

Tallinn University of Technology Doctoral Theses  
Series I: Social Sciences, No. 12

**An Integrated Model of Audit, Control  
and Supervision of the Local  
Government Sector:  
The Case of Estonia**

RAIVO LINNAS

**TUT**  
PRESS

**TALLINN UNIVERSITY OF TECHNOLOGY**  
**Faculty of Social Sciences**  
**The Institute of Public Administration**  
**Chair of Regional Policy**

This thesis was accepted for the defense of the degree of Doctor of Philosophy in Public Administration on 1 March 2010.

**Supervisor:** Professor Dr. Sulev Mäeltsemees, professor of regional policy and local government, Faculty of Social Sciences, Tallinn University of Technology.

**Opponents:** Professor Dr. Lasse Oulasvirta, professor of financial administration and public sector accounting, Department of Economics and Accounting, University of Tampere.

Professor Dr. Gerrit Sarens, professor of governance, control and auditing, Louvain School of Management, *Université Catholique de Louvain*.

Defence of the thesis: 28 April 2010.

Declaration:

Hereby I declare that this doctoral thesis, my original investigation and achievement, submitted for a doctoral degree at the Tallinn University of Technology, has not been submitted for any other academic degree.

Raivo Linnas

Copyright: Raivo Linnas, 2010  
ISSN 1406-4790  
ISBN 978-9985-59-978-5

## ***Contents***

Introduction .....	5
References .....	30
List of Original Publications .....	41
Abbreviations .....	42
Terms .....	43
Abstract .....	44
Kokkuvõte .....	48
Original Publications of the Author .....	53
<i>Article 1</i> .....	53
<i>Article 2</i> .....	66
<i>Article 3</i> .....	84
<i>Article 4</i> .....	106
Appendixes.....	127
Curriculum Vitae.....	127
Elulookirjeldus .....	133



## **Introduction**

The author of this dissertation considers the issue of audit, control and supervision systems of the local self-government sector based on the case of Estonia. The theme of this dissertation is real, pertinent, timely and relevant not only for Estonia, but for the European Union and the world as well. The challenges facing the local self-government sector in the 21st century are complex and rapidly changing (Boland and Coleman, 2008: 313). The challenges facing audit, control and supervision systems are also complex and rapidly changing. Not only are accounting-, auditing- and internal auditing-related (Carvalho, Camões, Jorge and Fernandes, 2007: 2; Goepfert, 2006; Jackson, 2007; Plant, Steyn and Plant 2008: 19) issues changing endlessly, but local governments (Haward and Zwart, 2000: 34; Aarrevaara, 2003: 298; Helander, 2003: 290; Hendriks and Tops, 2003: 304; Pihlajaniemi, 2003: 264, 268; Reichard, 2003: 349; Rynänen, 2003: 256; Woolas, 2005) and societies (Kettunen, 2003: 277, 287; Walker, 2005: 81) where local governments exist are in the process of permanent change as well.

Both the academic and non-academic literature confirms that the activities of audit, control and supervision in both the public and private sectors have a low capacity in the context of outcome and impact or have failed completely. There are many different theoretical and practical reasons for that. For example, budgeting and accounting systems in the public sector are changing and as a result there is a need for new methods of audit and control (Sterck, Scheers and Bouckaert, 2005: 13). There is also a need to rethink the concept of democratic accountability (Hanberger, 2009: 5). One principal key factor of failure is the incorrect paradigm of treatment of this particular object of research by the academic community as well as by the subjects of governance.

Governance issues differ from place to place and the solutions to governance problems must be tailored individually, because there is no possibility of having a 'one-size-fits-all' solution to governance issues (UNDP, 1996; AUSAID, 2000: 1). Further, control structures are one of the cornerstones of governance (ANAO 1997: 3); internal control systems are an integral part and an important constituent of management and governance (Linnas, 2009c); internal controls are essential to the effective operation of local governments (OSCSNY 2003, 1); internal control is an obvious benefit in the overall function of corporate governance (Caliyurt, Agun and Pamukcu, 2008: 5); internal audit is a significant part of governance (Barlow, Helberg, Large and Le Roux, 1999: 26; Goepfert, 2006); internal audit is a critical governance mechanism (Holt and DeZoort, 2009: 61); external and internal audit are core components of governance (Linnas, 2008: 66); and external and internal audit are significant success factors of good governance (Linnas, 2008: 66). Therefore, audit, control and supervision are core constituent substructures of a governance structure.

According to Gonzalez de Asis and Acuña-Alfaro (2002, 4), local governance is the processes and institutions by which authority in a local municipality is exercised for the common good. Accordingly, governance structures, including

local governance structures, and audit, control and supervision structures, are intertwined (Hanberger, 2009: 2), reciprocally influenced by and inseparable from each other in a given society.

The aim of this dissertation is to explore some of the key aspects of the matter of audit, control and supervision activities and systems of local self-government units in Estonia. The author of the dissertation describes the current model of the local self-government sector's audit, control and supervision system of Estonia; performs a critical analysis of the existing audit, control and supervision system of the local self-government sector in Estonia; argues reasons why the present paradigm of understanding and treatment of the audit, control and supervision system of the local self-government sector in Estonia cannot be a reliable means of contemporary good governance anymore and discusses principally new theoretical and practical ways (a new approach) of overcoming its malfunctions.

The object of the author's research in this dissertation is the system of audit, control and supervision of the local self-government sector in Estonia. The audit, control and supervision system of the local self-government sector as a matter of academic research is interesting because the object of research is complex and complicated, exists in an open environment and keeps changing with time. It is worthy of treatment based on the case of Estonia because no significant research in that particular field has been done there. The academic novelty of this research consists particularly of two core aspects: 1. The author's research performed on the state and functionality of the entire audit, control and supervision system of the local self-government sector was the first of its kind in Estonia; 2. The author discusses a principally new theoretical approach to the audit, control and supervision system of local self-government units (particularly for Estonia).

The theoretical framework of the dissertation draws mainly on the literature on audit, control, governance, local governance, local self-government, public administration and supervision research. The author used a multi-method research design because audit, control and supervision activities, relevant management and control systems, and the organization of audit, control and supervision in local self-government units are diverse, complex, complicated and interdisciplinary matters of research. More in-depth empirical analysis has been undertaken for the audit, control and supervision of the local self-government sector in Estonia. This dissertation is based on 4 years of extensive research in Estonia. The preliminary results of the dissertation were presented and discussed at the First Global Academic Conference on Internal Audit and Corporate Governance in Rotterdam.

The purpose of the introduction is to summarise the discussion on the theme of the dissertation presented in the original, published articles of the author of this dissertation. The first core original article discusses the current model of the local self-government's audit, control and supervision system of the Republic of Estonia; performs a critical analysis of the existing audit, control and supervision system of the local self-government sector there and proposes key principles for developing an optimal model of an audit, control and supervision system of the local self-government sector suitable not only for Estonia but for other countries as well. The

second core article discusses in more depth the issue of audit, particularly internal audit, in small local self-government units; presents an analytical overview of the state of the local self-government sector and audit therein in Estonia; presents some theoretical and practical options for the future development of external and internal audit in small local self-government units and discusses the strengths and weaknesses of the options presented by the author. The third core article discusses the issue of legal regulation and the present state of external control and supervision of local self-government units in Estonia, gives a thorough overview of the legislative framework underpinning the key control and supervisory bodies of local self-government units, highlights the present situation of external control and supervision of local self-government units, and gives suggestions for overcoming the malfunctioning of the external control and supervision system of the LGS in Estonia. The fourth article discusses a new approach to the issue of audit, control and supervision of local self-government units and presents some ideas for the operation of an integral system of audit, control and supervision of the local self-government sector, particularly focusing on small LGS units.

The introduction is divided into 5 parts. In setting a general background for the theme of the dissertation, the first part elaborates on the state of contemporary local self-government in Estonia and in a more global context, while the second part presents the state of audit, control and supervision in the contemporary world. In the third section, the failure of the present paradigm of the audit, control and supervision system of the local self-government sector in Estonia is discussed. The fourth part presents the integrated model of audit, control and supervision of the local self-government sector. Finally, the pros and cons of the integrated model of the ACS of LGS are discussed in the fifth part.

## **The state of contemporary local self-government**

According to Gerard Marcou (2008: 311), the autonomy of local government (hereinafter called LG) may be understood in the sense of political autonomy<sup>1</sup> and as administrative self-government.<sup>2</sup> There are differences in terminology and sometimes conceptualization, but they have no impact on the real content of 'autonomy' or 'self-government' (Marcou, 2008: 312). "*The European Charter for Local Self-government as well as the "Guidelines" recently adopted by the Governing Council of UN Habitat both refer to the second meaning*" (Marcou, 2008: 311).

Pursuant to Article 3 of the European Charter of Local Self-Government, LG denotes the right and ability of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population. Pursuant to Article 2 of

---

<sup>1</sup> It is a demand for sovereignty which stops at the limit of independence, from which it is distinct (Marcou, 2008: 311).

<sup>2</sup> It expresses the possibility for a local authority to govern its own affairs and those which the law entrusts to it (Marcou, 2008: 311).

the European Charter of Local Self-Government, the principle of local self-government shall be recognised in domestic legislation, and where practical, in the constitution (COE, 1985). According to Marcou and Wollman (2008: 129), local self-government has been recognized as a governing principle by the EU. The Parliament of Estonia, the *Riigikogu*, ratified the European Charter of Local Self-Government on 28 September 1994.

According to Sulev Mäeltseemes (2006), local self-government is thoroughly and well-regulated by the Constitution of the Republic of Estonia compared to the constitutions of other countries. Pursuant to Section 154 of the Constitution of the Republic of Estonia, *“All local issues shall be resolved and managed by local governments, which shall operate independently pursuant to law. Duties may be imposed on a local government only pursuant to law or by agreement with the local government. Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget.”* Pursuant to Subsection 2 (1) of Local Government Organising Act (hereinafter called LGOA), *“local government is the right, authority and duty of the democratically formed bodies of power of a local government provided for in the Constitution, a rural municipality or city, to independently organise and manage local issues pursuant to law and based on the legitimate needs and interests of the residents of the rural municipality or city, and considering the specific development of the rural municipality or city.”*

Pursuant to Section 3 of LGOA of Estonia, local government is based on the following principles: 1) the independent and final resolution of local issues, and organisation thereof; 2) mandatory guarantee of everyone’s lawful rights and freedoms in a rural municipality or city; 3) the observance of law in the performance of functions and duties; 4) the right of the residents of a rural municipality or city to participate in the exercise of local government; 5) responsibility for the performance of functions; 6) transparency of activities; and 7) the provision of public services under the most favourable terms. The foundations of local self-government in Estonia are substantially in compliance with the principles of the European Charter of Local Self-Government, but there are differences in how these principles are actually implemented.

Local self-government sectors (hereinafter called LGS) differ from each other all over the world: their tasks are very different, their sources of revenue are equally diverse, relations between the state and LGS are based on very different fundamental principles, and organisational structures are different from country to country (UNDP, 1996). There are big differences in compliance with accounting and reporting standards as well (Christianens, 2001: 158, 168; Oviir, 2006; SAO, 2006; Carvalho, Camões, Jorge and Fernandes, 2007: 2). Nevertheless, some trends and characteristics are common (Linnas, 2010; Marcou and Wollman, 2008: 129). For instance, a permanently changing environment (Kettunen, 2003: 277, 287; Sterck, Scheersand and Bouckaert, 2005: 13; Schoburgh, 2007: 169; Steyvers et al, 2008: 141); a mismatch between the responsibilities and sources of finance (Mäeltseemes, 1994; Haveri, 2003: 319; Ryyänen, 2003: 255, 256; King, Vanags,



Vilka and McNabb, 2004: 939, 945); life under permanent change, reform and merger processes (Haward and Zwart, 2000: 34; Heuru, 2003: 258; Sancton, 2005: 319; Dollery and Johnson, 2007: 198; Steyvers et al, 2008: 135; Van de Walle, Van Roosbroek and Bouckaert, 2008: 50); the political accountability of local authorities appears to have been circumvented and lost effectiveness (Kelly, 2003: 461; Vabo, 2005: 586; Oviir, 2006; SAO, 2006; Linnas, 2007: 286); the increasing share of networking (Aarrevaara, 2003: 302; Kettunen and Kungla, 2005: 357; Steyvers et al., 2008: 134) and co-operation between LGUs (Haveri, 2003: 316; Heuru, 2003: 258; Niemi-Iilahti, 2003: 284; Helander, 2003: 295; Oulasvirta, 2003: 340; Linnas, 2008: 77), and a number of non-local factors jeopardise local democracy (Smith, 1996: 167; Fender and Watt, 2002: 283).

The academic as well as non-academic literature confirms that the situation of LGUs does not depend only on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a particular country (Linnas, 2008: 77). For example, according to Sulev Mäeltsemees (1994), the legal acts regulating the affairs of local government in Estonia are unsystematic, sometimes even contradictory, and often declarative. Since Estonia regained independence, its local self-government units have had more and more tasks and functions heaped upon them, but in most cases there has never been enough money to fulfil them all (Mäeltsemees, 1994; Linnas, 2008: 69). The case of Estonia in this particular respect is not a unique phenomenon (Haveri, 2003: 319; Heuru, 2003: 261; Olulasvirta, 2003: 341; Pihlajaniemi, 2003: 267; Reichard, 2003: 347-348; Ryyänen, 2003: 255, 256). There is a general rule that says that states “*face many temptations to push the limits, like shifting responsibilities to local governments with little or no consultation and without corresponding financial resources*” (Marcou and Wollman, 2008: 12; UCLG 2008: 289) or local self-government is highly dependent on central government funding (Helden, 2000: 86). Nevertheless, “*the powers and responsibilities devolved to local authorities are increasing*” (Marcou and Wollman, 2008: 129). Consequently, the different issues of governance, including audit, control and supervision, of LGSs are of increasing importance as crucial factors of success in serving the residents of a given local society by its local government.

Since the adoption of the LGOA on 2 June 1993, Estonia has had a one-level local government system. There are no representative bodies elected by residents at the regional level and county governments have been given the status of state authorities. Estonia is divided into 15 counties. There is no regional-level government (MI, 2005: 20). All LGUs – towns and rural municipalities – are equal in their legal status (MI, 2005: 2). Internal organisation is based on two major institutions: a council and a government. The main task of a local council is to adopt decisions regarding important aspects of local life, administer the development of the local government, exercise control over the activities of the local government and adopt the budget of the rural municipality or town. A local government, on the other hand, is mainly responsible for performing day-to-day tasks.

A great majority of Estonia's LGUs are small in every aspect: the number of residents, size of territory, financial resources, natural resources and qualified experts (Linnas, 2007: 282). Although the size of LGUs in Estonia is quite varied, all of them are small or very small. 32 LGUs have a population of under 1000 inhabitants, only 3 have a population over 50 000 (MI, 2005: 3) and half have less than 2000 inhabitants (MI). LGUs in Estonia merge relatively actively, but the number of LGUs with less than 1000 inhabitants is growing (MI 2007, 10).

Nevertheless, Estonia is not a very rare case. According to Oulasvirta (2003: 340), most (57%) LGUs in Finland are small as well (2000-10000 inhabitants). The Estonian LGS depends to a great extent on the political decisions of each budgetary year of the sitting Parliament and State Government (Mäeltsemees 1994, 2006; Linnas 2009a: 144) because local taxes are not relevant sources of income for LGUs in Estonia (Linnas, 2007: 284). In the case of Estonia, political control via budgeting is significantly effective because according to the data provided by the Ministry of Finance of the Republic of Estonia in the report "Local Government Budget 2003-2007", the share of sustenance costs (staff, administrative and other costs) in the total expenditure of the local self-government sector was 70% in 2003, 75% in 2004, 72% in 2005, 68% in 2006 and 71% in 2007. Accordingly, the financial capacity (spare funds) remaining to provide public services to the LGUs' inhabitants is very weak and any change in the allocation of supplementary funds from the state budget to the LGS' total budget has a significant impact.

Sellers and Lidström (2007) argue that "*lower local capacities and in some instances more supervision make local government in these systems more state-dependent.*" This is what has happened with the LGS in Estonia. The general index values of local government capacity calculated for the LGS in Estonia during 2005 to 2008 vary very significantly (from 83.6 to 13.3 points on a 100-point scale) (Sepp, Noorkõiv and Loodla, 2009a: 12). Mihkel Oviir, the auditor general of Estonia, argues that "*smaller local governments are facing the difficulty of being unable to guarantee the required level of administrative functions due to their small budget*" (2006: 8; 2009, 65) and 90% of Estonia's local governments are extremely small to find and maintain well-qualified accountants, information technologists, lawyers and other specialists. Consequently, the local self-government sector in Estonia is facing a real need for change in the political, economic and administrative fields, including aspects of audit, control and supervision. However, this puzzle will be of the utmost challenge as well for politicians and public servants in addition to scientists and researchers. Rait Maruste (2007), a judge of the European Court of Human Rights, argues that "*a true and functioning constitutional democracy is based first of all on thinking, values, good will and practice, faith and experience. These are categories that take much longer and greater effort to evolve than economic wealth or formal lawfulness.*" "*It is not easy to change administration and the measures taken to change it may not bring along the desired results*" (Randma and Annus, 2000).

## **The state of audit, control and supervision in the contemporary world**

The concepts of 'control' and 'supervision' are not new and seem to be as old as human civilization. One can find clear evidence of the preliminary characteristics of control, inspection, monitoring and supervision activities from ancient Greek times (Xenophon) as well as from the times of Jean Baptiste Colbert (1619-1683), one of the greatest ministers of Louis XIV. However, according to Davis, Downe and Martin (2001: 2), the preoccupations of nineteenth-century inspection were very different from those of today (Linnas, 2009a: 142).

The typology and taxonomy of control (Wallace, 2002: 159) and supervision can be constructed in many different ways. Typology depends primarily on the basic viewpoint and particular interest of the observer (Linnas, 2009a: 142). Control frameworks present a superstructure above the hundreds of kinds of controls (Campbell, 2003: 4) and they can be classified into three 'communities'—models concerning control objectives, principles and Capability Maturity (Campbell, 2003: 5).

