



Norwegian Local Government – System of Internal Supervision and Control and External Audit¹

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Norges Kommunerevisorforbund
- på vakt for fellesskapets verdier

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Introduction

The aim of this document is to present a description of the Norwegian system of internal supervision and control and external audit in local government based on the Local Government Act and the Ministry's regulations.

On an introductory note we would first like to give a short outline of the system of local government in Norway.

Levels of Government

The public authorities' involvement, responsibilities and tasks have been divided between the central state, the counties and the municipalities. Norwegian local government is based on a two-tier structure currently consisting of 426 municipalities and 19 counties.² Both tiers have directly elected councils and their own administrations. The county is a local authority of equivalent status to the municipality, and enjoys with very few exceptions no hierarchical superiority.

The public sector in Norway can be depicted by the following matrix:³

	National bodies	County	Municipal
National level	Stortinget/ the Legislative Body Government Ministries Directorates		
Regional level	County governor other regional state offices	Counties (19)	Regional municipal cooperative bodies
Local level	Local state offices	Local county institutions	Municipalities (426)

Illustration 1: An overview of the different bodies and levels constituting the public sector in Norway.

At the central level we find the central government which is accountable to the national assembly/parliament – the Storting. The Storting is the legislative body and also decides the economic bounds within which the regional and local authorities can operate.

² Over the past few years the government has initiated a reform with the intention of reducing the number of municipalities and counties through voluntary “mergers”. As a result the number of municipalities will be reduced to 354 and the number of counties to 11 by 2020.

³ Adapted from *Local Government in the Nordic Countries. Facts and Figures* (1991). Oslo: Kommuneforlaget

Local Government in Norway

The principle of local autonomy within limits set by the parliament – the Storting - dates back to the Alderman Act of 1837. Local government in Norway enjoys a fairly strong position. Although the country is relatively small in terms of population⁴, geographic, social and cultural factors have contributed to a politically strong and active periphery, which to some extent has resulted in fairly robust local authorities. All the same Norway is a unitary state with local government depending, from a formal point of view, on delegated state authority (Larsen & Offerdal, 2000).

The municipalities and counties vary significantly in size, topography and population. The average size of the Norwegian municipalities is about 10,500 inhabitants, but more than half of them have less than 5,000 inhabitants. Only 15 have more than 50,000 inhabitants. Despite such differences, all municipalities and all counties are given the same responsibilities in their respective geographical areas. The framework regulating the activities of the counties and municipalities is laid down by the Storting through legislation and decisions regarding local government funding. The Storting determines the division of functions between the different levels of government, i.e. central government, counties and municipalities. Government can only assign new functions to local government by means of legislation or decisions made by the Storting. However, it is an important principle that counties and municipalities on their own initiative voluntarily may assume tasks or functions that have not been assigned to others by law.

As local authorities became agents for welfare state policies, their activities and budgets increased significantly (Larsen & Offerdal, 2000). At present just under 20 per cent of the workforce are employed by municipalities and counties. Of these more than nine out of ten are employed by the municipalities. The final consumption expenditure of local government amounts to 50 per cent of the total public consumption expenditure, demonstrating that the municipalities constitute an important factor in the country's economy. This is reflected in the fact that the services offered by the municipality play an important role in most people's daily lives literally from the cradle to the grave. This entails responsibility for the day-to-day welfare of the inhabitants in such fields as nurseries/kindergartens, child welfare, primary and lower secondary schools, care for the elderly and disabled, public primary health care,

⁴ 13.09.2017: 5 277 762 inhabitants

financial support for welfare clients, libraries, culture and business development, fire departments, harbours, water supply, sewage, garbage collection and disposal, agricultural issues, environmental issues, local planning and organisation of land usage, all within its geographical boundaries.

On average state grants account for about 30 per cent of the municipalities' revenue, whereas 36 per cent come from local taxes. The rest is mainly made up of fees and charges paid by the users, a source of revenue which has lately been growing in importance. In 1986 block grants were introduced in order to reduce the high number of sector and issue-specific grants which had become increasingly more dominant. However, the state sometimes deflects from this principle. Politicians at the national level do not refrain from tying grants to specific national policies, most notably within care for the elderly and disabled. This is not surprising, money being perhaps the most potent means to achieve political ends.

The counties are responsible for services on the regional level, such as secondary education, cultural affairs, public transport, dental health, economic development and planning and the development of the county road system. The counties get nearly 50 per cent of their revenue in the form of state grants and 35 per cent from taxes.

