational education, steering of the polytechnics and general education (2008)
- infrastructure management (2009)
- the effectiveness of the municipal and service structure (2011)

*D) Quality legislation as part of state's financial decision-making*

Legislation as a steering instrument and means of achieving objectives and the impacts of legislation will be evaluated in a performance audit. This perspective will also be considered in connection with the following themes.

- guaranteed access to treatment (2009)
- compensation for medication (2010)
- state budget financing for the Social Insurance Institution (2010)

*E) The management of environmental risks and environmental changes from an economic viewpoint*

- climate and energy policy (2010; energy taxation, achieving the obligation in the Kyoto Protocol, reliable supply of energy, support for renewable energy sources, steering of energy policy)

*F) Good governance of state activities and state property*

The setting of performance goals and related reporting, the functioning of e-government and the state's ownership policy will constantly receive attention in financial and performance audits.

- functioning of management by results (2007)
- functioning of the framework procedure and effectiveness of policy programmes (2010)
- employment policy (2012)

*G) An efficient and effective European Union, taking advantage of the possibilities it offers at the national level*

- the impacts of regional development programmes (2008)
- the effectiveness of the EU's aid systems and efficiency in the administration of aid (2010)
- the effectiveness of EU farm support (2011)

<b>Administrative sector:</b>								
<b>Subsector/policy area/function/cross-sectoral function:</b>								
<b>Type of risk</b>	<b>Risk/problem area</b>		<b>Risk/problem area</b>		<b>Risk/problem area</b>		<b>Risk/problem area</b>	
	Probability (1-3 or NA)	Impact (1-3 or NA)	Probability (1-3 or NA)	Impact (1-3 or NA)	Probability (1-3 or NA)	Impact (1-3 or NA)	Probability (1-3 or NA)	Impact (1-3 or NA)
1. Risks involving external factors (climate change, natural disasters, international crises, globalization, pandemics)								
2. Risks involving need and objective								
3. Risks involving actors and financing (organization, funds)								
4. Risks involving steering and operations (steering, planning, resources, quality, monitoring, reporting)								

<b>Administrative sector:</b>								
<b>Subsector/policy area/function/cross-sectoral function:</b>								
Type of risk	Risk/problem area		Risk/problem area		Risk/problem area		Risk/problem area	
	Probability (1-3 or NA)	Impact (1-3 or NA)	Probability (1-3 or NA)	Impact (1-3 or NA)	Probability (1-3 or NA)	Impact (1-3 or NA)	Probability (1-3 or NA)	Impact (1-3 or NA)
5. Risks involving outputs								
6. Risks involving impacts (impacts on customers, social impacts)								
7. Risks involving the achievement of objectives and input-output relations (effectiveness, economy, efficiency, productivity, cost-effectiveness)								
8. Risks involving transparency and accountability (legality, provision of information)								

<b>Administrative sector:</b>						
<b>Topic area</b>	<b>Types of risk 1-8</b>	<b>Key problems or risks</b>	<b>Probability of risk (1,2,3)</b>	<b>Impact of risk (1,2,3)</b>	<b>Direct significance for the state finances (NA, €)</b>	<b>Indirect significance for the state finances</b>

<b>Reasonings for a topic proposal</b>		
Topic:		
<b>Connection to the National Audit Office's strategy (theme areas and themes) and financial significance</b>		
<b>Key types of risk, overall risk according to risk analysis and main background assumptions regarding overall risk</b>		
<b>Tentative audit perspectives (making use of the perspectives described in the performance audit manual)</b>		
<b>Topic's significance from the following perspectives:</b>		
<b>Perspective</b>	<b>Yes</b>	<b>Not assessable</b>
Timeliness		
Feasibility		
Comprehensiveness		
Availability of audit resources		
Parliament's interest		
Significance in money terms		
Topic's role as a core function in the administrative sector		