Internal control, internal controls and an internal control system as subjects of research and management mean "*different issues to different people and causes up to day confusion among businesspeople, legislators, regulators and others*" (COSO, 1992). The definition of internal control (hereinafter called IC) has evolved over recent years as different internal control models (Campbell, 2003: 1; EBF, 2006) have been developed. According to the Committee of Sponsoring Organizations of the Treadway Commission (hereinafter called COSO), the main standard-setter on internal control, "*internal control is broadly defined as a process, affected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting and compliance with applicable laws and regulations. ... Internal controls are put in place to keep the company on course toward profitability goals and achievement of its mission, and to minimize surprises along the way. They enable management to deal with rapidly changing economic and competitive environments, shifting customer demands and priorities, and restructuring for future growth. Internal controls promote efficiency, reduce risk of asset loss, and help ensure the reliability of financial statements and compliance with laws and regulations*" (COSO, 1992).

According to COSO, internal control consists of five interrelated components which are derived from the way management runs a business and are integrated with the management process. The components of internal control are Control Environment, Risk Assessment, Control Activities, Information and Communication, and Monitoring. There is a synergy and linkage between these components forming an integrated system that reacts dynamically to changing conditions. According to COSO (1992), "*because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.*" According to the

ECIIA (2005: 2), “*the coordination and eventual convergence of the development of risk management and internal control at EU level should be a key issue for all regulators*” and “*principles of risk management and internal control have to develop harmoniously between private and public sectors.*”

Different countries have different approaches to the external control and supervision (hereinafter called ECS) of LGUs (Linnas, 2009a: 142). “*Countries generally rely on various combinations of instruments to exercise control over localities. Belgium, Greece, Austria and Spain rank high for both politico-administrative and fiscal supervision. Canada, Australia and the U.S. range relatively low in both. Countries between these two clusters, including all of the Scandinavian countries, have looked more to one than to the other type*” (Sellers and Lidström, 2007: 16). For example, the purpose of state supervision is clearly and simply defined in Article 108 of the Bavarian Local Government Law as follows: “*The supervisory authorities ought to advise, encourage and protect with understanding the municipalities in the performance of their tasks and they ought to reinforce the decision-making force and the responsibility for their own action of the municipality bodies*” (Haschke, 1997). Ezugbaia and Melkadze (2002: 109) argue that in a number of states, control is associated with full supervision both from the legal and the reasonability point of view, including the prior authorisation to act and the power to annul a local authority’s decision. Direct central government controls are more common in unitary states than in federations (Ter-Minassian and Craig, 1997: 13). According to Hanberger (2009: 8), state model governance represents one of the most common types of decentralised governance in democratic nation-states like Estonia.

Nevertheless, some characteristics are common to a number of countries (Linnas, 2009a: 142). Firstly, external control and supervision systems (hereinafter called ECSS) are sophisticated combinations of different types of control and supervision subsystems (Linnas 2009a: 142). Secondly, the relative importance and relations between the different subsystems and elements of ECSS are varied (Linnas 2009a: 142). Thirdly, the philosophical basis for the theoretical treatment and concept of the practical application of the ECSS of LGUs is very different even in the same organization (a confederation of states, federal state, union of states, the European Union, etc.) (Linnas 2009a: 142). Fourthly, due to the legal framework, political reality, historical and cultural context, and economic situation of the different institutions responsible for executing ECS activities over LGUs, they perform their tasks and duties with different authority, devotion, scope, regularity, thoroughness and focus (Linnas 2009a: 142). Fifthly, in many countries the state authorities executing control and supervision over LGUs are entitled with a large frame of powers and there exists a trend to increase this power<sup>3</sup> (Cole,

---

<sup>3</sup> In this aspect, the situation is very similar in Armenia (Arabyan, 2007: 15), Australia (Davis, Downe and Martin, 2001: 2), Latvia (IMF, 2001: 4), Norway (Sellers and Lidström, 2007), South Korea (Chong-Min, 2006: 14), the USA Coleman and Colantuono, 2003: 20) and Uzbekistan (Bektemirov and Rahimov, 2001: 507). One can see that the increasing

2003: 202; Kelly, 2003: 459; Schoburgh, 2007: 172; Andrews, 2008: 171; Linnas 2009a: 142). Sixthly, in small states, the state-level controllers and supervisors responsible for executing ECS activities over LGUs may be under the control of a few specific interest groups (Fender and Watt, 2002: 283; Linnas 2009a: 142). Seventhly, complete centralized control is impossible in any complex system (Mathews, 1996, 41; Linnas, 2009: 143). Eighthly, state-level administration systems and local self-government-level administration systems form a holistic, integral and complex public administration system in society (Sepp, Noorkõiv and Haljaste, 2006: 3; Almann, 2007; Linnas 2009a: 143). Finally, internal managerial control mechanisms are obliged to operate within a legal framework (CDLR, 2003: 5), which is a form of external control (Wallace, 2002: 159).

According to INTOSAI's Lima Declaration (1998), the concept and establishment of audit is inherent in public financial administration. Local government audit is an instrument for local democratic control (SGOR, 2004: 3). Audit is well-defined all over the world, but there are still some material differences in its definitions and treatment (Nieuwlands, 2006) by academicians, politicians, public administrators and audit professionals of different states and regions across the globe (Linnas, 2008: 69-70).

According to Nicolaisen (2006), the audit profession has been challenged as never before during the past few years because accounting standards are biased, financial reporting is too complex, evolving to another level and *"it's tough in this complicated world for smaller businesses, whether they're private or public, to get all the right information at the right time, so that they can prepare their financial statements accurately and so that auditors can audit them with confidence."* Auditing is under permanent change (Caplain, 2005; E&YA, 2005: 6; E&YF, 2007: 6; Fogarty, Graham and Schubert, 2006; McConnell and Banks, 2003; Ramos, 2003).

Despite the fact that there are a number of different theoretical conceptions, models, frameworks and approaches to audit, control and supervision, and countries design, implement and maintain audit, control and supervision frameworks, models and functions differently all over the world, both the academic and non-academic literature confirms that the activities of audit, control and supervision (hereinafter called ACS) in the public and private sectors have a low capacity in the context of outcome and impact or have failed completely. (See below)

---

power of state control and supervision over LGUs does not depend on the political order, degree of democracy, liberalism, welfare or socio-cultural environment of a country.

## **Failure of the present paradigm of the audit, control and supervision system of the local self-government sector in Estonia**

The aim of this section is to elaborate on why the present paradigm of understanding and treating the ACS activities and systems of LGUs in Estonia cannot be a reliable means of contemporary good governance anymore.

In the context of the social sciences, state theory and public management, the primary issues are not inputs, subjects, processes, systems or outputs, but first of all outcomes and impacts (Linnas, 2007: 287). At the level of outcome and impact (Linnas, 2007: 287), one can recognise that internal control over LGUs in Estonia is weak (Kõrge, 2006: 18), control systems and internal control systems are ineffective or inefficient (Metsalu, 2006: 2; Kõrge, 2006: 20-21), smaller local government units lack functioning internal control systems (Oviir, 2006: 46), the extensive backwardness of accounting compared to public sector units (ministries, larger local governments, etc.) and an insufficient level of accounting in those units (*Ibid*, 8), funds received are not used for their specified purposes (*Ibid*, 25), the current control systems of LGUs do not make sure that only those who are really destitute receive subsistence benefits (*Ibid*, 42), audited local governments lacked a comprehensive overview of their assets and value thereof, budgetary funds were not used only for their designated purposes, and when needs changed, the budget was not upgraded accordingly (*Ibid*, 47). According to the SAO (2006), the reasons for this unsatisfactory situation in a major number of cases are mostly the irresponsible attitude of members of city or rural municipal governments and deficient control over their activities.

According to the Public Company Accounting Oversight Board (hereinafter called PCAOB), smaller companies by their nature have fewer employees, which limits their opportunity to segregate incompatible duties (PCAOB). The majority of LGUs in Estonia are small or tiny organizations. Therefore, internal control activities in most Estonian LGUs are at real risk. Nevertheless, in some LGUs internal control systems, accountancy and formal procedures are in good condition (Aas, 2007: 7; Mikli, 2007a: 1). Internal control activity and internal control systems might be rather weak because small LGUs do not have a sufficient amount of financial (Haveri, 2003: 321; Pihlajaniemi, 2003: 268; Oviir, 2006; SAO, 2006: 8; Linnas, 2007: 284) and human resources (Haveri; Pihlajaniemi; Oviir) to hire, educate, train and keep in office experienced, skilled and well-qualified persons.

Furthermore, personnel in municipal government and administration are under pressure because of the high level of unemployment in most LGUs in Estonia and they are afraid of losing their jobs. Due to that, they are not strict enough in protecting the interests of the inhabitants of the LGU in question or in standing up against the biased interests of domestic politicians and their sponsors. Even though the given examples are concentrated within a short period of time, these problems and occurrences have been present during the entire period of Estonian re-independence. The progress of improvement of the situation of internal control activities and systems in the LGS is rather tardy. Consequently, the usual existing

arrangements, improvements and developments of internal control activities and systems of the LGS are not relevant means for an intermittent increase in the effectiveness of the operating of internal control systems and activities.

The operational capacity and quality of external audit in Estonia is surely not missing completely, but due to the existence of a large number of small LGUs the lack of coordination between external auditors (the State Audit Office, Ministry of Finance, European Commission, European Court of Audits, outsourced chartered auditors, etc.) and the insufficient audit capability of external auditors, the amount of time between external audits in any particular LGU is rather too long (Linnas, 2009a).

The *Riigikontroll* (SAO) acts only as an external auditor providing independent and objective information first of all to *Riigikogu* and society at large. Municipal councils and governments are very free to decide whether to follow the recommendations of SAO or not. A special audit department (with 12 auditors as of 30 January 2009) to audit LGUs in SAO was set up on 1 January 2006, but due to the large number of entities within the scope of SAO auditing, very limited resources for the performance of LGU audits is available and subsequently a risk-based approach is used; the auditing of an LGU or an activity or issue of an LGU takes place once every 3 to 5 years (Linnas, 2007, 286). For example, the State Audit Office (hereinafter called SAO) of Estonia performed at least 1 audit on the legality and compliance of the annual accounts of each LGU of Estonia in 2007 or 2008, but this is rather the exception than the rule in Estonia. In essence, the audits performed by the SAO are rather superficial. They do not go very deep into problems and the reasons behind them (Linnas, 2007: 286).

The Ministry of Finance exercises the audit of foreign aid-related funds and those allocated for specific purposes as well as the purposeful and lawful usage of the assistance granted, but its capability in performing those tasks is restricted due to limited resources (Metsalu, 2006: 3). One may argue that the failure of the state in the external assessment and evaluation of the LGS is conventionally supported by contracted chartered external auditors (Linnas, 2009a). Not all public and private entities in Estonia, including some LGUs, have a compulsory responsibility to contract an internal or external audit of annual accounts and reports (Linnas, 2008: 71).

However, external audit activity is an important part of the audit, control and supervision system (hereinafter called ACSS), but does not help very much by itself because contracted external auditors almost always depend only on the customer of their services (auditee) as regards the expected result (Linnas, 2007: 286; 2008: 74). A contracted external auditor cannot be truly independent and objective in his/her work if the payment for his or her job depends solely on the expectations and will of the auditee. Financial dependency can affect the temporal and content-related scope of audit as well as the main issues treated under engagement. Consequently, there is an inherent conflict-of-interest situation at present. Thus, external audit activity itself needs the 'support' of external control and/or supervisory activities.

The scope of the Estonian definition of an internal audit is very narrow in comparison with that determined by the IIA and is actually out of touch with the modern approaches to an internal audit (Linnas, 2008: 71). Pursuant to Clause 543 (1) of the Statute of the City of Tallinn, the scope of activities of the internal audit service of the City of Tallinn is also narrowly focused on an ICS. Pursuant to Clause II (5) of the Bylaw of the Internal Audit Service of the City of Pärnu, the scope of activities of Pärnu's internal audit service is wider there than in Tallinn, but nevertheless, it is not in compliance with the international standards mentioned earlier (Linnas, 2008: 71). In contrast, §46 of the Statute of the City of Tartu sets the scope of activities of Tartu's internal audit service on almost the same scope as that defined by the IIA (Linnas, 2008: 71). Therefore, the legal definition of an internal audit in Estonia should be reviewed and revised.

However modern, proper and fit the situation with the definition of IA in Estonia is, there is no legal obligation to establish an internal audit unit or appoint an internal auditor in LGUs in Estonia. Only 12 out of 227 LGUs in Estonia have some sort of IA unit (Oviir, 2009: 72). Small LGUs do not have sufficient capacity or the resources needed to establish internal audit units within their jurisdictions that can conduct audits in accordance with internationally recognized standards. According to Linnas (2008: 75), “*there is no space at all in tiny LGUs for internal audit because having an internal auditor or internal audit team in the organization of an LGU with insufficient or limited resources is an additional, potentially unbearable, burden on its resources.*” Most LGUs audited by the SAO had an IA unit whose activity was not in compliance with the standards of the IIA (Oviir, 2009: 72).

The majority of the *Revisjonikomisjons* of local government councils (political internal supervisory body and substitute for an internal audit committee) in Estonia do not fully meet the meaning of independence and cannot be expected to conduct audits as objectively as one might expect (Linnas, 2008: 72). In several cases *Revisjonikomisjon* had failed to perform the objectives prescribed by law and their roles were mainly formal (SAO, 2006; Oviir, 2006: 46). The operational capacity and quality of internal political supervision in a given LGU is often weak because of situations where the council of an LGU consists of representatives of only one political party or interest group whose fellow party or interest group members are also members of the council.

Allar Jõks (2008), former Chancellor of Justice, argues that in Estonia party affiliation is taking on terrifying dimensions, where the preference of private interests over public interests is rather the rule than the exception, meaning that the clan economy needs to be handled. However, this is not only the case of Estonia. For example, party affiliation seems to be a very strong coordinating mechanism in Norwegian local government as well (Vabo, 2005: 586). Thus, one can deduce that internal audit activities without the support of external audit, control and supervision activities cannot serve as proper and effective tools supporting good governance in small LGUs in Estonia (Linnas, 2008: 69) Consequently, the



common approaches used to improve and develop the effectiveness and impact of internal audit activities and systems of the LGS are not relevant means.

The author suggests some incremental, moderate or radical changes as alternative options for the improvement of internal audit activity in the LGS in Estonia as follows: 1) The merger of small LGUs (a radical change); 2) Starting wide-range co-operation between LGUs in the field of an internal audit's activities (the creation of joint audit units in the county associations of LGUs or joint outsourcing of internal audit activities; a medium change); 3) The creation of audit units in county governors' offices and the enlargement of the audit capacity, mandate and scope of the county governors' offices (A radical change that will move the focus from an internal audit unit of an LGU to the external audit unit of a county governor's office); 4) Strengthening the audit capacity of the State Audit Office (strengthening an external audit, a medium change); 5) Widening outsourced audit activities, including internal audit activity, but under a principally changed keystone (An LGU as an auditee should not be able to decide who will be its auditor, whether or not to accept or refuse audit results, or make or refuse to make payment for an audit or audit report; a radical change); 6) A change in the principles and procedures for appointing the members of audit committees of LGU councils (a radical change); 7) A change from an appointment-based approach to an election-based approach in staffing *Revisjonikomisjons* and the post of internal auditor in LGUs (a radical change); and 8) A combination of the abovementioned options. It is possible to implement each option on this list, but there is a different likelihood of each coming into actuality during the next decade. These options are not very specific for Estonia and other countries in transition, but they have a more generic sphere of application (Linnas, 2008: 67). However, the abovementioned remedies would have a rather incremental impact and would give rise to a significant improvement in the local governance of the LGS.

The external control and supervision system of LGUs in Estonia is “*definitely based on a solid and adequate constitutional and legal framework*”; “*is in full accordance with the European Charter of Local Self-Government in this particular respect*” and the administrative, constitutional, governmental, judicial and political control and supervision over the LGS executed by the state in Estonia is “*in general and by large sufficiently public, transparent and democratic enough*”, but the external control and supervision system of LGUs in Estonia is not understood, treated, designed or maintained like an integral, coherent holistic system or organisation (Linnas 2009a: 141). The SAO argues that the control systems over the LGS in Estonia are inefficient or ineffective (SAO, 2006), there is lack of systemic external supervision over the LGS and political control over the performance of LGUs does not function (Oviir, 2009: 73). This is similar to how the situation is in Sweden (Hanberger, 2009: 18).

For instance, judicial supervision is rather marginal in Estonia because no court has the right to act on its own initiative in protecting the rights, freedoms and interests of anyone in the country. For example, county governments filed 29 lawsuits in the administrative court against LGUs in Estonia in 2006 and 396

lawsuits against 61 LGUs in 2007. However, according to Jean-Marie Woehrling (2005: 2), "... *judicial control appears to be an indispensable instrument to enhance the quality of administrative action and ensure good governance.*"

The legal framework for judicial control and supervision (*ex post* control and supervision) has been enacted on both the constitutional and legal levels in Estonia. The constitutional review (constitutional control) done by the Chancellor of Justice (hereinafter called CJ) is often based on a single complaint, although the CJ also performs independent systemic risk-based supervision. For example, in Estonia in 2006, 207 cases were opened by the CJ to scrutinise the legality and constitutionality of legislation, bylaws and other rules of a similar nature, as well as of the constitutionality and legality of the regulations of local councils or of the executive boards of those councils (45 cases: 5 on the basis of county governors' petitions, 39 on individuals' petitions and 1 on the CJ's own initiative) (OCJ, 2007: 63, 250, 251). 55 cases opened by the CJ in 2006 were in the area of local government organisation law (OCJ, 2007: 247). However, Indrek Teder, the CJ of Estonia (2008), argues that there are too many LGUs in Estonia for his office to have effective constitutional control over them all.

Supervision (administrative, legal) over the LGS done by county governors is only supervision over the legitimacy of individual acts adopted by the councils and governments of the local government units of a given county, and, in the cases and to the extent provided by law, also over the legitimacy, purposefulness and expediency of putting state assets to use by the LGU in question, but not over the expediency, efficiency and effectiveness of activities and financing. The actual administrative capacity of a county governor in supervising the lawfulness of local government activities is often unsystematic, eclectic and insufficient (Linnas, 2007: 286). Some results characterising the performance of county governors are presented in Tables 1 and 2 of Appendix 2. A county governor may also be politically biased and not objective, as the posts of county governors are allocated according to political affiliation or other political reasons and one's competence is of secondary importance (Linnas, 2007: 286). Besides, county governors are in a permanent situation of political pressure and uncertainty because of ongoing discussions over the role and scope of their responsibilities.