Both municipalities and counties are headed by an elected council – the kommunestyre and the fylkesting respectively. As a result of the Local Government Act of 1992 municipalities and counties were granted a high degree of freedom concerning the management and organisation of their own affairs. Putting it simply one could say that local authorities are given autonomy as to how they wish to organise themselves, but when it comes to the substance of their policies, they are bound by goals set by the state. This can be said to constitute an integrational model of local government as opposed to an autonomous model. The reasons for choosing an integrational model is based on the view that political participation by local citizens in the running of municipal affairs must be weighed against the need for efficiency, rule of law, fair distribution of public goods, and macro-economic concerns. Thus local government is seen as an instrument to be used by the state in order to implement national policies (Larsen og Offerdal, 2000).

Separation of Functions

The system of governance in local government is based on the principle of separation of functions, that is a clear distinction between political and administrative matters. The Act of 1992 stresses the importance of forming a unitary and hierarchical system of management in municipalities and counties. In accordance with this, all communications between the administrative and political areas of local government should be channelled through the office of the chief municipal executive. The responsibility of the chief municipal executive is reinforced and expanded in all matters relating to the management of personell and administrative organisation. It is more or less understood that the politicians should refrain from interfering in the way the chief municipal executive manages 'his/hers' administration (Larsen & Offerdal, 2000).

The division of functions is facilitated by introducing the style of governance based on the principles of management by objectives: The popularly elected bodies determine by way of their decisions what should be done, whilst the administration ought to be given a large amount of discretion as to how the tasks should be solved (Larsen & Offerdal, 2000).

One of the aims of the Act of 1992 was to make Norwegian local government more effective and efficient. Management by objectives is seen as a tool for improving both aspects. Problems of political capacity, overload and co-ordination are intended to be overcome by having politicians avoid involvement in minor issues and detailed regulations, and instead concentrate on setting goals and making priorities. The Act allows for a considerable degree of delegation of authority, both from political bodies to the administration and also from the chief municipal executive to lower levels of administrative competence. What may not be delegated are matters of principle (Larsen & Offerdal, 2000).

Thus one might say that the Act is a proponent of an idealised picture of public administration as a hierarchy of independent and politically neutral institutions. It has no political power or role in this hierarchy; its functions are designated by formal rules and political signals, and civil servants should act as obedient and loyal implementors of political decisions. Politicians on their hand should avoid interfering in administrative matters (Larsen & Offerdal, 2000).

Supervision, Control and External Audit

To compensate for the relative freedom instituted by the Act of 1992, new provisions concerning internal supervision and control and external audit were implemented. A new

political body– the control committee – was established. The committee is elected by the council, and its exclusive task is to deal with supervision, control and audits. The following model illustrates the function and position of the different elements of local government and how they relate to each other:

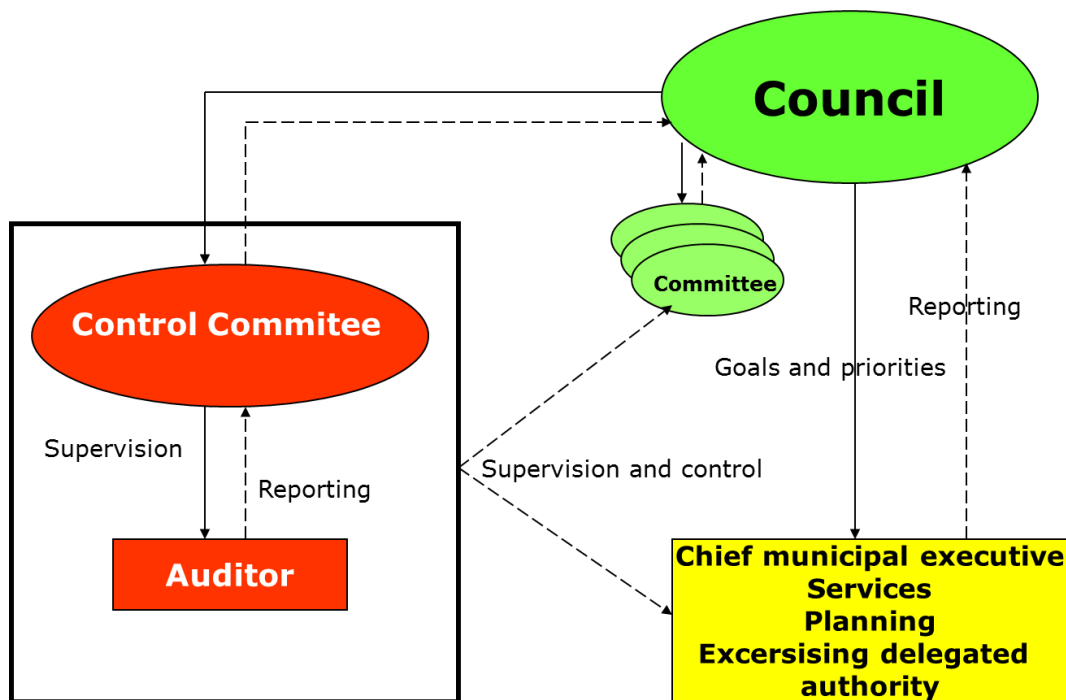


Illustration 2: The different elements of municipal governance, supervision, control and audit in Norway

The illustration shows that two separate lines of supervision converge in the council itself; the line of governance through the chief municipal executive and his administration and the line of supervision and control through the control committee. The chief municipal executive is responsible for the system of internal controls, whereas the control committee handles the external audits.

From 2004 the regulations concerning internal supervision and control and external audit were amended and expanded and collected in a separate chapter of the Act – *Chapter 12. Internal supervision and control. Audit*. The chapter comprises five sections - §§ 76-80 – dealing with the following themes:

- § 76. *Supervisory responsibility of the municipal council and the county council*
- § 77. *Control committee*

- § 78. *Audit*
- § 79. *Independence of the auditor*
- § 80. *Rights of information and inspection in companies*

The statutes are elaborated in regulations issued by the Ministry. The regulations give further provisions for how the tasks concerning supervision, control and audit should be carried out. One set of regulations concerns the duties and activities of the control committee while another set concerns the auditing of local government.

The Council

According to § 76 the ultimate responsibility for the supervision of the municipal and county authority management lies with the council itself. Ensuring that the annual accounts are audited in a satisfactory manner constitutes a fundamental part of this responsibility. It is solely up to the municipal council itself to decide on their audit arrangements and the actual choice of auditor. They may either choose to recruit and employ their own auditors, or they may enter into partnership with other municipalities or counties on audit arrangements, or as a third option they may decide to enter into a contract with another auditor. The council's resolution on this matter must be based on a motion from the control committee. The same procedure applies to the actual appointing of the auditor.

The Control Committee

To take care of the day to day supervision of municipal and county authority management the council must elect a control committee whose sole purpose is supervision and control. There are strict limitations as to what other positions the committee members may hold. As a rule they may only have a seat on the council itself in addition to the seat on the control committee. In fact, the Act demands that at least one member of the committee also must be a regular member of the council. This is to facilitate that matters concerning control and audit are given due attention by the council. The chairman of the committee is granted the right to attend and speak at council meetings when business concerning the affairs of the control committee is transacted.

One of the main responsibilities of the control committee is to see to it that the annual accounts of the municipality are audited in a satisfactory manner. This entails monitoring the progress of the audit to ensure that it is carried out in consistency with relevant laws and

regulations and in accordance with good local government auditing practice. The committee shall further make sure that the financial management is being monitored and conducted in conformity with current provisions and resolutions. Part of the responsibility is also to carry out systematic assessments of economy, productivity, goal achievement and outcome. Frequently used terms for this latter type of audit are performance audit or value for money audit. The object of such audits is to assess the economy, efficiency and effectiveness of the dispositions made by the chief municipal executive and his administration.

In addition to financial audits and performance audits the committee shall also ensure that the administration of the municipality's interests in partnerships are duly monitored.

The Ministry's regulations lay down as an important overriding principle that the activities of the control committee must not entail a reassessment or contestation of the political priorities made by the council or other politically elected bodies with decision-making capacity.

To enable the committee to carry out its tasks, it is granted access to any piece of information, report or document within the municipality. It may also undertake any investigation as it sees fit in order to fulfill its obligation. This right also extends to partnerships in inter municipal companies and limited companies where one municipality alone, or together with other municipalities or counties, owns all the shares. The same applies to wholly owned daughters of such companies. The control committee and the auditor can demand information from the general manager, the board of directors and the company's auditor. They are also to be notified when general meetings are being held, where they have the right to be present.