Another supervisory subject executing legal supervision of the local government is the National Electoral Committee (hereinafter called NEC), which serves as the second level of appeal in electoral complaints. The NEC has two types of actions. During LGU council elections, the NEC serves as the second level of appeal for electoral complaints. During the time between elections, the NEC processes complaints about the premature termination of a council member's authority, suspension of a council member's authority and the replacement of a council member by an alternate council member. According to the data provided to the author by the Elections Department of the *Riigikogu*, the NEC in its supervisory process over LGUs handled cases as follows: in 2000, 1 supervision; in 2001, 1 supervision and 1 complaint; in 2002, 4 supervisions and 18 complaints; in 2003, 11 complaints; in 2004, 2 supervisions and 14 complaints; in 2005, 1 supervision

and 30 complaints; in 2006, 1 supervision and 8 complaints; in 2007, 1 supervision and 4 complaints; and in 2008, 1 supervision and 1 complaint. Thus, the role of the NEC in the ECS activities of LGUs remains less numerous in respect to the number of control and supervisory cases in comparison with the activities of other subjects responsible for ECS over LGUs. *“It can be concluded that legal framework gives an authority and responsibility for guard, control, assess and audit the operations of LOG (Local Government – the author) for number of institutions, but audit, control and supervision activities of the legitimacy, efficiency, and effectiveness of the operation of LOG units are unsystematic, insufficient, politically biased, often in an objective situation of conflict of interests and do not form an integral and coherent system”* (Linnas, 2007: 287).

The absolute abstract autonomy of the LGS as an end in itself, without the context of the most important purpose of a nation-state and without the main purpose of the LGS within the state (Hendriks and Tops, 2003: 302; Hanberger, 2009: 8), would not be a relevant object of treatment in actual socio-political life, may be misleading and does not match the paradigm of the Charter as well (Linnas, 2009a: 144). LGUs need external control and supervision which has the relevant capacity to ascertain and assure everyone that the constitutional rights and freedoms as well as any other interests of the residents of any LGU in a given state are available. Nevertheless, the constitutional rights of local self-government should be granted and the external control and supervision of LGUs shall be exercised in such a way as to ensure that the intervention of the controlling or supervising authority is kept in proportion to the importance of the interests that it is intended to protect (Linnas, 2009a: 143).

Summing up this part of the introduction, one can conclude that each activity and subsystem of an audit, control and supervision system has a number of evident deficiencies and insufficiencies. Consequently, there is a need for persistent, well-coordinated and thoroughly focused cooperation of all subsystems and elements of the ACSS. Thus, the present situation of the audit, control and supervision systems (including internal and external systems) of the local self-government sector in Estonia does not serve the citizens and inhabitants of the LGS in Estonia as they may expect in the 21<sup>st</sup> century.

World-wide, long-lasting practical experience from the public, non-governmental and private sectors shows significantly that internal audit, external audit, internal control, external control, internal supervision and external supervision activities have broadly failed. There are many different theoretical and practical reasons for that, but the principal factor is an incorrect paradigm of treatment of this particular object of research. A review of the academic and non-academic literature confirms that scientists, researchers and practitioners are used to treating the matter of audit, control and supervision of private, non-governmental and public organizations in a separate, non-holistic and unsystematic manner in a paradigm of mathematics-based sciences (exact sciences). Few authors have treated the issues of ACS in pairs (internal audit – external audit, control – supervision) or like a “control or audit pyramid”. However, approaches like a

“control pyramid” (Sterck, Scheers and Bouckaert, 2005: 15) or an “audit pyramid” still have principal limits and are not holistic solutions. The “control pyramid” approach focuses only on different control subsystems and the “audit pyramid” approach focuses only on the audit subsystem of an ACSS. Therefore, these approaches do not consider all the aspects of ACSS and may not objectively or entirely characterise the situation of an ACSS in its complete wholeness. Accordingly, one can conclude that the existing paradigm under which ACS activities are treated does not have the impact expected by society, particularly by the inhabitants of LGUs.

The author argues that the treatment of audit, control and supervision activities of local self-government units in the present paradigm (not understood, treated, designed and maintained like an integral, coherent holistic system or organisation) has so many imperfections that it cannot be a reliable means of modern good governance anymore. This statement is definitely relevant to Estonia. As a result, a new paradigm of treatment of the ACSS of the LGS in Estonia is to come into use.

### **Integrated Model of Audit, Control and Supervision of the Local Self-government Sector: The Case of Estonia**

The aim of this part of the introduction is to discuss the integrated model of audit, control and supervision of the local self-government sector based on the case of Estonia. In the previous section of the introduction, the author argued that the treatment of ACS activities of LGUs in the present paradigm (treated separately from each other or only as a ‘control or audit pyramid’) has so many imperfections that it cannot be a reliable means of modern good governance anymore. The author suggests that in order to design and develop an integrated ACSS of LGUs that is scientifically justified, as well as appropriate and functional in real life, a theoretical platform that stands on at least 5 pillars is needed as follows: 1. The holistic approach; 2. The reciprocal-balance approach; 3. The uniqueness principle; 4. The paradigm of uncertainty; and 5. The compatibility approach (Linnas, 2007: 290; Linnas 2010). The author also discusses four options for their implementation in actual life within the integral model of audit, control and supervision of the LGS.

Social systems and processes are very complex (Bosanquet, 1899: 12; Wallerstein, 1998: 5; Näpinen, 2002: 130, 131), they operate under the influence of self-organizing processes (Prigogine and Stengers, 1984: 22, Heyligen, 2002: 23; Näpinen, 1994: 164) and work in open systems (Prigogine, 2000: 895), sometimes called a world-system (Wallerstein, 1974: 347; Straussfogel, 1997: 123) or eco-social system (Lemke, 1995: 16). A state and an LGU as an organization, institution or system inevitably consist of human beings, they are social, eco-social or real systems. According to Worrall, Collinge and Bill (1998: 472, 490), local authorities are very complex organisations.

For example, Joseph A. Schumpeter treated business, economic and industrial entities like living organisms, calling those bodies ‘business organisms’ (Schumpeter, 1939: 272), ‘economic organisms’ (Schumpeter, 1939: 265, 351,

370) and ‘industrial organisms’, accordingly (Schumpeter, 1939: 358). According to Henry Mintzberg (1996: 82), a professor of management, “*an organization without human commitment is like a person without a soul...*” Consequently, the ACSS of a LGS is a real, socio or eco-socio system as well. Accordingly, one cannot discard the paradigm of the laws of nature and the system approach when treating the issue of ACSS of LGUs.

Local-level governance is a complex phenomenon (Sepp, Noorkõiv and Loodla, 2009b: 32) and local authorities are very complex organizations which exist in a highly turbulent environment (Worrall, Collinge and Bill, 1998: 472). According to Work (1998), a society as a whole system is a rather horizontal playing field with autonomous yet interrelated actors, sectors and geographic areas. Therefore, it is unrealistic to imagine that one person or a single agency can have complete control over all of a system and that only one interacting part can cause precisely expected results in the system as whole. Accordingly, relations, dependencies and impacts between the subsystems and elements of ACSS cannot be studied as linear processes as well.

The principal elements of the state are people (Bluntschli, 1875:14). According to the Self-Government Theory, people are sovereign rulers in a democracy. Consequently, taking into account that Estonia is a democratic state and the inhabitants of each LGU in Estonia are sovereign, it is inevitable that one has to take into account people as the main actors in this very social system. Thereby, the ACSS of LGUs is a system where people with their needs, desires, demands and behaviour are actors and a key factor (the human-centered approach). Therefore, on a theoretical basis, the exact sciences-based approach to social issues is not relevant at all, because exact sciences deal with objects and social sciences with human beings (subjects) (Drechsler, 2000: 246).

Furthermore, leaving aside the theoretical aspect, each person plays a great role in the day-to-day life of any size LGU, but a particularly greater role in small LGUs. For example, in the smallest LGUs in Estonia, (such as the rural municipalities of Kihnu,<sup>4</sup> Ruhnu<sup>5</sup> and Piiressaare<sup>6</sup>), the number of inhabitants is so small that each living soul has the greatest value from the political or administrative point of view. For example, the replacement of the chairman of council or mayor of an LGU may cause a complete change in its management and organizational culture, control environment, risk appetite and administrative capacity (Linnas, 2010).

Moreover, according to Geert Hofstede (2007: 413), cultural values differ among societies, but within a society they are remarkably stable over time. Hofstede (2007: 413) claims that management, which is a part of culture, differs among societies but within societies is stable over time (Hofstede, 2007: 413) too. Consequently, although general principles and legal frameworks of governance and management used to be very similar in the modern democratic world, each state,

---

<sup>4</sup> 639 inhabitants as of 3 November 2004.

<sup>5</sup> 64 inhabitants as of 1 January 2007.

<sup>6</sup> 94 inhabitants as of 1 January 2008.

region and locality has its own unique characteristics and particularities in this respect. Accordingly, each LGU and its ACSS should be handled like a unique organism (the uniqueness principle). A single model for the development of the LGS does not exist (UNDP, 1996). Therefore, each LGU should be analysed, evaluated and assessed thoroughly before taking any actions concerning the structure and organisation of its ACSS.

According to the spirit of the CRE and LGOA [Clause 6 (4)] of Estonia, the central and local governments form a holistic integral organization in Estonia and the local self-government sector is one particular level of the holistic public administration organization in a state (Linnas, 2009a: 144). According to Sepp, Noorkõiv and Haljaste (2006, 3), LGUs are to be understood in four dimensions: as a part of the state administrative system, a supplier of local public services, a territorial corporation, and a satisfier of the interests, needs and expectations of the domestic inhabitants.

According to Woodrow Wilson (1887: 221), a local self-government system is a subsystem of a federal self-government system. Accordingly, if the European-, state- and local self-government level governance structures form an integral whole, then the audit, control and supervision of LGUs form a uniform cohesive whole as well (Linnas, 2007: 290). Therefore, the audit, control and supervision system of an LGS forms a holistic, integral and complex public system in society as well (the holistic approach).

The elements and subsystems of an ACSS are in constant interaction (Linnas, 2007: 288). This cohesive whole may serve as an excellent system, even if an element or subsystem is not present at all. For example, if there is a lack of some subsystem or element, or any subsystem or element is malfunctioning, then the malfunctioning subsystem can be balanced by the functioning of another subsystem, or the malfunctioning element can be balanced by the functioning of another element (the reciprocal balance or reciprocal compensation or reciprocal support approach). First of all, the systems, subsystems and elements of external control, supervision and audit can support each other and systems, subsystems and elements of internal audit, control and supervision can compensate for each other's malfunctions.

The idea is more deeply explained on the basis of four different theoretical options presented afterwards in this section (See Table 1).<sup>7</sup> The possible combinations of the different options of the functional/operational capacity and quality of ACSS subsystems and elements are significantly larger, but the four options presented by the author are good enough to support the explanation of his ideas.

---

<sup>7</sup> The figures from 0 to 5 in Table 3 indicate the theoretical functional/operational capacity and quality of the ACSS subsystems and elements. A 0 means that one or another part of the ACSS does not exist at all. A 5 shows that one or another part of the ACSS has an excellent function/operational capacity and quality. These figures have only an explanatory meaning.

*Table 1 Different options of ACSS composition.*

<b>Function</b>	<b>Option 1</b>	<b>Option 2</b>	<b>Option 3</b>	<b>Option 4</b>
Internal Audit	0	0	4	5
Internal Control	2	5	5	5
Internal Supervision	2	0	5	5
External Audit	0	2	0	5
External Control	5	5	2	5
External Supervision	5	5	2	5

***Option 1: Weak internal audit, control and supervision in an LGU***

In the theoretical case presented in Option 1 of the ACSS composition of a particular LGU, one can see that the internal and external audit functions are completely missing; the operational capacity and quality of the internal control function, internal control systems and internal supervision are rather weak, while the operational capacity and quality of external control and supervision are rather excellent. There might be a number of reasons for the different levels of operational capacity and quality of subsystems and elements of the ACSS of this particular LGU.

However, the focus of this chapter is on what to do if internal and external audit are not present at all (it does not matter why) and internal control and supervision are rather weak. In such cases, it is important to strengthen the operational capacity of external control and supervision. This means that the most important institutions of political, administrative, constitutional and legal control and supervision have to focus more on the issues concerning the activities of all LGUs or a particular LGU. Equally, democratic public supervisors and controllers have to be more observant and diligent.

However, the municipal landscape is an ever-changing situation (Homer and Schuhmann, 2005: 224). Therefore, the situation described in Option 1 can be replaced rather quickly by Options 2, 3 or 4. The approach offered by the author provides one with a suitable flexibility in designing an ACSS.

***Option 2: Weak internal audit, internal supervision and external audit in an LGU***

In the theoretical case presented in Option 2, one can see that the internal audit and supervision functions are completely missing, while the operational capacity and quality of the external audit function is rather weak or rarely present during a particular period of time. Internal control, external control and external supervision are performed excellently. There might be a number of reasons for this situation.

What can be done if internal audit and internal supervision are not present at all (it does not matter why) and external audit is rather weak? In cases like Option 2, it is important to strengthen the operational capacity of external control and supervision. The Government of the Republic has to draw up, implement and maintain a sufficiently coordinated plan of political and administrative control as well as a supervision plan for the ministries and county governors. This plan should also be coordinated with the Chancellor of Justice. The Chancellor of Justice has to focus on the medium term and its annual working plans on the LGUs where internal control systems are weak, municipal councils and governments are consistently composed of members or representatives of only one party or interest group or where the county governor is related to the political leaders of the LGU, which creates a conflict of interest in the performance of his/her duties. The Ministry of Justice and the Prosecutor's Office have to concentrate on the plans of surveillance necessary to detect and combat criminal offences in the LGUs which have a high risk level of corruption, theft and misuse of public assets. The Ministry of Finance has to strengthen the exercise of financial supervision, control and review over foreign aid-related funds and those allocated for specific purposes as well as the purposeful and lawful usage of the assistance granted to LGUs with no internal audit and supervisory functions. The State Archivist has to focus the execution of its supervision over document management, records management and archiving in the LGUs with a higher risk level. The Environmental Investment Centre should strengthen its control activities over the expedient use of the funds channelled to LGUs via environmental investment projects that are financed by the income gained from environmental usage in LGUs with a higher level of risk.

In cases such as Option 2, it is very important that the municipal council *in corpore* or at least the governing coalition finds the political will, managerial professionalism and statesman-like conduct to put in place a mayor or municipal government *in corpore* with well-experienced, skilled and highly qualified professionals. Different democratic public supervisors and controllers such as voters, non-governmental organisations, parties in opposition and the media have to remain vigilant and watch over the LGUs with higher risk levels as well.

According to Vallo Olle (2002: 9-10), direct democracy as a phenomenon in the municipal sector is nothing new to Estonia because this was in actual practice during the second half of the 1920s and the first half of the 30s. Olle also argues that practicing direct democracy in exercising local governance in Estonia is not just hypothetical, but a useful, real and realistic option.

### ***Option 3: Weak external audit, control and supervision over an LGU***

In Option 3, one can see that the external audit functions are completely missing or the period of time between external audits in a particular LGU has been long. The operational capacity and quality of the external control and supervision function are rather weak. Internal audit, internal control and internal supervision are well or excellently performed. There might be a number of reasons for this situation as



well. For example, the activities of ACS authorities are non-systematic, and performed in a rather fragmentary and variety of ways; the proportions between audit, control and supervision activities are not optimal and overall there is a real risk that some fields, activities and/or LGUs are under excessive 'oversight' of the state, while others are entirely out of 'sight'. (Linnas, 2007: 287) The external evaluation of LGUs by the state is inefficient not only in Estonia (Linnas, 2007: 286-287), but the same situation also exists in Finland (Oulasvirta, 2003: 346), Israel (Friedberg, 1999: 11), the United Kingdom (Woolas, 2005) and in other countries as well.

What can be done if the external audit functions are completely missing or the length of time between external audits in a particular LGU has been long and the external control and supervision activities over that particular LGU are rather weak, unsystematic, superficial, politically biased, fragmented or focused altogether on too few fields or aspects? In cases such as Option 3, it is an unavoidable task to strengthen the operational capacity and quality of internal audit, control and supervision activities of the LGU in question; develop purposeful, systematic and reliable internal control systems of the LGU and try to direct the attention of those external supervisors and controllers who are not politically biased, do not have a conflict of interest or suffer from a lack of resources, on it.

A situation such as this is an extreme challenge for the coordinators of audit, control and supervision activities and for members of a particular municipal council and government. However, one has no right to discard this theoretical possibility only because it seems to be too challenging for practical use. There are a number of LGUs in Estonia which have smoothly running internal audit, control and supervision activities; fit and proper politicians and managers, and well-designed reliable internal control systems. However, in cases such as Option 3 and Option 4, it is important to keep in mind that in Estonia internal auditors or internal audit units exist only in big municipalities at present.

#### ***Option 4: An excellent ACSS of an LGU***

In Option 4, one can see that the operational capacity and quality of all levels (international, federal, state, regional and local self-government) and all types of audit, control and supervision activities are well or excellently performed. This does not mean that all aspects of all levels and all kinds of audit, control and supervision activities are in full service in the field of public management and administration of a particular LGU or that all the different institutions responsible for carrying out political, constitutional, judicial, administrative, financial or legal control over the LGS are focused persistently on a single or few LGUs. Because of a different composition of subjects in ACS, it is possible that some of them do not exercise their functions during a particular period of time over a particular LGU at all. However, at the same time, other ACS subjects could perform their ACS duties over a particular LGU. As a result, there might be a situation where the ACS

functions performed over a particular LGU might still be rather good or even excellent.

The example presented in Option 4 does not mean that in actual life one cannot see situations where a number of internal and external auditors, controllers or supervisors are accidentally or persistently focused on a particular LGU, group of LGUs or fields of activities of an LGU. For example, a sporadic concentration of internal and external audit, control and supervision activities may be seen in very big municipalities concerning huge amounts of public money flows, municipalities at particular risk of corruption, etc. After all, it is indispensable to take into account the strong economic control performed by the state over the LGS (Heuru, 2003: 261; Mäeltsemees, 1994; Helden, 2000: 86; Olulasvirta, 2003: 341; Pihlajaniemi, 2003: 267).

When handling cases such as Option 4, one has to keep in mind the need to look very carefully at the reasonable, efficient and effective allocation and use of human, financial and other resources with the aim of avoiding an unnecessary administrative load (Sterck, Scheers and Bouckaert, 2005: 13, 15) and disturbance of the performance of the government and administration of the LGU in question under sharp oversight, a waste of state budget resources and a weakening of ACS functions in other types of higher risks. Option 4 is the most challenging for coordinators of ACS activities in all levels of the public management hierarchy.

Nevertheless, in light of the new public administration model in globalization and Europeanization (Laakso, 2003: 311; Pihlajaniemi, 2003: 264; Matei and Matei, 2008: 34), situations such as Option 4 may be more and more realistic in actual life.

### **Pros and cons of the integrated model of ACS of LGS**

The author recognizes that the new approach to the treatment of ACS matters has pros and cons that depend on cultural, political, economical and legal factors. One material risk that can arise from a new approach to the treatment of the matter of ACS of LGS is the risk of increasing dependency of a LGU on the central government. There is a common assumption all over the world that the regulation and inspection regime is a mechanism for improvement, but the inspection and regulation bodies in Wales have diverse views about their impact on the improvement of public services (LGPSC, 2005: 25). Thus, there is at present a real risk threatening the discovery of a quick, optimal and reliable solution to that.

In many countries, state authorities executing control and supervision of LGUs are entitled with a large array of powers and there exists a trend to increase this power. In this aspect, the situation is very similar in Armenia (Arabyan, 2007: 15), Australia (Davis, Downe and Martin, 2001: 2), Canada (Sancton, 2005: 317), Latvia (IMF, 2001: 4), Norway (Sellers and Lidström, 2007), South Korea (Chong-Min, 2006: 14), the USA (Coleman and Colantuono, 2003: 20) and Uzbekistan (Bektemirov and Rahimov, 2001: 507). This may lead to a violation of the sovereignty of local self-government (Arabyan, 2007: 15).

Political parties, politicians, lawyers and managers of LGUs in Estonia complain about the unlawful and disproportional execution of *ex post* administrative, constitutional, economic and legal control and supervision over the LGS (Linnas, 2009a: 154). Therefore, there is a theoretical risk that this symptom may be more acute in Estonia. According to Sellers and Lidström (2007; 17-18), “*lower local capacities and in some instances more supervision make local government in these systems more state-dependent.*” “*Supervision from above without local capacities would produce a monopoly of policy and implementation for supralocal governments. Even weak local capacities along with strong supervision would leave local government dependent on initiatives from higher level units.*” (Sellers and Lidström, 2007: 6-7) Only under conditions of full local political and fiscal autonomy will local government possess strong capabilities without hierarchical supervision (Sellers and Lidström, 2007; 6-7). Consequently, there is a real risk that the entire LGS will be more dependent on the state if the allocation of resources to the LGUs does not match their actual functions and tasks.

Nevertheless, local democracy may be in some way imperfect (Fender and Watt, 2002: 283; CDLR, 2003: 2). Accordingly, there is a need to keep a legitimate and purposeful balance between the rights and obligations of the central government and local self-government in applying an integral ACSS to real life. On the one hand, the central government should not have to overrule or override the LG sector. On the other hand, the inhabitants of a particular LGU should not have to suffer because of the low administrative capacity of local governance institutions or because of improper and corrupt action of local politicians or civil servants (Fender and Watt, 2002: 283). The residents of all LGUs in a given state should have access to public services as do the inhabitants of other LGUs of the same country and they should all be of the same level of quality.

The author’s approach only works on the precondition that there is the possibility of deeming a set of different international, governmental, regional and local organizations to actually be acting and belonging to one particular virtual organization. For example, there are international bodies of co-operation (NATO, the IMF, WB, etc.), confederations of states (Switzerland), unions of states (the USA, Germany), states co-operating under treaty (the European Union, CIS) or unitary states (Estonia, Finland). Thus, at present, there should be clear and explicit political, legal, economic, organisational and administrative links and relations between particular bodies acting on different levels (international, federal, state, regional and local self-government levels) as subjects of an integral ACSS.

According to Gunaratne (2003: 437), complex systems are both nonlinear and adaptive. According to Prigogine (1983), “*In large societies it becomes increasingly difficult to maintain the spontaneous activity of members of that society.*” Social systems and processes are very complex (Wallerstein, 1998: 5; Näpinen, 2002: 130-131), they operate under the influence of self-organizing processes (Heyligen, 2002: 23; Näpinen, 1994: 164) and work in open systems (Prigogine 2000: 895), sometimes called a world-system (Wallerstein, 1974: 347; Straussfogel, 1997: 123) or eco-social system (Lemke, 1995: 16). In social

systems, individual information (such as individual values, norms, conclusions, rules, opinions, ideas and beliefs) changes dynamically because of the new experiences of individuals (Fuchs and Hofkirchner, 1999: 4).

Control is a normative phenomenon that is rooted in the values and beliefs of human beings (Minzberg, 1996: 81). Appropriate attitudes, behaviours and incentive structures are required to be present (Sanderson, 2001: 302). Therefore, politicians and civil servants willing to make a difference and be responsible for the development and improvement of ACSS do not have the measures and tools to assure a certain desired and expected impact at a planned time. In addition, the successful introduction of an integral ACSS into the context of actual governance and local self-governance is a serious challenge for politicians and civil servants because this requires a high level of coordination (Dollery and Johnson, 2007: 206; Linnas, 2009a: 148) of ACS activities between the different bodies responsible for watching over the performance of a particular LGU.

One important factor impacting the success of developments is an aversion to change (Carvalho, Camões, Jorge and Fernandes, 2007: 2) both on the state and local levels. There are more factors counteracting the successful implementation of the IACSS of LGUs in a given society (Bosanquet, 1899: 13; Haward and Zwart, 2000: 44; Wallis and Dollery, 2001: 538; Cole, 2003: 197; Schoburgh, 2007: 159; Hanberger, 2009: 45). Consequently, a theoretically enjoyable and practical, suitably desirable solution may not be easily implemented in real life because of the number of material and less material factors involved. Some particular and rather theoretical legal restrictions may arise from the European Charter of Local Self-Government, the European Urban Charter II and the constitution of a particular state.

Local self-governments in different political, legal, historical, cultural and economic environments are very different (UNDP, 1996; Linnas, 2008: 77). The number of matters in a local self-government's life is municipality specific (Sancton, 2005: 326; Vabo, 2005: 587; Carvalho, Camões, Jorge and Fernandes, 2007: 3; Gao, 2009: 29). Public sector organisations are diverse and a single governance model will not serve all organizations (UNDP, 1996; IIA, 2006: 15). Due to that, different models of ACSS of LGS apply to different political, legal, historical, cultural and economical environments, and different models of ACSS of LGU apply to municipalities with different sizes (Raivo Linnas, 2007: 289). Thus, the flexible and multivalent approach presented by the author gives plenty of good possibilities of designing, implementing and maintaining a suitable ACSS for a particular LGU in any political, legal, economic, cultural or historical context of environment.

According to Barry Quirk (2005: 616), system-wide approaches to improving public sector efficiency have previously relied on top-down regimes and models. The optimum approach presented by the author is a synthesis of the top-down and bottom-up models.

According to Swiderska, Roe, Siegele and Grieg-Gran (2008: 22), *'Representative democracy has often failed to represent people adequately in*

*governance, which means that additional spaces may need to be created for direct participation (e.g., citizens' juries).*' Günter Schmidt (2003: 21) argues, "...Administrative culture in the meaning of enhancing administrative output has to be kept under permanent control, and the best way of controlling is done by the citizen (or the client)." Public control is a part of democratic control and participatory policy (Hanberger, 2009: 1). "Sustainable local democracy requires a combination of a liberal democratic model of local government and the prerequisites of democratic stability: economic development, equality, political culture and the development of civil society" (Smith, 1996: 163). Thus, the author's ideas allow for the possibility of increasing the degree of direct participation in the public self-governance processes of a particular LGU via including voters and non-governmental organisations in the ACSS as subjects of democratic external political control and external public supervision. Therefore, the author's approach supports the sustainability of local democracy.

However, the approach presented by the author is evidently a step further in the theoretical and practical treatment of the issues of audit, control and supervision in the local self-government sector. Still, further research has to be performed to discover more particular pros and cons challenging the introduction and application of the holistic approach of the ACSS of LGS in different types and sizes of countries. Even though the author's research is based on the case of Estonia, known as a small constitutional democratic liberal society with an open economy, his ideas are applicable to other democratic societies as well.

## **Conclusion**

The author of this dissertation argues that the treatment of audit, control and supervision activities of local self-government units in the present paradigm (treated separately from each other or only as a 'control or audit pyramid' or 'integral control system'; treated as mechanical systems; treated in the paradigm of exact sciences) has so many imperfections that it cannot be a reliable means of contemporary good governance anymore. The author further suggests that external and internal audit, external and internal control, and external and internal supervision of the local self-government sector should be treated as subsystems of an integral holistic system of audit, control and supervision of the local self-government sector.

Currently, international, federal, state, regional and LG-level administration systems form a holistic, integrated and complex public administration system as a whole. As a result, the author suggests that the matter of external audit, internal audit, external control, internal control, external supervision and internal supervision should be treated as an integrated whole as well. The author develops his idea more deeply on the basis of four different theoretical options. According to these options, four theoretical cases of LGUs, each of which has different circumstances regarding their functional/operational capacity and quality of ACSS subsystems and elements, are discussed. The flexibility and multivalency of the

ISACS approach provides enough good possibilities of designing, implementing and maintaining suitable audit, control and supervision systems for a particular local self-government unit in any political, legal, economic, cultural or historical context of environment.

Although the ISACS approach of LGUs has a fundamental difference and certain advantages in comparison with the present paradigm, the author points out that his approach has obvious limits as well. Although the approach offered by the author is generic, the practical effects that can arise from the implementation of a new paradigm of ACS in an actual socio-economical environment depends on the particular historical, cultural, political, legal, economic and other aspects of the society in question. More relevant legal restrictions and material pros may arise from the constitution of a particular state.

There is no doubt that Estonia needs the introduction and application of the ISACS approach of LGUs, though the successful introduction of an integral ACSS into the context of actual governance and local self-governance is a serious challenge for politicians and civil servants. This requires a high level of coordination of ACS activities between the different bodies responsible for watching over the performance of a particular LGU.

The author's approach is evidently a step further along in the theoretical and practical treatment of the issues of ACS in the LGS. Even though the author's research is based on the case of Estonia, a small constitutional democratic liberal society with an open economy, his ideas are applicable to other democratic societies as well. However, any proposed solution should be very carefully analysed, evaluated and assessed taking into account all the relevant aspects of the environment's characteristics for that particular society (Bryld, 2003: 41).

## References

- Aarrevaara, Timo.** 2003. Municipalities and Europeanized Networks. – Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja no 4, pp. 298–306.
- Aas, Krista.** 2007. Kohaliku omavalitsuse üksuste investeringud. Riigikontrolli aruanne Riigikogule, <http://www.riigikontroll.ee/>, January 12, 2008.
- Almann, Arno.** 2007. The Area of Responsibility of a Local Government at the County Level and Possibilities for the Legal Organisation Thereof. – *Juridica International*, 2007 II, pp. 125–130.
- Andrews, Christina W.** 2008. Legitimacy and Context: Implications for Public Sector Reform in Developing Countries. – *Public Administration and Development*, 28, pp. 171–180.
- Arabyan, Knarik.** 2007. Audit in the Local Self-Government System of the Republic of Armenia: Legislative Frameworks and Practices. *In: Local Governments in Eastern Europe, in the Caucasus and in Central Asia.*
- Barlow, P. Helberg, P. Large, N. Le Roux, K.** 1995. The business approach to internal auditing, Cape Town: Juta & Co Ltd.

- Bektemirov, Kuatbay. Rahimov, Eduard.** 2001. Local Government in Uzbekistan.
- Bluntschli, Johan Kaspar.** 1875. The Theory of the State, First published in German in 1875, First English edition published in 1895, This edition published in 2000, Batoche Books Limited, Kitchener: Ontario.
- Boland, Leo. Coleman, Emer.** 2008. New Development: What Lies Beyond Service Delivery? Leadership Behaviours for Place Shaping in Local Government. – Public Money and Management, 28/5, pp. 313–318.
- Bosanquet, Bernard.** 1899. The Philosophical Theory of the State, Originally published in 1899, This edition published in 2001, Batoche Books Limited, Kitchener: Ontario.
- Bryld, Erik.** 2003. Local Government Management in Nepal: An Urban Perspective. – Public Administration & Management: An Interactive Journal, 8(2), pp. 40–53.
- Caliyurt, Kiymet. Agun, Cuneyt. Pamukcu, Ayse.** 2008. Recent Developments in Internal Auditing Legislation in Public Institutions of Turkey: A Hospital Case. Presented at the Seventh European Academic Conference on Internal Audit & Corporate Governance, April 2008, London.
- Campbell, Philip L.** 2003. An Introduction to Information Control Models, [http://www.sandia.gov/scada/documents/sand\\_2002\\_0131.pdf](http://www.sandia.gov/scada/documents/sand_2002_0131.pdf), January 10, 2008.
- Caplain, Bruce.** 2005. Jump-Start Success, Journal of Accountancy, February 2005, pp. 34-38.
- Carvalho, João Baptista da Costa. Camões, Pedro J. Jorge, Susana Margarida. Fernandes, Maria José.** 2007. Conformity and Diversity of Accounting and Financial Reporting in Portuguese Local Government. – Canadian Journal of Administrative Sciences, 24, pp. 2–14.
- Chong-Min, Park.** 2006. Local Governance and Community Power in Korea. – Korea Journal, Winter 2006, pp. 9–32.
- Christianens, Johan.** 2001. Converging New Public Management Reforms and Diverging Accounting Practices in Flemish Local Governments. – Financial Accountability and Management, 17(2), pp. 153–170.
- Cole, Michael.** 2003. Local Government Reform in Britain 1997–2001: National Forces and International Trends, Government and Opposition, Blackwell Publishing, pp. 181-202.
- Coleman, Michael. Colantuono, Michael G.** 2003. The Origin and Devolution of Local Revenue Authority.
- Council of Europe (COE).** 1985. European Charter of Local Self-Government. <http://conventions.coe.int/Treaty/en/Treaties/Html/122.htm>, November 19, 2009.
- Davis, Howard. Downe, James. Martin, Steve.** 2001. External inspection of local government. Driving improvement or drowning in detail?
- D’Arcy, Simon.** 2007. In Nail Baker’s article Joined Up Assurance, Internal Auditing & Business Risk,

- [http://www.iaa.org.uk/en/other/document\\_summary.cfm/docid/6825E8A1-1F7A-439F-8244BD5E953F665C](http://www.iaa.org.uk/en/other/document_summary.cfm/docid/6825E8A1-1F7A-439F-8244BD5E953F665C), December 30, 2007.
- Dollery, Brian. Johnson, Andrew.** 2007. An Analysis of the Joint Board or County Model as the Structural Basis for Effective Australian Local Governance. – Australian Journal of Public Administration, 66(2), pp. 198–209.
- Drechsler, Wolfgang.** 2000. On the possibility of quantitative-mathematical social science, chiefly economics. Some preliminary considerations. – Journal of Economic Studies, 27(4/5), pp. 246–259.
- Encyclopedia of Business and Finance (EBF).** 2006. Internal Control Systems. Ed. Allison McClintic Marion. Gale Group, Inc., 2001. eNotes.com. 2006, <http://www.enotes.com/business-finance-encyclopedia/internal-control-systems>, January 09, 2008.
- Ernst and Young Australia (E&YA).** (2005) Trends in Australian and New Zealand Internal Auditing. Second Annual Benchmarking Survey 2005, [http://www.iaa.org.au/pdf/InternalAuditBenchmarkingSurvey\\_ebookey2005.pdf](http://www.iaa.org.au/pdf/InternalAuditBenchmarkingSurvey_ebookey2005.pdf), January 03, 2008.
- Ernst and Young Finland (E&YF).** (2007) Trends in Finnish Internal Auditing, Finnish Internal Audit: Benchmarking Survey II, [http://www.ey.com/global/download.nsf/Finland/Trends\\_in\\_Finnish\\_InternalAuditing/\\$file/TrendsinFinnishInternalAuditing.pdf](http://www.ey.com/global/download.nsf/Finland/Trends_in_Finnish_InternalAuditing/$file/TrendsinFinnishInternalAuditing.pdf), January 03, 2008.
- Ezugbaia, Zurab. Melkadze, Otar.** 2002. Some Comments on the Implementation of the European Charter on Local Self-Government, [http://www.geplac.org/publicat/law/blr02n1e/p\\_97arte.pdf](http://www.geplac.org/publicat/law/blr02n1e/p_97arte.pdf), January 29, 2008.
- Fender, John. Watt, Peter A.** 2002. Should central government seek to control the level of local authority expenditures? – Fiscal Studies, 23(2), pp. 265–285.
- Friedberg, Asher.** 1999. Evaluating the Effectiveness of Public and Internal Audit in Local Government - The Case of Israel, [http://www.asosai.org/journal1999/evaluating\\_the\\_effectiveness.htm](http://www.asosai.org/journal1999/evaluating_the_effectiveness.htm), November 30, 2006.
- Fogarty, John A. Graham, Lynford. Schubert, Darrel R.** 2006. Assessing and Responding to Risks in a Financial Statement Audit, Journal of Accountancy, July 2006, <http://www.aicpa.org/pubs/jofa/jul2006/fogarty.htm>, April 23, 2007.
- Gao, Jie.** 2009. Governing by Goals and Numbers: A Case Study in the Use of Performance Measurement to Build State Capacity in China, Public Administration and Development, 29, pp. 21–31.
- Goepfert, Stephen.** 2006. Tell the World! – Internal Auditor, 63(4), pp. 76–82.
- Gonzalez de Asis, Maria. Acuña-Alfaro, Jairo.** (2002) Civic Participation in Local Governance, [http://www.worldbank.org/wbi/governance/pdf/fy02brief/civic\\_local\\_annex.pdf](http://www.worldbank.org/wbi/governance/pdf/fy02brief/civic_local_annex.pdf), March 09, 2008.
- Gunaratne, Shelton A.** 2003. Thank you Newton, welcome Prigogine: ‘Unthinking’ old paradigms and embracing new directions. Part 1: Theoretical distinctions, Communications, 28, pp. 435-455.