The control committee reports the results of its work to the council that carries the ultimate responsibility for the activities of the municipality. Before any matter is reported the chief municipal executive must be allowed the opportunity to voice his comments on the matters in question.

The meetings of the control committee are open to the public except in matters where disclosure is prohibited by law. The statutory auditor in charge of an assignment is granted the right to speak up at the committee's meetings. He may also demand that his opinions be included in the minutes of the meeting

The committee is assisted by an especially designated secretariat whose task is to ensure that all matters put before the committee are properly and duly investigated and analysed. It shall also make sure that the committee's resolutions are implemented. The regulations make it explicit that secretarial functions cannot be carried out by the auditor. It follows logically the other way round that the secretariat cannot conduct audits.

Thus far we can conclude that the task of the control committee is threefold:

- Audit of the annual accounts
- Performance audits/Value for money audits
- Monitoring of the administration of the municipality's interests in partnerships and companies

The Auditor

The audit of the municipality shall be carried out in accordance with good local government auditing practice pertaining both to the audit of the annual accounts and to performance audit.

It is also an indispensable claim that any person carrying out an audit must be independent and objective in all respects. The auditor and his close associates cannot be connected with the audited body itself, its employees or office-holders in such a way that it might compromise the auditor's independence and objectivity. Being employed as the municipality's auditor is not considered to compromise the auditor's independence since the auditor does not report to the chief municipal executive who is the target of control, but to the control committee and the council alone.

The auditor may only take on consulting as long as his independence and objectivity are not compromised.

The Ministry's regulations concerning audit state that all the municipality's accounts must be audited by one and the same auditor who must of course meet the formal requirements stated by law and regulations. If the council has engaged an audit firm to carry out the audit, the firm must appoint a statutory auditor to take charge of each assignment. The council may choose separate auditors to audit the accounts of municipal enterprises. The same applies to performance audits.

The regulations demand that the statutory auditor in charge of the assignment must have achieved a bachelor's or a master's degree in auditing and that he has obtained three years of practice in auditing thus meeting the requirements of the title registered or state authorized auditor.

Since performance audit is an altogether different type of audit where many educational backgrounds may be useful, the regulations demand that the person responsible for each assignment of performance audit must have completed a minimum of three years of college or university studies.

In addition to the educational demands the statutory auditor in charge of the assignment must meet certain requirements concerning his good repute, he must be capable of fulfilling his obligation as they fall due, and he must be of legal age and capacity.

Like the control committee the auditor may demand any piece of information, report or document whatsoever from the local authority and may undertake any investigation that he finds necessary in order to carry out his duties as auditor. The auditor must maintain secrecy in respect of matters of which he becomes aware in performing his work in so far as it is laid down by law.

The auditor reports about the results of his audit and scrutiny to the control committee.

Audit of the Annual Accounts

The task of the auditor is to assess whether annual accounts have been prepared and approved in accordance with laws and regulations and good local government accounting practice. This entails assessing whether the accounts present a fair expression of the economic activities that have taken place in the municipality in the year gone by and the financial position at the end of the year. The assessment must ascertain that the accounts correspond to the current budgets allocated by the council, and that material discrepancies have been accounted for in the annual statement of the chief municipal executive. The auditor must also assess whether the management has fulfilled its duty to produce a proper, law-abiding, and clearly set out registration and documentation of the accounting records. It is also the duty of the auditor to ascertain that the chief municipal executive has established a satisfactory system of internal

controls. Finally it is clearly stated in the regulations that the auditor should contribute to the prohibition and unveiling of frauds and errors.

The regulations also contain statutory guidance on how the audit should be carried out. First of all the audit must be planned, carried out and reported in agreement with laws, regulations, and good local government auditing practice. This implies that the auditing of local government is to be performed in compliance with the Norwegian version of International Standards on Auditing (ISA's) in so far as they are considered appropriate. The standards have been supplemented with additional sections dealing particularly with a public sector perspective. The International Organization of Supreme Audit Institutions (INTOSAI) also develops and endorses its own collection of professional standards and best practice guidelines for public sector auditors – the so-called ISSAIs. These are also relevant in local government auditing.

The audit must include an assessment of the risk of material misstatement in the annual financial statement due to fraud or error. The auditor must report in writing if he unveils weaknesses in the registration and documentation of the accounting records, or in the internal control systems, or if he uncovers frauds. The same applies to errors which may result in misstatements in the annual financial statement. If he wants to resign from the engagement he must give his reasons for doing so in a written statement.