- Hanberger, Anders.** 2009. Democratic Accountability in Decentralised Governance. – *Scandinavian Political Studies*, 32 (1), pp. 1–22.
- Haveri, Arto.** 2003. Inter-municipal Cooperation as a Part of Local Governance. – *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, pp. 316–325.
- Haward, Marcus. Zwart, Ivan.** 2000. Local Government in Tasmania: Reform and Restructuring. – *Australian Journal of Public Administration*, 59(3), pp. 34–48.
- Helander, Voitto.** 2003. Public Sector Reforms and the Third Sector. – *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, pp. 290–297.
- Helden, G. Jan van.** 2000. Is Financial Stress an Incentive for the Adoption of Business-like Planning and Control in Local Government? - A Comparative Study of Eight Dutch Municipalities. – *Financial Accountability and Management*, 16(1), pp. 83–100.
- Hendriks, Frank. Tops, Pieter.** 2003. Local Public Management Reforms in the Netherlands: Fads, Fashions and Winds of Change, *Public Administration*, 81(2), pp. 301–323.
- Heuru, Kauko.** 2003. Development of Municipal Administration in Finland, *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*. – 4, pp. 257–262.
- Hofstede, Geert.** 2007. Asian management in the 21st century. – *Asia Pacific Journal of Management*, 24, pp. 411–420.
- Holt, Travis P. DeZoort, Todd.** 2009. The Effects of Internal Audit Report Disclosure on Investor Confidence and Investment Decisions. – *International Journal of Auditing*, 13, pp. 61–77.
- Homer, Frederic D. Schuhmann, Robert A.** 2005. The Municipal Balance of Power: Lessons from Federalist 51. – *Public Administration and Management: An Interactive Journal*, 10(3), pp. 224–227.
- International Monetary Fund (IMF).** 2001. Report on the Observance of Standards and Codes (ROSC). Latvia, March 29, 2001.
- Jackson, Russell A.** 2007. A heavier weight to carry: Despite initial pressures to emphasize financial controls more than governance, internal auditors are now bearing additional responsibility for both and raising their stature as a result, *Internal Auditor*, June 2007.
- Jõks, Allar.** Kellele kuulub Eesti riik? – *Postimees* 2008, nr. 56 (5235).
- Kelly, Josie.** 2003. The Audit Commission: Guiding, Steering and Regulating Local Government. – *Public Administration*, 81(3), pp. 459–476.
- Kettunen, Pekka.** 2003. How Democratic are the Finnish Local Governments? – *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, pp. 271–278.
- Kettunen, Pekka. Kungla, Tarvo.** 2005. Europeanization of Sub-national Governance in Unitary States: Estonia and Finland. – *Regional and Federal Studies*, 15/ 3, pp. 353–378.

- King, Gundar J. Vanags, Edvins. Vilka, Inga. McNabb, David E.** 2004. Local Government Reforms in Latvia, 1990 – 2003: Transition to a Democratic Society. – *Public Administration*, 82(4), pp. 931–950.
- Kõrge, Jüri.** 2006. Riigieelarvest omavalitsustele toimetulekutoetusteks antud raha käsutamine: nr. OSIII-2-6/06/17, [http://www.riigikontroll.ee/fake\\_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669](http://www.riigikontroll.ee/fake_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669), 15. oktoober 2006.
- Kungla, Tarvo.** 2007. Patterns of Multi-Level Governance in Europe: The Challenge of the EU's Enlargement, Tallinn: TUT Press, p. 102.
- Laakso, Seppo.** 2003. The Europeanization of the Administrative Law in Finland, *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, pp. 307–315.
- Lemke, Jay L.** 1995. *Textual Politics: Discourse and Social Dynamics*. Bristol, PA: Taylor and Francis.
- Linnas, Raivo.** 2010. Integral Model of Audit, Control and Supervision of Local Self-Government. – *Local Government Studies* (Forthcoming).
- Linnas, Raivo.** 2009a. Legal Framework and Present State of External Control and Supervision over Local Self-Government Units in Estonia. – *Kunnallistieteellinen Aikakauskirja*, 2, pp. 141–162.
- Linnas, Raivo.** 2009b. Siseaudit Eestis on Euroopa keskmisel tasemel. – *Eesti Majanduse Teataja* nr. 9 (220), lk 27–37.
- Linnas, Raivo.** 2009c. Internal Control in Small Local Government Units: The Case of Estonia. – *Management* (Forthcoming).
- Linnas, Raivo.** 2008. Audit in Small Local Government Units: The Case of Estonia. – *Kunnallistieteellinen Aikakauskirja*, 1, pp. 65–82.
- Linnas, Raivo.** 2007. Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments (Based on the Case of Estonia). – *Kunnallistieteellinen Aikakauskirja*, 3, pp. 282 - 294.
- Marcou, Gérard.** 2008. Postface: Essay on the clarification of some key concepts and methodical problems. In *Decentralization and local democracy in the world: first global report by United Cities and Local Governments*. The World Bank and United Cities and Local Governments, Barcelona – Spain, pp. 305–313.
- Marcou, Gérard. Wollman, Hellmut.** (2008) Europe. In *Decentralization and local democracy in the world: first global report by United Cities and Local Governments*. The World Bank and United Cities and Local Governments, Barcelona – Spain, pp. 305–313.
- Maruste, Rait.** 2007. The Role of the Constitutional Court in Democratic Society. – *Juridica International*, 2007 II, pp. 8–13.
- Matei, Lucica. Matei, Ani I.** 2008. Globalization and Europeanization – A Projection on a European Model of Public Administration. – *Theoretical and Applied Economics*, 4/ 4, pp. 33–52.
- Mathews, J.** 1996. Holonic organisational architectures. – *Human Systems Management*, 15/1, pp. 27–54.

- McConnell, Donald K. Jr. Banks, George Y.** 2003. How Sarbanes-Oxley will change the audit process: CPAs will have to develop new procedures and scrap some old ones. – *Journal of Accountancy*, 196, pp. 49–56.
- Metsalu, Ines.** 2006. Euroopa Komisjoni abiprojekt HACSO Sonda vallas: nr. OSI-2-6/06/39, <http://www.riigikontroll.ee/fakeindex.php?lang=et&uri=%2Faudil.php%3Fdokument%3D669>, 15. oktoober 2006.
- Mikli, Airi.** 2007a. Rae valla majandustegevus 2006. Aastal. Riigikontrolli aruanne Riigikogule, <http://www.riigikontroll.ee/>, January 12, 2008.
- Mikli, Airi.** 2007b. Pedagoogide ja teiste haridustöötajate töötasudeks eraldatud raha kasutamine kohalikes omavalitsustes. Riigikontrolli aruanne Riigikogule, <http://www.riigikontroll.ee/>, 12. jaanuar 2008.
- Ministry of the Interior (MI).** 2007. Lisa 2. Rahvastiku ja regionaalala hetkeolukorra analüüs. Siseministeeriumi valitsemisala arengukava 2008-2011, <http://www.siseministeerium.ee/>, 10. jaanuar 2008.
- Mintzberg, Henry.** 1996. Managing Government, Governing Management. – *Harvard Business Review*, May – June, pp. 75–1983.
- Mäeltsemees, Sulev.** 2006. Local Self-government: Definition, its Position in Public Administration and Historical Development. *Estonica*, [http://www.estonica.org/eng/lugu.html?menyy\\_id=1255&kateg=39&nimi=&alam=48&tekst\\_id=1256](http://www.estonica.org/eng/lugu.html?menyy_id=1255&kateg=39&nimi=&alam=48&tekst_id=1256), November 18, 2009.
- Mäeltsemees, Sulev.** 1994. Estonia 1994. <http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN003969.htm>, October 15, 2006.
- Nieuwlands, Hans.** 2006. The Role of Auditing in Public Sector Governance. Presentation at the Academic Seminar on “Internal Audit and Supervision Models and Internal Control Systems in the Public Sector”, August 25<sup>th</sup> 2006, Tallinn University of Technology, House of Humanities.
- Nicolaisen, Donald T.** 2006 In an exit interview with the Chief Accountant of the SEC by Geoffrey Pickard. A Future That Matters, <http://www.aicpa.org/pubs/jofa/feb2006/pickard.htm>, April 23, 2007.
- Oviir, Mihkel.** 2006. Presentation at the Riigikogu on the overview of the use and preservation of state assets in 2005. Shorthand report from the 8th session (8.11.2006) of the 10th composition of the Riigikogu, <http://web.riigikogu.ee/ems/stenograms/2006/11/m06110807.html>, December 30, 2007.
- Olle, Vallo.** 2007. Settlement of Disputes Related to Election Rules for Local Government Councils: Judicial Practice of the Estonian Supreme Court, *Juridica International*, II, pp. 131–140.
- Oulasvirta, Lasse.** 2003. Local Government Finance and Grants in Finland. – *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, pp. 340–348.

- Oviir, Mihkel.** 2009. Ülevaade riigi vara kasutamisest ja säilimisest 2008. aastal. Riigikontrolöri kokkuvõtte aasta jooksul tähele pandust. Riigikontrolli aruanne Riigikogule, Tallinn 2009, [www.riigikontroll.ee](http://www.riigikontroll.ee), 20. november 2009.
- Oviir, Mihkel.** 2006. Ülevaade riigi vara kasutamise ja säilimise kohta 2005. aastal, [http://www.riigikontroll.ee/fake\\_index.php?lang=et&uri=%2Farvamus.php%3Fdokument%3D68](http://www.riigikontroll.ee/fake_index.php?lang=et&uri=%2Farvamus.php%3Fdokument%3D68), 29. oktoober 2006.
- Pihlajaniemi, Toivo.** 2003. The Changing Roles of the State and Municipalities. – Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja, 4, pp. 263–270.
- Plant, Kato. Steyn, Blanché. Plant, Gregory.** 2008. The status of and demand for internal auditing in South African companies. Presented at the Seventh European Academic Conference on Internal Audit & Corporate Governance, April 2008, London.
- Prigogine, Ilya.** 1983. *Ilya Prigogine: Wizard of Time*. Interviewed May 1983 by Robert B. Tucker, [http://www.edu365.cat/aulanet/comsoc/visions/documentos/interview\\_prigogine1983.htm](http://www.edu365.cat/aulanet/comsoc/visions/documentos/interview_prigogine1983.htm), August 07, 2009.
- Prigogine, Ilya.** 2000. The networked society. – Journal of World-Systems Research, 6, pp. 892–898.
- Prigogine, Ilya. Stengers, Isabelle.** 1984. Order out of chaos: Man's new dialogue with Nature. New York: Bantam.
- Ramos, Michael.** 2003. Auditors' Responsibility for Fraud Detection. – Journal of Accountancy, 195/, pp. 28–35.
- Randma, Tiina. Annus, Taavi.** (2000) Haldusreformi müüdid. – Riigikogu Toimetised, 2, pp. 135–144.
- Reichard, Christoph.** 2003. Local Public Management Reforms in Germany. – Public Administration, 81(2), pp. 345–363.
- Rosendorff, B. Peter. Doces, John.** 2006. Democracy and Transparency. – Swiss Political Science Review, 12/3, pp. 99–112.
- Ryynänen, Aimo.** 2003. Modification of Finnish Local Government - Between Continuity and Change. – Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja, 4, pp. 255–262.
- Sancton, Andrew.** 2005. The Governance of Metropolitan Areas in Canada. – Public Administration and Development, 25, pp. 317–327.
- Sanderson, Ian.** 2001. Performance Management, Evaluation and Learning in 'Modern' Local Government. – Public Administration, 79(2), pp. 297 – 313.
- Schoburgh, Eris D.** 2007. Local Government Reform in Jamaica and Trinidad: A Policy Dilemma. – Public Administration and Development, 27, pp. 159–174.
- Schumpeter, Joseph A.** 1939. Business Cycles. A Theoretical, Historical and Statistical Analysis of the Capitalist Process. Abridged, with an introduction by Rendigs Fels. New York Toronto London: McGraw-Hill Book Company.
- Sellers, Jefferey M. Lidström, Anders.** 2007. Decentralization, Local Government and the Welfare State. – Governance, 20 (4), pp. 609–632.

- Sepp, Veiko. Noorkõiv, Rivo. Haljaste, Karin-Liis.** 2006. Kohaliku omavalitsuse üksuste haldussuutlikkuse hindamise meetodika, Geomedia, Tartu 2006.
- Sepp, Veiko. Noorkõiv, Rivo. Loodla, Kaja.** 2009a. Kohaliku omavalitsuse võimekuse hindamine: indeks ja analüüs, Geomedia, Tartu 2009, lk. 17.
- Sepp, Veiko. Noorkõiv, Rivo. Loodla, Kaja.** 2009b. Eesti kohaliku omavalitsuse üksuste võimekuse indeks: meetodika ja tulemused 2005–2008. *In* Linnad ja vallad arvudes. 2009. Cities and Rural Municipalities in Figures, Statistikaamet, pp. 10–42.
- Smith, B.C.** 1996. Sustainable Local Democracy. – Public Administration and Development, 16, pp. 163–178.
- State Audit Office/Riigikontroll (SAO).** 2006. Riigikontrollil valmis kokkuvõtte kohalike omavalitsuste auditeerimise kohta 2006. aastal, <http://www.riigikontroll.ee/>, January 14, 2008.
- Sterck, Miekatrien. Scheers, Bram. Bouckaert, Geert.** 2005. The Modernization of the Public Control Pyramid: International Trends. Report D/2005/10106/018. Bestuurlijke Organisatie Vlaanderen.
- Straussfogel, Debra.** 1997. A system perspective on world-systems theory. – Journal of Geography, 96, pp. 119–126.
- Steering Committee on Local and Regional Democracy (CDLR).** 2003. Public ethics at the local level, model initiatives package [DG-I (2003) 2]. Strasbourg, 13 January 2003, p. 60. [http://www.coe.int/t/e/ngo/public/groupings/ngo\\_towns/documents/2003/PackageEthics-rev.asp#TopOfPage](http://www.coe.int/t/e/ngo/public/groupings/ngo_towns/documents/2003/PackageEthics-rev.asp#TopOfPage), January 2007, 2006.
- Swedish Government Official Reports (SGOR).** 2004. Examining and determining accountability in local governments, Summary (SOU 2004: 107). Ministry of Finance, Report of the Inquiry concerning local government auditing. Stockholm, <http://www.sweden.gov.se/sb/d/574/a/35832>, December 21, 2004.
- Swiderska, Krystyna. Roe, Dilys. Siegele, Linda. Grieg-Gran, Maryanne.** 2008. The Governance of Nature and the Nature of Governance: Policy that works for biodiversity and livelihoods.
- Teder, Indrek.** 2008. Riigikogu, 23.09.2008 stenogramm.
- Ter-Minassian, Teresa. Craig, Jon.** 1997. Control of Sub-national Government Borrowing. *In*: Teresa Ter-Minassian, ed, Fiscal Federalism in Theory and Practice: A Collection of Essays, International National Monetary Fund.
- The Australian National Audit Office (ANAO).** 1997. A Framework for Effective Control, [http://www.anao.gov.au/uploads/documents/A\\_Framework\\_for\\_Effective\\_Control.pdf](http://www.anao.gov.au/uploads/documents/A_Framework_for_Effective_Control.pdf), January 10, 2008.
- The Australian Government's Overseas Aid Program (AUSAID).** 2000. Good Governance – Guiding principles for implementation, [http://www.usaid.gov.au/publications/pdf/good\\_governance.pdf](http://www.usaid.gov.au/publications/pdf/good_governance.pdf), January 08, 2008.

- The Institute of Internal Auditors (IIA).** 2006. The role of Auditing in Public Sector Governance. Professional Guidance. November 2006. Altamonte Springs, USA, p. 24.
- The Committee of Sponsoring Organizations of the Treadway Commission (COSO).** 1992. Internal Control - Integrated Framework, [http://www.coso.org/publications/executive\\_summary\\_integrated\\_framework.htm](http://www.coso.org/publications/executive_summary_integrated_framework.htm), January 08, 2008.
- The European Confederation of Institutes of Internal Auditing (ECIIA).** 2005. Risk Management and Internal Control in the EU. Discussion Paper. Response from the Confederation of Institutes of Internal Auditing, [http://www.eciia.org/images/stories/dwn\\_pub/dp\\_05/2005\\_07\\_29\\_ECIIA\\_response\\_to\\_FEE\\_RiskControlPaper.pdf](http://www.eciia.org/images/stories/dwn_pub/dp_05/2005_07_29_ECIIA_response_to_FEE_RiskControlPaper.pdf), January 11, 2008.
- United Cities and Local Governments (UCLG).** (2008) Decentralization and local democracy in the world: first global report by United Cities and Local Governments. The World Bank and United Cities and Local Governments, Barcelona – Spain, p. 341.
- United Nations Development Programme (UNDP).** 1996. Local Governance. Report of the United Nations Global Forum on Innovative Policies and Practices in Local Governance. Gothenburg, Sweden, 23-27 September 1996, [mirror.undp.org/magnet/docs/dec/GLOBAL2.HTM](http://mirror.undp.org/magnet/docs/dec/GLOBAL2.HTM), December 15, 2009.
- Vabo, Signy Irene.** 2005. Committee structure and political preferences: The case of Norwegian local government. – European Journal of Political Research, 44, pp. 563–592.
- Walle, Steven van de. Roosbroek, Steven van. Bouckaert, Geert.** 2008. Trust in the Public Sector: Is There Any Evidence for a Long-Term Decline? – International Review of Administrative Sciences, 74/1, pp. 45–62.
- Walker, David M.** 2005. The Government Accountability Office Report GAO-05-325SP: 21st Century Challenges: Re-examining the Base of the Federal Government, <http://www.gao.gov/new.items/d05325sp.pdf>, December 30, 2007.
- Wallace, Cynthia Day.** 2002. The Multinational Enterprise and Legal Control: Host State Sovereignty in an Era of Economic Globalization. The Hague / London / New York: Martinus Nijhoff.
- Wallerstein, Immanuel.** 1998. The Heritage of Sociology. The Promise of Social Science. – Current Sociology, 47/1, pp. 1-37.
- Wallerstein, Immanuel.** 1974. The Modern World-System: Capitalist Agriculture and the Origins of the European World Economy in the Sixteenth Century. New York: Academic Press.
- Wallis, Joe. Dollery, Brian.** 2001. Local Government Policy Evolution in New Zealand: Radical Reform and the Ex Post Emergence of Consensus or Rival Advocacy Coalitions. – Public Administration, 79(3), pp. 533–560.
- Wilson, Woodrow.** 1887. The Study of Administration. – Political Science Quarterly, 2(2), pp. 197–222.

**Woehrling, Jean – Marie.** 2005. Judicial Control of the Administration in Europe: Progressive Construction of a Common Model, <http://www.sigmaxweb.org/dataoecd/33/40/35676763.pdf>, January 23, 2008.

**Woolas, Phil.** 2005. Inspection of Local Services: Launch of Inspection Consultation Document, November 28, 2005.

**Work, Robertson.** 1998. Factors to Consider in Designing Decentralised Governance Policies and Programmes to Achieve Sustainable People-Centred Development, Management Development and Governance Division, United Nations Development Programme, New York, February 1998.

**Worrall, Les. Collinge, Chris. Bill, Tony.** 1998. Managing strategy in local government. – The International Journal of Public Sector Management, 11 (6), pp. 472–493.

### *Laws and regulations*

**Archives Act (AA)** (RT I 1998, 36/37, 552)  
**Authorised Public Accountants Act (APAA)** (RT I 1999, 24, 360)  
**Chancellor of Justice Act (CJA)** (RTI 1999, 29, 406)  
**Government of the Republic Act (GRA)** (RT I 1995, 94, 1628)  
**Local Government Council Election Act (LCEA)** (RT I 1996, 37, 739)  
**Local Government Organisation Act (LGOA)** (RT I 2005, 31, 230)  
**Public Service Act of Estonia (PSA)** (RT I 1995, 16, 228)  
**Rural Municipality and City Budgets Act (RMCBA)** (RT I 1993, 42, 615)  
**State Audit Office Act (SAOA)** (RT I 2002, 21, 117)  
**State Budget Act (SBA)** (RT I 1999, 55, 584)  
**The Constitution of the Republic of Estonia (CRE)** (RTI, 28.06.2007, 43, 311)

### *Dedications*

This thesis is dedicated to my wife Annika, my mother Eha and my children Eneli, Merili and Richard – the most important people in my life.

### *Acknowledgements*

The planning, performing and fine tuning of this thesis would have taken far longer to complete without the encouragement and assistance from many distinguished and generous persons. It is a delight to acknowledge those who have supported me over the last five years. First of all, I am very grateful to my supervisor, Prof. Dr. Sulev Mäeltsemees, who took the risk to become my supervisor and from early on provided advice and encouragement. In addition, I would also like to thank him particularly for showing a great academic liberality in accepting the theme of this thesis. I would like to thank my supervisor as well for giving me satisfactory academic freedom and a working rhythm suitable for me in performing my research and completing the thesis. I would like to thank very much professors Dr. Rainer Kattel and Dr. Ülo Kaevats, of the Institute of Public Administration,

Tallinn University of Technology, for their great encouragement during my study and for commenting on and guiding the drafts of my other papers that have already been published. In addition, I would like to thank very much all my professors and lecturers for interesting, academically enjoyable and enriching lectures, seminars and workshops given during my PhD study. My personal development and academic progress would not have been possible without their contribution. Moreover, I would like to express my thanks to Piret Kähr, Merli Reidolf and Elve Vunn, of the Faculty of Social Sciences, Tallinn University of Technology, for their charming and sedulous assistance in day-to-day affairs. I am very grateful to Sari Saastamoinen, *toimitussihteeri*, Kunnallistieteellinen aikakauskirja, and to the editors of the Local Government Studies, Dr. Philip Whiteman and Helen Hancock, for their gracious assistance and patience in processing my papers for publication which are basis of this thesis. Furthermore, my thanks go to the editors of other publications for their gracious assistance and patience in processing my papers which are not linked with this thesis, but which have contributed greatly to my academic development. My thanks go to the undisclosed reviewers of my published papers for their reasonable, constructive criticism and helpful guiding comments as well. I am grateful to Raul Malmstein, the Chairman of the Estonian Financial Supervision Authority, and all the other persons who contributed to my research in many different ways for the encouragement and support they showed me during my PhD studies. My thanks go to my fellows in the PhD program for their support and amity during the seminars and workshops. Many thanks go to George Franchi for proofreading and correcting my papers as a native English speaker before their publication. Finally, I would like to thank my family for their significant and continuous support and for the time I have taken off during my studies. Any errors, inconsistencies or miswriting are my own.

Publication of this thesis is granted by the Doctoral School in Economics and Innovation created under the auspices of European Social Fund.



## List of Original Publications

This dissertation is based on the following original publications of the author:

1. **Linnas, Raivo.** (2010) Integral Model of Audit, Control and Supervision of Local Self-Government. *Local Government Studies*, 1–30, (Forthcoming, ETIS 1.1).
2. **Linnas, Raivo.** (2009) Legal Framework and Present State of External Control and Supervision of Local Self-Government Units in Estonia. *Kunnallistieteellinen Aikakauskirja*, 141–162. (ETIS 1.2)
3. **Linnas, Raivo.** (2008) Audit in Small Local Government Units: The Case of Estonia. *Kunnallistieteellinen Aikakauskirja*, 65 - 82. (ETIS 1.2)
4. **Linnas, Raivo.** (2007) Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments. (Based on the Case of the Estonia). *Kunnallistieteellinen Aikakauskirja*, 282–294. (ETIS 1.2)

## **Abbreviations**

**ACS** – audit, control and supervision

**ACSS** – audit, control and supervision system

**EA** – external audit

**EC** – external control

**ECS** – external control system

**IA** – Internal audit

**IC** – internal control

**ICS** – Internal control system

**INTOSAI** - International Organization of Supreme Audit Institutions

**ISACS** – integral system of audit, control and supervision

**LG** – local self-government

**LGS** – local self-government sector

**LGU** – local self-government unit

## Terms

**Internal audit (IA)** – „Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes.“ (The IIA)

**Internal Control (IC)** – Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting and compliance with applicable laws and regulations.” (COSO, 1992)

**Internal Controls** – „Internal controls are put in place to keep the company on course toward profitability goals and achievement of its mission, and to minimize surprises along the way. They enable management to deal with rapidly changing economic and competitive environments, shifting customer demands and priorities, and restructuring for future growth. Internal controls promote efficiency, reduce risk of asset loss, and help ensure the reliability of financial statements and compliance with laws and regulations.” (COSO, 1992)

**Internal control system (ICS)** – „An internal control system encompasses the policies, processes, tasks, behaviours and other aspects of a company that, taken together: facilitate its effective and efficient operation by enabling it to respond appropriately to significant business, operational, financial, compliance and other risks to achieving the company's objectives. This includes the safeguarding of assets from inappropriate use or from loss and fraud and ensuring that liabilities are identified and managed; help ensure the quality of internal and external reporting. This requires the maintenance of proper records and processes that generate a flow of timely, relevant and reliable information from within and outside the organisation; help ensure compliance with applicable laws and regulations, and also with internal policies with respect to the conduct of business.” (FRC, 2005: 7)

**Local self-government (LG)** – „Local self-government denotes the right and the ability of local authorities, within the limits of the law, to regulate and manage a substantial share of public affairs under their own responsibility and in the interests of the local population.“ (Council of Europe, 1985)

**Local self-government sector (LGS)** – local self-government sector is a public sector which consists of local self-government units that are based on the idea of a community that is responsible for solving the problems of the said community and managing its affairs.

**Local self-government unit (LGU)** – a rural municipality and town.

## **Abstract**

The author of this dissertation considers the issue of audit, control and supervision systems of the local self-government sector based on the case of Estonia. The theme of this dissertation is real, pertinent, timely and relevant not only for Estonia, but for the European Union and the world as well.

The aim of this dissertation is to explore some of the key aspects of the matter of audit, control and supervision activities and systems of local self-government units in Estonia. The author of the dissertation describes the current model of the local self-government sector's audit, control and supervision system of Estonia; performs a critical analysis of the existing audit, control and supervision system of the local self-government sector in Estonia; argues reasons why the present paradigm of understanding and treatment of the audit, control and supervision system of the local self-government sector in Estonia cannot be a reliable means of contemporary good governance anymore and discusses principally new theoretical and practical ways (a new approach) of overcoming its malfunctions.

The object of the author's research in this dissertation is the system of audit, control and supervision of the local self-government sector in Estonia. The audit, control and supervision system of the local self-government sector as a matter of academic research is interesting because the object of research is complex and complicated, exists in an open environment and keeps changing with time. It is worthy of treatment based on the case of Estonia because no significant research in that particular field has been done there.

The academic novelty of this research consists particularly of two core aspects: 1. The author's research performed on the state and functionality of the entire audit, control and supervision system of the local self-government sector was the first of its kind in Estonia; 2. The author discusses a principally new theoretical approach to the audit, control and supervision system of local self-government units (particularly for Estonia, but not only there).

The theoretical framework of the dissertation draws mainly on the literature on audit, control, governance, local governance, local self-government, public administration and supervision research. The author used a multi-method research design because audit, control and supervision activities, relevant management and control systems, and the organization of audit, control and supervision in local self-government units are diverse, complex, complicated and interdisciplinary matters of research. More in-depth empirical analysis has been undertaken for the audit, control and supervision of the local self-government sector in Estonia. This dissertation is based on 4 years of extensive research in Estonia. The preliminary results of the dissertation were presented and discussed at the First Global Academic Conference on Internal Audit and Corporate Governance in Rotterdam.

This dissertation is based on four original, published articles of the author. The first core original article discusses the current model of the local self-government's audit, control and supervision system of the Republic of Estonia; performs a

critical analysis of the existing audit, control and supervision system of the local self-government sector there and proposes key principles for developing an optimal model of an audit, control and supervision system of the local self-government sector suitable not only for Estonia but for other countries as well. The second core article discusses in more depth the issue of audit, particularly internal audit, in small local self-government units; presents an analytical overview of the state of the local self-government sector and audit therein in Estonia; presents some theoretical and practical options for the future development of external and internal audit in small local self-government units and discusses the strengths and weaknesses of the options presented by the author. The third core article discusses the issue of legal regulation and the present state of external control and supervision of local self-government units in Estonia, gives a thorough overview of the legislative framework underpinning the key control and supervisory bodies of local self-government units, highlights the present situation of external control and supervision of local self-government units, and gives suggestions for overcoming the malfunctioning of the external control and supervision system of the LGS in Estonia. The fourth article discusses a new approach to the issue of audit, control and supervision of local self-government units and presents some ideas for the operation of an integral system of audit, control and supervision of the local self-government sector, particularly focusing on small LGS units. The author has published more articles on the theme of the dissertation, but these articles have not been included as part of its basis.

The introduction of this dissertation is divided into 5 parts. In setting a general background for the theme of the dissertation, the first part elaborates on the state of contemporary local self-government in Estonia and in a more global context, while the second part presents the state of audit, control and supervision in the contemporary world. In the third section, the failure of the present paradigm of the audit, control and supervision system of the local self-government sector in Estonia is discussed. The fourth part presents the integrated model of audit, control and supervision of the local self-government sector. Finally, the pros and cons of the integrated model of the ACS of LGS are discussed in the fifth part.

Local self-government sectors differ from each other all over the world: their tasks are very different, their sources of revenue are equally diverse, relations between the state and LGS are based on very different fundamental principles, and organisational structures are different from country to country. There are big differences in compliance with accounting and reporting standards as well. Nevertheless, some trends and characteristics are common. For instance, a permanently changing environment; a mismatch between the responsibilities and sources of finance; life under permanent change, reform and merger processes; the political accountability of local authorities appears to have been circumvented and lost effectiveness; the increasing share of networking and co-operation between LGUs, and a number of non-local factors jeopardise local democracy. The academic as well as non-academic literature confirms that the situation of LGUs

does not depend only on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a particular country.

Despite the fact that there are a number of different theoretical conceptions, models, frameworks and approaches to audit, control and supervision, and countries design, implement and maintain audit, control and supervision frameworks, models and functions differently all over the world, both the academic and non-academic literature confirms that the activities of audit, control and supervision in the public and private sectors have a low capacity in the context of outcome and impact or have failed completely. The local self-government sector in Estonia is facing a real need for change in the political, economic and administrative fields, including aspects of audit, control and supervision. The author argues that the treatment of audit, control and supervision activities of local self-government units in the present paradigm (not understood, treated, designed and maintained like an integral, coherent holistic system or organisation) has so many imperfections that it cannot be a reliable means of modern good governance anymore. This statement is definitely relevant to Estonia. As a result, a new paradigm of treatment of the ACSS of the LGS in Estonia is to come into use.

The author suggests that in order to design and develop an integrated ACSS of LGUs that is scientifically justified, as well as appropriate and functional in real life, a philosophical platform that stands on at least 7 pillars is needed as follows: 1. The paradigm of the laws of nature; 2. The holistic approach; 3. The paradigm of self-organization; 4. The reciprocal-balance approach; 5. The uniqueness principle; 6. The paradigm of uncertainty; and 7. The compatibility approach. The author also discusses four options for their implementation in actual life within the integral model of audit, control and supervision of the LGS. The author explains his idea more deeply in his original papers.

Social systems and processes are very complex, they operate under the influence of self-organizing processes and work in open systems, sometimes called a world-system or eco-social system. The operations of social systems are indeterministic, unpredictable and uncertain. A state and an LGU as an organization, institution or system inevitably consist of human beings, they are social, eco-social or real systems. Local-level governance is a complex phenomenon and local authorities are very complex organizations which exist in a highly turbulent environment. Therefore, society, LGUs and ACSS are constantly changing in time and space. Accordingly, one can argue that ACSS is permanently under conditions of uncertainty, indeterminacy and self-organization as well. Therefore, when one tries to find scientifically justified and theoretically correct solutions, it is especially important to make sure that the LGS as a whole and each municipality separately are treated not as an isolated and rigid system that is always in balance, regardless of time, but on a philosophical basis, proceeding from the paradigm of self-organisation.

The principal elements of the state are people. According to the Self-Government Theory, people are sovereign rulers in a democracy. Consequently, taking into account that Estonia is a democratic state and the inhabitants of each

LGU in Estonia are sovereign, it is inevitable that one has to take into account people as the main actors in this very social system. Thereby, the ACSS of LGUs is a system where people with their needs, desires, demands and behaviour are actors and a key factor (the human-centred approach). Therefore, the human-centred approach and the paradigm of the laws of nature are inevitable necessities in dealing with social processes and systems.

The author recognizes that the new approach to the treatment of ACS matters has pros and cons that depend on cultural, political, economical and legal factors. One material risk that can arise from a new approach to the treatment of the matter of ACSS of LGS is the risk of increasing dependency of a LGU on the central government. Nevertheless, local democracy may be in some way imperfect. Accordingly, there is a need to keep a legitimate and purposeful balance between the rights and obligations of the central government and local self-government in applying an integral ACSS to real life. On the one hand, the central government should not have to overrule or override the LG sector. On the other hand, the inhabitants of a particular LGU should not have to suffer because of the low administrative capacity of local governance institutions or because of improper and corrupt action of local politicians or civil servants.

However, the approach presented by the author is evidently a step further in the theoretical and practical treatment of the issues of audit, control and supervision in the local self-government sector. Still, further research has to be performed to discover more particular pros and cons challenging the introduction and application of the holistic approach of the ACSS of LGS in different types and sizes of countries.

Even though the author's research is based on the case of Estonia, known as a small constitutional democratic liberal society with an open economy, his ideas are applicable to other democratic societies as well.

## Kokkuvõte

Käesoleva doktoritöö uurimisobjekt on kohaliku omavalitsuse (edaspidi KOV) auditi, järelevalve ja kontrolli (edaspidi AJK) süsteem Eesti Vabariigis. Auditi, järelevalve ja kontrolli süsteem (edaspidi AJKS) on keeruline ja mitmetahuline uurimisobjekt. Kogu süsteem on ajas pidevas muutumises, toimib avatud keskkonnas ja selle osised mõjutavad üksteist vastastikku. Audit, järelevalve ja kontroll on omavahel väga keerulistes seostes, nad avaldavad vastastikku mõju mittelineaarselt ja raskesti määratletavates või isegi tuvastamatutes seostes.

Doktoritöö eesmärk on kirjeldada KOV AJK süsteemi Eestis, analüüsida olemasoleva AJKS ja selle osiste (auditi, järelevalve ja kontrolli alam süsteemid) vähese toimimise põhjusi, esitleda põhimõtteliselt uut lähenemist KOV AJKS akadeemilisele uurimisele ja käsitlemisele ning kirjeldada uuenduste praktikas rakendamise võimalikke tugevusi, nõrkusi ja riske.

Käesolev doktoritöö on ajakohane, sest KOV AJK teemasid on uuritud Eestis väga vähe. KOV auditi-, kontrolli-, ja järelevalve süsteemide toimes esineb tõrkeid nii Eestis, kui ka teistes riikides ja avaliku sektori AJK süsteemid vajavad kohandamist muutunud oludega avalikus halduses.

Doktoritöö akadeemiline uudsus nii rahvusvahelisel tasandil kui ka Eestis seisneb peamiselt järgnevas:

1. Autor käsitleb esmakordselt KOV AJKS ühtse tervikuna (holistlik lähenemine).
2. Autor esitleb põhimõtteliselt uut lähenemist KOV AJKS käsitlemiseks ja arendamiseks.

Doktoritöö tugineb peamiselt auditi, järelevalve, kontrolli, valitsemise, kohaliku omavalitsuse ja avaliku halduse ala teoreetilisele kirjandusele ja teadusuuringute tulemustele. Autor on kasutanud ka teemakohast ametialast, erialast ja kutsealast kirjandust. Autor kavandas uurimistöö kombineerides mitut meetodit ja teooriat, sest KOV auditi, järelevalve ja kontrolli tegevused, kohased juhtimis- ja kontrollisüsteemid ning AJK organisatsioon on keeruline, mitmetahuline ja interdistsiplinaarne uurimisaines. Uurimistöö käigus kasutati KOV AJKS ja selle erinevate osiste empiiriliste analüüside ja päringute tulemusi.

Käesolev doktoritöö põhineb neljal pingelisel teadustöö aastal Tallinna Tehnikaülikoolis. Uuringute esmaseid tulemusi on esitletud ja nende üle diskuteeritud rahvusvahelisel teaduskonverentsil *First Global Academic Conference on Internal Audit and Corporate Governance* Rotterdams. Autor on doktoriõppe ajal avaldanud 7 teaduslikku, populaarteaduslikku ja muud artiklit doktoritöö teemal ja allteemadel.

Doktoritöö põhineb neljal algupärasel teadusartiklil. Autor käsitleb esimeses teadusartiklis KOV AJKS Eestis, kirjeldades ja esitades olemasoleva KOV AJKS analüüsi tulemusi ning esitleb uusi teoreetilisi põhimõtteid KOV AJK optimaalse süsteemi väljaarendamiseks. Teises teadusartiklis kirjeldatakse põhjalikult KOV auditi, ennekõike siseauditi, teemat, keskendudes väikeste KOV üksuste näidetele.