After the audit has been carried out the auditor must submit an auditor's report to the council by 15 April each year. The report must contain statements on all relevant issues ensuing from the audit. If the auditor finds the annual financial statement unacceptable, this must be stated clearly in the report. An auditor's report must be submitted even if the annual financial statement is missing or incomplete.

A copy of the auditor's report is to be sent to the control committee upon which the committee issues its own statement on the subject of the municipality's financial statement and submits it to the council. It is the duty of the committee to ensure that any remark and critical statement voiced by the auditor receives proper attention by the chief municipal executive and his administration, and that practices are changed where appropriate. The committee is to report back to the council on this matter.

Performance Audit – Value for Money Audit

The Ministry's regulations oblige the committee to ensure that performance audits are carried out on a regular basis. The regulations demand that the committee makes a plan pointing to areas or sectors which are eligible for performance audits. Prior to the plan the committee must carry out a general analysis⁵ of the municipality's total activities in the light of risk and materiality in order to identify what areas and sectors are displaying signs of weaknesses implying a call for performance audit. The plan must be endorsed by the council. The committee reports to the council about the performance audits that have been carried out.

Performance audit/value for money audit entails assessing the economy, efficiency and effectiveness of the dispositions made by the chief municipal executive and his administration. This can be illustrated by the following model:

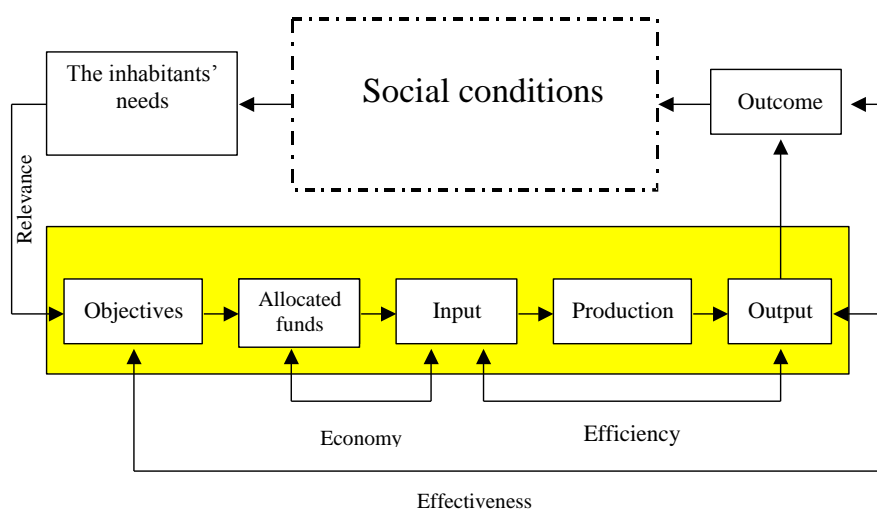


Illustration 3: Performance audit/value for money audit of economy, efficiency and effectiveness. Adapted from Pollitt e al 1999: 10.

The model illustrates that there is a relationship between social conditions and the needs of the inhabitants for municipal services. The objectives set by the council should mirror these needs. The objectives of the council are presumed to determine to what purposes funds are allocated. These funds finance the resources that go into the production process to create results and outcomes. The outcome supposedly affects social conditions and the welfare of the

⁵ The Norwegian Association of Local Government Auditors (NKRF) has issued guidelines on how to conduct a general analysis.

inhabitants, and the circle is complete. Within the framework of this model studies of economy, efficiency and effectiveness can be carried out.

In addition to assessment of the three E's – Economy, Efficiency and Effectiveness – performance audit may also include the assessment of compliance with laws and regulations, assessment of how well the administration of the municipality is governed, and assessment of the quality of the preparation of matters put before the council and other political bodies. It is compulsory that assessment criteria are established and made explicit for each performance audit.

The Norwegian Association of Local Government Auditors (NKRF) has established an audit standard⁶ that must be met in order to comply with good local audit practice in the field. This is elaborated further in a handbook on performance audit.⁷

The results of the audits must be reported consecutively to the control committee. The chief municipal executive's comments and opinions must always be included as part of each individual report.

Inspection of Partnerships in Companies

The third area of control for which the committee is responsible is to make sure that the administration of the interests of the municipality in partnerships in inter municipal companies and limited companies is monitored. The purpose is to make sure that the council's interests are taken due care of, and that the person who represents the council as owner and shareholder does this in accordance with the council's resolutions and presuppositions.