Autor annab artiklis ülevaate KOV auditi ja siseauditi olukorrast Eesti kohaliku omavalitsuse sektoris, esitleb teoreetilisi võimalusi ja praktilisi soovitusi KOV auditi ja siseauditi olukorra parandamiseks ning mõtiskleb välja pakutud lahenduste tugevate ja nõrkade külgede üle. Autor keskendub kolmandas teadusartiklis KOV välise (eksternse) AJK süsteemi ja subjektide tegevuse õiguslikku raamistiku ja hetke olukorra analüüsile Eestis. Samas esitleb ta mõningaid teoreetilisi lahendusi ja annab praktilisi soovitusi KOV eksternse AJK süsteemi toimimise parandamiseks. Neljandas teadusartiklis tutvustatakse põhimõtteliselt uut teoreetilist lähenemist KOV AJK süsteemile, analüüsitakse uue lähenemise kasutuselevõtu vajadust ning mõtiskletakse uue lähenemise tugevuste ja nõrkuste ning selle rakendamisel esile kerkida võivate takistuste üle.

Käesoleva doktoritöö sissejuhatav artikkel koosneb viiest peatükist. Autor annab esimeses peatükis üldise ülevaate KOV olukorrast Eestis ja ka mujal, seda uurimisainese konteksti paremaks mõistmiseks. Teises peatükis avatakse AJK olukorda nüüdisaegses maailmas. Kolmandas peatükis kirjeldatakse KOV AJKS praeguse paradigma puudusi ja selle põhjusi Eestis. Neljandas peatükis avatakse KOV AJKS põhimõtteliselt uue lähenemise sisu ja viiendas kirjeldatakse uue lähenemise tugevusi ja nõrkusi.

Kohaliku omavalitsuse mudeleid on maailmas palju. Erinevad on ka KOVide ülesanded, tulubaasid, rahastamise allikad, mõjujõud ja suhted KOV ja keskvalitsuse vahel, samuti organisatsiooniline ülesehitus, majandusarvestus ning aruandlus. Siiski on KOV arengute mitmed trendid maailmas sarnased. Näiteks pidevalt muutuv keskkond, lõhe kohustuste ja finantside vahel, pidevad reformid ja reorganiseerimised, vähene poliitiline vastutus ning üha suurenev koostöö KOV üksuste vahel. Akadeemilisele ja muule erialasele kirjandusele tuginedes võib väita, et KOV olukord ei sõltu ainult ühiskonna poliitilisest korrast, demokraatia tasemest, liberalismi või autokraatia määrast, heaolu tasemest ega ka vaadeldava ühiskonna sotsio-kultuurilisest keskkonnast.

Ka valitsemise ja juhtimise mudelid on maailmas väga erinevad, mistõttu valitsemis- ja juhtimisprobleemidele lahenduste leidmine on nagu "rätsepatöö", mis sõltub mitmetest teguritest. Vaatamata eeltoodule on kontrolli struktuurid valitsemise nurgakiviks. Sisekontrolli süsteem on juhtimis- või valitsemisüsteemi lahutamatu osis ja siseaudit on valitsemise ja juhtimise oluline mehhanism kogu maailmas. Järelikult - auditi, järelevalve ja kontrollstruktuurid on valitsemisstruktuuri lahutamatud osised sõltumata riigi geograafilisest asendist või õiguskorrast.

Nii akadeemilised kui ka mitteakadeemilised allikad kinnitavad veenvalt, et nii avaliku kui ka erasektori auditi, järelevalve ja kontrolli tegevused ja süsteemid on osutunud vähe mõjusaiks või lausa kasutuks. Doktoritöö autor tõendab, et ka KOV AJK süsteemid Eestis ei ole enam küllaldaselt mõjusad või on lausa sobimatud nüüdisaegsele avalikule haldusele. AJK tegevuste ja süsteemi vähese mõju või läbikukkumise põhjusi on palju. Doktoritöö autor väidab, et üheks olulisemaks põhjuseks on AJKS käsitlemine vales paradigmas. Teadus- ning kutse-, ameti- ja erialakirjanduses domineerib käsitlus, kus KOV üksusi ja KOV AJKS uuritakse

masinalaadsete mehaaniliste süsteemidena, mida võib uurida, analüüsida, konstrueerida, käivitada ja seisata, kuid mille lahutamatu ja loomupärane põhiosis ei ole mingil juhul inimene ise.

Käesoleva doktoritöö autor soovib KOV tervikliku AJKS kujundamisel ja arendamisel lähtuda filosoofilisest alusest, mis seisab 7 järgmisel põhisambal:

1. Loodusseaduste paradigma.
2. Terviklik (holistlik) lähenemine.
3. Iseorganiseerumise paradigma.
4. Vastastikuse tasakaalu (retsiprookne) lähenemine.
5. Unikaalsuse printsiip.
6. Määramatuse paradigma.
7. Ühilduvuse printsiip.

Autor avab eelnimetatud põhisammaste sisu ning rakendamise tähtsuse ja võimalused põhjalikumalt käesoleva doktoritöö aluseks olevates teadusartiklites.

Sotsiaalsed süsteemid ja protsessid on väga keerukad, nende toimimine on käsitletav iseorganiseerumise paradigmas ja nad toimivad avatud süsteemides. KOV üksused on väga keerukad organisatsioonid ja sotsiaalsed või öko-sotsiaalsed süsteemid, mis on pidevas muutumises. Sotsiaalsete süsteemide toimimine on ettemääramatu, prognoosimatu ja tõsikindlusetu. Järelikult on ettemääramatud, prognoosimatud, tõsikindlusetud ja pidevas muutumises ka KOV ning KOV AJKS. KOV ja KOV AJKS toimivad samuti iseorganiseerimise mõju all. Ühiskonna, riigi ja KOV peamiseks subjektiks on inimene, mistõttu ühiskondade ning sotsiaalsete nähtuste, protsesside ja süsteemide uurimisel tuleb inimest käsitleda keskse mõjutajana (inimkeskne lähenemine).

Autor mõistab, et teooria praktikasse rakendamise tulemused ei ole täielikult ette ennustatavad, üks-üheselt juhitavad ja tõsikindlalt tagatavad ei autori, ega ka autori ideid ellu rakendada kavatsevate praktikute poolt. Üheks oluliseks ohuks autori ideede väärade juurutamise korral võib olla KOV sõltuvuse suurenemine keskvalitsusest. Demokraatia ei ole täiuslik nähtus, mistõttu on oht, et riigi ja kohalikud poliitikud või ametnikud ei täida erinevatel põhjustel neile põhiseaduse ja seadustega pandud kohustusi või nende tegevus (tegevusetus) ei vasta KOV üksuse elanike põhjendatud ootustele. Järelikult peavad olema teoreetilised ja praktilised õiguspärased ja -kindlad võimalused tagamaks tasakaalu KOV elanike põhiseaduslike õiguste ja KOV küllaldase autonoomia tagamise vahel.

Doktoritöö oluline praktiline väärtus seisneb peamiselt kahes asjaolus:

1. Autori esitletud lahendus võimaldab paindlikult valida iga riigi kohaliku omavalitsuse sektorile ja igale KOV üksusele optimaalse auditi, järelevalve ja kontrolli mudeli.

2. Autori väljatöötlus võimaldab tagada tasakaalu KOV üksuse elanike põhiseaduslike õiguste tagamise ja KOV autonoomia tagamise vahel.

Autor mõistab, et erinevate eksternsete ja internsete audiitorite, järelevalvajate ja kontrollijate tegevuse koordineerimise keerukus võib ideede elluviimist oluliselt raskendada, kuid ei välista idee rakendamise võimalikkust. Tuleb mõõnda, et autori

ideede ellu rakendamist võib takistada poliitikute tahtmatus KOV auditi, järelevalve ja kontrolli tegevuse mõjususe suurendamiseks.

Autori esitletud teoreetilised võimalused KOV AJKS põhimõtteliseks ümberkorraldamiseks sobivad rakendamiseks ka teistes riikides, kuigi uurimistöö on läbi viidud Eesti näitel. Siiski on vältimatult vaja järgida nõuet, et enne lõplike otsuste tegemist on vaja välja selgitada, millised eeldused ideede rakendamiseks olemas on või hoopiski puuduvad ning millistele AJKS alamsüsteemidele enim, millistele vähem rolli määrata.

Käesolev doktoritöö on üheks sammuks KOV AJKS uurimiste jadas Eestis, kuid KOV AJKS uurimistööd tuleb jätkata mitmest erinevast aspektist lähtudes.



Raivo Linnas, Theoretical and Practical Problems..., Kunnallistieteellinen aikakauskirja 3/07

# Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments. (Based on the Case of the Estonia)

Raivo Linnas [raivo.linnas@kallio.fi](mailto:raivo.linnas@kallio.fi)

## Abstract

The aim of this article is to describe the current model of local governments' audit, control and supervision system of the Republic of Estonia, perform critical analyse of existing audit, control and supervision system in Estonia and propose foundational principles for developing an optimal model of an audit, control and supervision system of local government suitable not only for the Estonia. Author is of concluding opinion that does exist a possibility to design, arrange and maintain theoretically well founded and practically reasonably functioning integral and coherent audit, control and supervision system, but does not exist possibility to offer uniform, standard solution fitting to the municipal sector in general, because different models do apply to huge, big, middle-sized, small and tiny municipalities. Author presents six principles that should form a general philosophical basis for designing of an optimal model of audit, control and supervision system of municipalities, for developing solution that is scientifically justified, as well as appropriate for implementing and functional in real life. The broader meaning of this article is that ideas proposed by author are relevant as well for other countries that have a similar to the Estonia level of development of society and democracy and where municipalities are with very different size or where rather do dominate considerably small units than large ones.

**Keywords:** Audit, Control, Estonia, Internal Audit, Internal Control, Local Government, Supervision.

## An Introduction

The aim of this article is to describe the current model of local governments' audit, control and supervision (hereinafter jointly referred to as ACS) system of the Republic of Estonia, to perform critical analyse of existing ACS system (hereinafter referred to as ACSS) in the Estonia and propose foundational principles for develop of an optimal

model of the ACSS of local government (hereinafter referred to as LOG) sector suitable not only for the Estonia.

The ACSS of LOG in the Republic of Estonia constitutes a commendable and interesting object of study, mainly due to the fact that a great majority of the Estonia's LOG units are small in every aspect: number of residents, size of territory, financial resources, natural resources and qualified experts. This is one of the reasons why the challenge facing the researcher – to find solutions which would be both theoretically appropriate and applica-

<sup>1</sup> Author is using terms "internal audit" as defined by the IIA (IIA 2004) and "internal control" as defined by the COSO (COSO 2001).

ble in real life as well – is considerably bigger, than it would be in the case of very large and large municipalities. The novelty of the present research lies in the author's attempt to "draw a map on a *tabula rasa*" in a new paradigm. Currently there is no scientific knowledge or certainty regarding the functionality of the ACSS of LOG in the Estonia. Unfortunately, this is not an exception but rather a rule. (Raudjärv 2006, 374) As of today, it has not been scientifically ascertained how well-functioning the ACSS of LOG in the Estonia really is. There is no scientific proof affirming that audit, control and supervision form an integral whole and that this whole is in compliance with values and principles of a modern society and generally recognised core values of democracy.

Author performed research based on qualitative approach of methodology and used qualitative methods of collecting, processing and interpreting data. Author is of opinion that qualitative approach and methods are relevant for solving main problem of this particular research. Author performed structural and non-structural search of relevant theoretical publications and different other sources of information and data (laws and other legal norms, standards, official documents, verbatim reports of constitutional institutions, academic dissertations, websites of international organizations and public journals and newspapers), validated information, analysed and synthesised collected information. Selected out sources of information were qualitatively analyzed by the aspects of semantics and content.

Current article consist 4 chapters: A Broader Context, An Overview and Critics of the Present model of the ACS of LOG in the Estonia, General Philosophical Basis and the Principles Underlying Research of the ACSS of LOG and the Development of Functional Solutions and Conclusions and Closing Remarks.

### 1. A Broader Context

The foundations of the Estonia's present-day

LOG sector were established after the re-independence of the Estonia. Local government in the Estonia had constituted a significant part of administrative arrangement before Soviet era as well, but a new system had to be established rather than the old one restored, as the interim centralised regime had brought about thorough reorganisations. Parliament of the Estonia the *Riigikogu* ratified the European Charter of Local Self-Government on 28.09.1994. (RTII, 01.01.1994, 95) Since that the Estonia does have its own set of LOG principles matching with core principles of local governments in other states of Europe. It is important to admit that in the case of Estonia, the foundations of LOG and administrative arrangement do not differ substantially from the principles of the "European Charter of Local Self-Government" (CE). However, there are differences in how these principles are actually implemented. The legal acts regulating the affairs of local government are unsystematic, sometimes even contradictory, and often declarative. (Mäeltsemees 1994) The state refers obligations to local authorities that are not covered by the necessary finances. (Mäeltsemees 1994) It is unbelievable, but the situation has so far not much changed over fifteen years.

After the adoption of the Local Government Organisation Act on 02.06.1993 (RT I 1993, 37, 558) the Estonia does have a one-level LOG system. There are no representative bodies elected by residents at the regional level and county governments were given the status of state authorities. The internal organisation is based on two major institutions: a council and a government. (RT I 2006, 32, 244) The main task of a council is to adopt decisions regarding important aspects of local life, administer the development of the LOG, exercise control over the activities of the LOG, and adopt the budget of the rural municipality or the town. A government, on the other hand, is mainly responsible for performing day-to-day tasks. (RT I 2006, 32, 244)

Estonia's local governments are characterised by small population (in 70% of the local governments the number of residents is

up to 5,000) and low population density (the average population density 12 people per square kilometre). (Suur 2006) The average surface area of local governments is 180 km<sup>2</sup>. (Suur 2006) 90% of Estonia's local governments are extremely small for finding and maintaining well-qualified accountants, information technologists, lawyers, and other specialists. (Oviir 2006)

The volume of local governments' consolidated assets amounted to 42 billion kroons, liabilities to 8 billion kroons, and net assets to 34 billion kroons as at the end of the year 2005. The total consolidated net gain constituted 1 billion kroons (2005). (Sõerd 2006) The average budget size is 15 million Estonian kroons (1 EUR = 15,6 EEK). (Suur 2006) A major share of income of the Estonia's LOG sector is formed by the income tax paid by resident natural persons. Local governments are allowed to impose local taxes. Local taxes are sales tax, boat tax, advertisement tax, road and street closure tax, motor vehicle tax, animal tax, entertainment tax, parking charge, (RT I 2004, 45, 319) but such taxes are with minor importance of the revenue. In general, local taxes are not relevant sources of income for LOG units. A national regional policy is still lacking, and the central government bodies pay too little attention to rural problems. (Mäeltsemees 1994) From year to year, more tasks and functions are enjoined on local governments, but there has never been enough money to fulfil them. (Pelisaar 2004) Without any further comments, it is clear that in a situation where the number of tasks is growing but the funds needed to perform those tasks are decreasing, the role of the ACSS is becoming increasingly more important, whereas less and less attention is being paid to it. (Johanson 2002, 2004) The State Audit Office (hereinafter referred to as SAO) has clearly pointed out one of the reasons behind the problems, stating that "*Smaller local governments are facing the difficulty of being unable to guarantee the required level of administrative functions due to their small budget.*" (Oviir 2006, 8)<sup>2</sup> Thus, the Estonian LOG sector depends to a great extent on political decisions of each budgetary year

of the sitting Parliament and the State Government. Getting a yearly revenue support grant from the state has been like a bad bargain for local authorities, although the grant should be clearly defined as a definite percentage of the state budget for a certain period. (Mäeltsemees 1994) So far there are neither further researches made into this subject, nor appropriate solutions offered. The problem might be that, even if possible solution has been sought, that has been done in a wrong paradigm.

During the time of writing this article, but also earlier, the people of Estonia (citizens, taxpayers) are lacking legitimate possibilities to control the activities of the politicians they have elected and of the officials appointed by those politicians, and they have no considerable influence on the decisions adopted by the latter.<sup>3</sup> Why? First of all, politicians stop being controlled by people immediately after elections, as coalition governments appoint members of controlling bodies only from among politically and professionally loyal persons; those performing supervisory functions are more often under the influence of the political forces forming the coalition, and the persons being subject to audit (i.e., politicians, officials) are often those commissioning the audit. Second of all, on the state level, the political leaders belonging to the government coalition channel the execution of power into a coalition council, which is not provided by the constitution. (KL 2005) The coalition council issues political guidelines to both the legislative power the Riigikogu and

<sup>2</sup> As one of the possible approaches to alleviate the problem, the author supports a suggestion made by the SAO, according to which "the Ministry of Finance should support those local governments wishing to centralise their accounting, change their accounting programmes, and reorganise their accounting by providing them with knowledge, instructions, and ready-made solutions. County governments could serve as centres ready to offer accounting and reporting services to smaller local governments." The field of accounting and reporting is a very significant, but still a small sphere in promoting the administrative capacity of the entire public administration, achieving meaningful activities, and ensuring the welfare of members of the society. The question is what is the most optimal way to do this?

<sup>3</sup> See also Kekic 2006



the executive power the Government of the Republic. This means the leadership of the state is in the hands of few people who provide guidelines to the legislative power and the executive power as well and the legislative body does not have possibility to perform political control over the executive body. This means the role of the majority of members of the Riigikogu is mostly to follow orders.

Hopefully reader is now more able to grasp the subject of this article, to comprehend the ideas of the author and to shape their opinions and conclusions on the topic.