The inspection of partnerships consists of a compulsory ownership control and an optional inspection by means of performance audit. The control committee is free to decide who shall undertake the ownership control. Since ownership control is not defined as audit, it may be performed by the committee's own secretariat. An optional performance audit must, however, be carried out by someone else, and in accordance with the appropriate standards and regulations. This is illustrated below.

⁶ RSK 001 Standard for forvaltningsrevisjon

⁷ NKRF Veileder i forvaltningsrevisjon

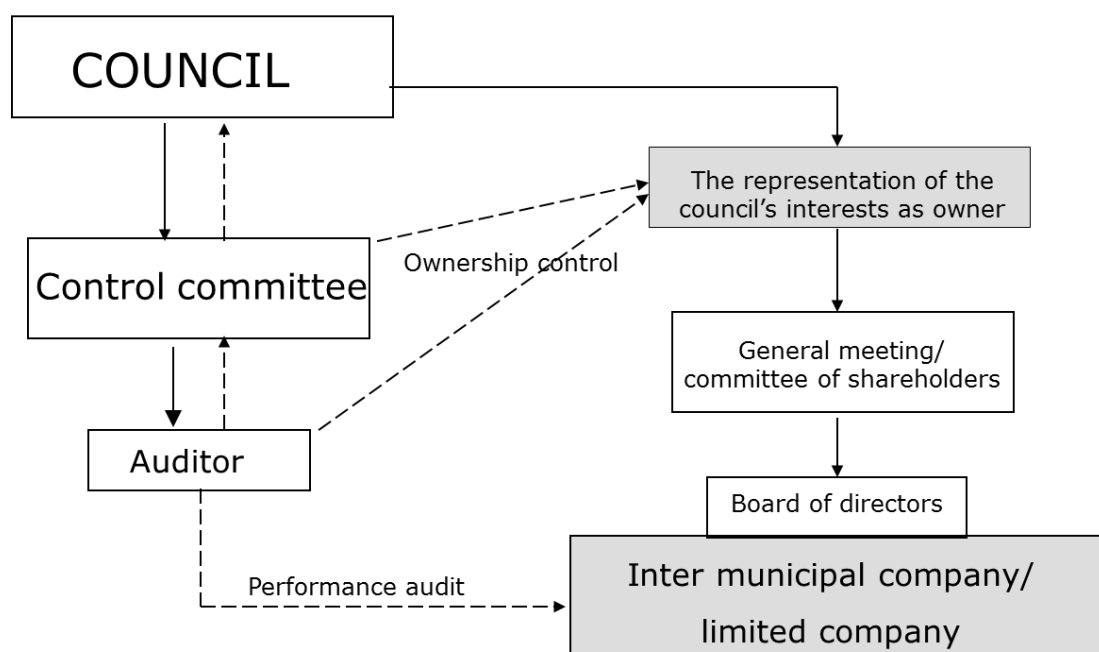


Illustration 4: Inspection of partnerships in companies

The illustration shows that the council elects who is to represent the council's interests as shareholder in the general meeting. It is the duty of the control committee on behalf of the council to inspect how the council's interests are taken care of by the elected delegate.

The regulations state that the committee must make a plan for their control activities in the area of partnerships control, and the plan must be endorsed by the council. The control committee is to report to the council how the control has been carried out and the ensuing results.

This is a new area of control in a municipal context, and as such no set standard of good practice has as yet been established. The Norwegian Association of Local Government Auditors (NKRF) has issued guidelines describing how the inspection of partnerships may be carried out.⁸

⁸ NKRF Veileder for gjennomføring av selskapskontroll

Concluding Remarks

Chapter 12 of the Local Government Act of 1992 and its regulations constitute a sound and solid basis for carrying out supervision, control and audit in the best interest of a healthy development of Norwegian municipalities and counties. This is reflected in the fact that no substantial changes on this subject have been put forth in the present process of revising the Law of 1992. However, it is underscored in the Official Norwegian Report on the matter that the central purpose of all supervision, control and audit is to initiate processes of learning and improvement, contributing to the municipalities' and counties' becoming learning organisations, enabling them to provide ever better services to the citizens. To achieve this, the mere existence of provisions in law and regulations to that end are not enough. It is also necessary that the politicians display a will to make full use of the tools of supervision, control and audit offered by the legislation.

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