## 2. An Overview and Critics of the Present model of the ACS of LOG in the Estonia

A superficial examination may give one the impression that the ACS of LOG units in the Estonia is of sufficient coverage, well-functioning, and ensures the prevention or management of essential risks. ACS performance from the state level is done by different constitutional and governmental institutes. The Chancellor of Justice (RT I 2005, 31, 230; RT I 2006, 7, 42) and county governors (RT I 2005, 31, 230; RT I 2006, 14, 111) exercise supervision over LOG. The Minister of Regional Affairs and the Ministry of Internal Affairs (RT I 2006, 14, 111) exercise supervision over certain aspects of the activities of LOG. Partial economic control is performed by the SAO (RT I 2005, 32, 235). Projects funded from the financing sources of the European Union are audited by an authorised auditor appointed by an authorised body of the European Union, (RT I 2006, 7, 42) but also by the SAO, (RT I 2005, 32, 235, RT I 2006, 25, 190) the Ministry of Finance (RT I 2006, 7, 42; RT I 2006, 25, 190) and the Ministry of Internal Affairs (RT I 2006, 25, 190). The State Archivist executes archival supervision. (RT I 2004, 28, 188) The foundation Environmental Investment Centre is responsible for controlling the expedient use of the funds channelled to local governments via environmental investment projects that are financed by the money gained from the usage

of environment. (RT I 2005, 67, 512) As a functional transfer or arising from law, independent legitimacy, regularity, compliance, performance or financial audit is conducted by a private auditor. (RT I 2003, 88, 588; RT I 2005, 61, 478)

Political control over local governments is performed by local government authorities via the audit committee of a rural municipality or city council. (RT I 2005, 31, 230). The audit committee of LOG monitors the conformity of the activities of a rural municipality or city government with the council's regulations and resolutions; the accuracy of accounting of rural municipality or city administrative agencies and agencies under the administration of a rural municipality or city administrative agencies, and the purposeful use of rural municipality or city funds; the timely collection and registering of revenue and the conformity of expenditure with the budget of a rural municipality or city; the performance of contracts concluded by a rural municipality or city; the lawfulness and purposefulness of the activities of the rural municipality or city government and the agencies thereof. (*Ibid*) In the capital city Tallinn, internal audit of administrative agencies is performed by the city's internal audit unit – the internal audit service. In the institutions administered by the administrative agencies of the city, internal audit is organised by the respective institution. For that purpose, the head of each institution appoints a respective person to do it or forms a structural unit therefore, if necessary. (RT I 2005, 61, 478) The list of auditing, controlling, supervising and assessing authorities is long, but not exhaustive in this article. At this point, is not difficult to imagine a depressing picture of an endless army of auditors, controllers, supervisors and assessors pestering "poor" LOG units. The notional picture can be easily elaborated into an image of pointless red tape, overregulation and excessive control. This is true in some aspects, on certain fields of activity of the LOG and at the very particular moment. However, the question is whether that virtual picture is factual situation as well in Estonia?



Let us treat the legal facts presented above as one pole of the whole (it is not important at the moment whether it is the negative or positive one) and the following real-life facts as the other pole. Supervision by the Chancellor of Justice (hereinafter the CJ) is restricted to reviewing legislation of general application of local governments for conformity with the Constitution of the Republic of Estonia (hereinafter the Constitution) and the Acts of the Republic of Estonia. The CJ verifies whether agencies under supervision adhere to the principles of observance of the fundamental rights and freedoms and principles of sound administration but also the application of the principles of equality and equal treatment. (RT I 2006, 7, 42) Supervision done by the CJ is often based on a single complaint, although the CJ does perform also independent systemic risk-based supervision. Supervision by the county governor over the local government is only supervision over the legitimacy of individual acts adopted by the councils and governments of the local government units of the given county, and, in the cases and to the extent provided by law, also over the legitimacy, purposefulness (RT I 2004, 89, 605) and expediency (RT I 2006, 14, 111) of using the state assets in use by local government units, but not over the expediency, efficiency and effectiveness of activities and financing. The actual administrative capacity of the county governor in supervising the lawfulness of local government activities is often unsystematic, eclectic and insufficient. County governor may also be not objective and politically biased, as the posts of county governors are being allocated according to political affiliation or other political reasons and one's competence has become of secondary importance. The SAO may assess the legitimacy of internal control, financial management, financial accounting and financial statements audited; the legitimacy of economic activities, including economic transactions and the reliability of information technology systems, but not the efficiency of management, organisation and operations. (RT I 2005, 32, 235) Also the SAO's resources for performing audits of LOG units are very limited and audits

performed by the SAO are risk-based. That means the auditing of a LOG unit or an activity or issue of a LOG unit takes place once in 3 to 5 years. In its essence, the audits performed by the SAO are rather superficial. They do not go very deep into problems and reasons behind these problems. The Ministry of Finance exercises supervision, audits, controls and reviews foreign aid related funds and those allocated for specific purposes and the purposeful and lawful usage of the assistance granted, (RT I 2006, 7, 42) but its capability in performing those tasks is restricted due to limited resources. (Metsalu 2006, 3) The purchased-sold audit services in the form of outsourcing are affected concerning their temporal and content-related scope and the main issues treated, and largely dependent on the customer of the services as regards the expected result. The sole competence of a LOG unit council includes the appointment of auditors (RT I 2005, 31, 230) and establishment and termination of activities of council commissions, including the internal audit committee, election of chairmen and deputy chairmen for these commissions among council members and approval of membership of the commissions. (*Ibid*) Situations, where a council does consist of representatives of only one political party or interest group, whose fellow party men or interest group members are members of city or rural municipality council, are not rare. In general, the activities of the internal audit commission of a LOG unit's council in reviewing the operation of local government authorities and institutions administered by them are, in a way, in both objective and subjective situation of a conflict of interests, as internal audit committees are usually appointed by the political powers in office. (Metsalu 2006, 2) Even more, an internal audit service, even if any does exist, of LOG is in both objective and subjective situation of a conflict of interests, as their activities are directly steered by the will of the political powers in office via a local council or government. These facts are only minor facts in number, but very essential and expressive facts in matter. Thus, auditing, controlling and supervising authorities do not

cover all substantial spheres, activities, regions and LOG units with the same intensity, scope and regularity. One can conclude that activities of the ACS authorities are not systematic, but rather performed fragmentary and by mosaic way; proportions between audit, control and supervision activities could be not optimal and overall is existing real risk that some fields, activities and/or LOG units are under excessive "sight" of state, some of them entirely out of "sight".

In the context of social sciences, state theory and public management primary issues are not inputs, subjects, processes, systems and outputs, but first of all outcomes and impacts. At the level of outcome and impact one can recognise that internal control over LOG units is weak; (Kõrge 2006, 18) control systems and internal control systems are ineffective or inefficient; (Metsalu 2006, 2; Kõrge 2006, 20,21) smaller local government units lack functioning internal control systems; (Oviir 2006, 46) the extensive backwardness of accounting compared to the public sector units (ministries, larger local governments, etc) and insufficient level of accounting in those units; (*Ibid*, 8) in several cases, the internal audit committee had failed to perform the objectives provided by law and its role was mainly formal; (*Ibid*, 46) LOG funds received are not used for specific purposes; (*Ibid*, 25) the current LOG control systems do not make sure that only those receive subsistence benefits who are really destitute; (*Ibid*, 42) audited local governments were lacking a comprehensive overview of their assets and value thereof; budgetary funds were used not only for designated purposes and when needs changed, the budget was not accordingly upgraded. (*Ibid*, 47) The SAO does co-operate with the Government of the Republic in order to improve the internal control system and internal audit function of government authorities and state authorities administered by government authorities, but the Government of the Republic has no solutions for preventing local governments from encountering solvency problems, for dealing with such local governments that have already encountered financial difficulties, and for organising

financial supervision over the financial situation of local governments. (Metsalu 2006, 3) This list is not exhaustive.

When treating the two poles mentioned earlier as a whole, it can be concluded that legal framework gives an authority and responsibility for guard, control, assess and audit the operations of LOG for number of institutions, but audit, control and supervision activities of the legitimacy, efficiency, and effectiveness of the operation of LOG units are unsystematic, insufficient, politically biased, often in an objective situation of conflict of interests and do not form an integral and coherent system. Taking into account before described facts, one can conclude, that the result of combination of those two aspects does give to us unwelcome and inadmissible situation for modern society and public administration. Furthermore, one has to conclude that the ACSS of LOG is not functioning according to the justified expectations of modern society and public administration. This conclusion leads one inevitably to more general conclusion, that present model of ACSS of LOG in the Estonia has to be substantially improved, even if all relevant and obligatory component parts [audit (external and internal), control (external and internal) and supervision (external and internal)] of an integral ACSS are at present in whatever form and extent at the moment as well.

### **3. General Philosophical Basis and the Principles Underlying the Research of the ACSS of LOG and the Development of Functional Solutions**

#### **3.1 General Philosophical Basis for Further Treatment of the Theme**

In order to not go too much into detail and disperse the interest and attention of the reader, this article is confined to examine, create and formulate the principles underlying a model of the ACSS of LOG. The author will treat the topic of optimal model of the ACSS of LOG more narrowly and thoroughly in his



subsequent article, because the matter is very complex and complicated.

Getting started in proper manner is important to adjust ones apparatus of mind and build up a relevant philosophical basis for further treatment of theme on the ACSS of LOG. An enthusiastic researcher might try to describe the object of study in a comprehensive, exhaustive and clearly determined way within the framework of the research. However, it is disputable, whether a finite, uniform and comprehensive clarification and description of the object of the study (ACSS of LOG) is a task practically possible to fulfil or not. There are at least six, but not only six, main reasons as follows to ask a question like that. 1. The object of a study is a complex and complicated system (system approach) consisting of many conceptually different research objects (LOG, ACSS, audit, control, supervision, interconnections between LOG and ACSS, interconnections between subsystems and elements, impacts of particular environment etc).<sup>4</sup> 2. The ACSS of LOG as a whole and each separate LOG unit is an open system interacting with larger systems, which, in turn, are open systems as well. A state-wide ACSS of LOG should be treated as a whole, and an ACSS of each municipality has to be treated as a whole as well (holistic approach). State-wide ACSS and ACSS of LOG units do form a single integral system in day-to-day life and due that have to form one integral system in the apparatus of mind of researcher as well. Thus, when one does try to find scientifically justified and theoretically correct solutions, it is especially important to make sure that LOG sector as a whole and each municipality separately are treated not as an isolated and rigid system that is always in bal-

ance, regardless of time, but on a philosophical basis, proceeding from the paradigm of self-organisation. (Näpinen 1994, 179) 3. Audit (including internal audit), control (including internal control) and supervision (internal and external supervision) are interconnected in a complex, non-linear manner, which is either difficult to determine or, in some cases, even indeterminable (Näpinen 2002, 130, 131) and that is why it used to be and still is not very easy to conduct the research and offer simple solution. (Randma, Annus 2000, 136). The ACSS of LOG is consisting subsystems and elements that are at the same time a part of the system as a subject and an object. For example, internal audit is a subsystem of the ACSS and an element of internal control system, but also an influencer of the internal control system and subject for the external and internal supervision as well.<sup>5</sup> The object of the study is constantly changing in time and in space, because the object of study is in inevitable way linked with society and processes acting in society.<sup>5</sup> The local government sector and each municipality as an organisation are inherently part of the human society in direct meaning and with all the naturally arising consequences. LOG system of each particular country is substantially different from LOG system of any other country and different municipalities of the same LOG system do have very various characters. Because of that, it is impossible to offer uniform solutions covering the entire local government sector as one universal object. Each LOG system is in very particular domestic environment. For example, compared to European and other world states being in the forefront of public administration (e.g., Australia, Canada, Denmark, Netherlands, New Zealand, UK, USA), Estonian politicians and officials acting in the municipal sector, as well as their electors, are, in

<sup>4</sup> Only two of them themselves, in turn, do comprise complex subsystems and components. Subsystems do comprise more subsystems and elements as well. A fixed, uniform and permanent description and comprehension of the system as a whole or of its subsystems and components is destined to be a failure, as the two main parts (LOG and the ACSS of the LOG) of the object of study are defined, treated and comprehended differently in various parts of the world, as well as in different international organisations, various legal systems and by different scientists and experts.

<sup>5</sup> According to Näpinen, the society is an unpredictable self-organizing organism, and "The self-organisation processes in society are not among those processes that are planned ahead and subject to set objectives, but among those that come into being unexpectedly and notwithstanding of the conscious activities of people." (Näpinen 1994, 179)

actual behaviour, still rather oblivious of such concepts and activities as European good governance, (EC 2001) modern management, (Roots 2003) audit, control (including internal control) and supervision, which is why the subjects mentioned are often rather novel and alien. So, what is evidently suitable for leading countries on public administration, this is not by default suitable for the Estonia. Arising from Estonia's political, legal, historical and cultural peculiarities, the impact of the public, primarily of the voters, on the political elite is almost negligible between elections. This is why one has to keep in mind that control performed by voters and other public subjects over the administrators of LOG units is much feebler than in many other countries.<sup>6</sup> Democracy in Estonia is still very young, entailing both risks and benefits arising therefrom. (Kallas 2006, 18; Sutrop 2005) Thus, the ACSS of a LOG belongs to the context of social phenomena. Deriving therefrom, it is necessary to study and treat LOG and the ACSS of LOG from a human-centred point of view and that without exceptions. The main difficulty and inaccuracy in examining, analysing and searching for the scientific meaning of the ACSS of LOG, but also in devising solutions functional in real life, has been the fact that LOG and ACSS of LOG are examined without taking into consideration the most important factor influencing those objects – the human being. From a scientific viewpoint, such approach would be understandable and acceptable, if the field of study belonged to the area of exact sciences based on mathematics. (Näpinen 2002, 117, 118) However, in scientific, vocational, professional, and special literature, LOG units and the ACSS of LOG units are dominantly treated as mechanical systems that people may study, analyse, construct, actuate and bring to a halt, but where the human being is not con-

sidered as their inseparable, inherent component. Using the paradigm of mathematics-based sciences (exact sciences) is, of course, possible and necessary, but the question is whether such approach is the only possible direction, considering that the aim of our research does not lie in finding a solution to an abstract theoretical problem. But not only that – LOG and the ACSS of LOG do need to be looked at as an organism, rather than a mechanism.

Based on previously described arguments and ideas, one has only way to conclude, that does not exist possibility to offer uniform, standard solution fitting to the LOG sectors of every state and to LOG sector as a whole as well, because: 1. LOG sectors in different political, legal, historical, cultural and economical environment are very different; 2. Different models of ACSS of LOG do apply to different political, legal, historical, cultural and economical environments; 3. Different models of ACSS of LOG do apply to huge, big, middle-sized, small and tiny municipalities. Regardless of that, the philosophical platform for designing of an optimal model of the ACSS of LOG has to be uniform and in proper paradigm.

### 3.2 Foundational Principles for Develop of an Optimal Model of the ACSS of Local Government

Contents of the entire topic, including each of its components (LOG, audit, control, supervision) are commonly and clearly indefinable (Joamets 2003), as it is a phenomenon that keeps changing with time and exists in an open environment. That is why it would be conceited to imagine one would be able to describe the object of research fully, completely and invariably in time, to identify the factors behind the problem and to provide absolute scientific solutions and suggestions to affect the factors causing the problem. To minimize or decrease a level of risk of complete failure in attempt to design an optimal model of the ACSS of LOG one has to keep in mind that the minimum general precondition for success is to deal with the subject

<sup>6</sup> Günter Schmidt emphasises: "...Administrative culture in the meaning of enhancing administrative output has to be kept under permanent control, and the best way of controlling is be done by the citizen (or the client). Therefore the law-maker should try to set up regulations which provide a claim for the citizen." (Schmidt 2003, 21)

resting on two feet or two pillars: 1. on the philosophical platform, LOG and the ACSS of LOG need to be dealt with as an organism the central factor of which is the human being with his attitudes, convictions, values and demeanour, flaws and virtues; (self-organisation paradigm) and 2. using also the set of tools of the paradigms of mathematics-based sciences provided that it is applicable to social sciences and that the approach is not confined to only mathematics-based paradigms. Here it has to be emphasised that both feet are vital and they have to be of the same length, size and carrying capacity. Consequently, the paradigm commonly used in the research and scientific treatment of the ACSS of LOG units needs to be changed.

Taking into account all relevant arguments said above and by summarising everything claimed in previous chapters, the foundational principles underlying the research and functional, viable solutions of the ACSS of LOG can be formulated as follows:

1. LOG and the ACSS of LOG have to be treated rather as a living organism, not a mechanical system, the central factor (influencer, organiser), but not the only and major factor, of which is the human being with his attitudes, convictions, values and demeanour, flaws and virtues. Thus, change of the head of municipality administration or the only internal auditor in particular municipality will cause a major change in behaviour and functioning of the ACSS of this very particular municipality. Than smaller the LOG unit is, than bigger a change in behaviour and function of the ACSS is.
2. It is not possible to offer uniform and standard solution fitting to the LOG sectors of every state and to LOG sector as a whole as well, but different ACSS models apply to large, big, middle-sized, small and tiny LOG units. (Uniqueness principle)
3. The contents of the general field of the subject under examination as a whole (LOG basics and administrative arrangement) as well as its different constituents taken separately (audit, control, supervision) are univocally and clearly indefinable, constantly changing with time and located in an open environment. Thus, one has to accept fatally that optimal solution is changing in the time and a probability of failure in this particular attempt is nothing unlikely.
4. The audit, control and supervision of LOG units (organs, constituents) form a uniform cohesive whole (holistic approach) and are in constant interaction, which is why it is impossible to refer to a permanent equilibrium when speaking about the ACSS, although the balance of the organism (ACSS) as a whole and fixed proportions of its organs-constituents (audit, control, supervision) may be the desired result.
5. When examining the ACSS of LOG and trying to develop best solution, both the narrower (general governance environment of a LOG unit, general environment of the specific region, the Republic of Estonia) and wider (the European Union) political, economic, legal, cultural and historical context of the environment has to be known and taken into consideration.
6. When examining the ACSS of LOG and trying to develop best solution, it is necessary to know and take into account the rate of democracy and autocracy, as well as that of liberalism and totalitarianism in the society the ACSS of which is examined and a new, more appropriate system will be developed.

These six principles should form the minimum philosophical basis for designing and performing scientific research of the ACSS of LOG and for developing of solution that is scientifically justified, as well as appropriate and functional in real life. These are the principles the author is going to rely on in his subsequent research and analysis. The author is ready to acknowledge that results of practical application of theoretical solution are not fully predictable or controllable and they can not be ensured either by the author or any follower of his ideas. One of the reasons therefore is that no system of the society is perfect, close to the ideal, free from defects and

fully operational at any point in time. A system as a whole cannot be a hundred per cent reliable when even just one of its sub-systems is not dependable. It is impossible to disregard the recognition by COSO:

“An internal control system, no matter how well conceived and operated, can provide only reasonable – not absolute – assurance to management and the board regarding achievement of an entity’s objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management has the ability to override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.” (COSO 2001)

### Conclusions and Closing Remarks

The objective of the present article is to introduce the issue, calling the readers’ attention and thoughts to the significant aspects of the wider context, general philosophical basis and foundational principles for develop of an optimal model of the ACSS of LOG. Does exist a slight hope that the current article is of help for scientists researching the subject of the ACSS of LOG and for policy analysts, politicians and officials in understanding the foundational problems of the ACSS of LOG and LOG units on a wider scale and in directing their thoughts to even more thorough examination, fruitful reflections, and further actions in solving the tasks facing the society. The author is hoping that this particular article does give an adequate and appropriate description of the current model of local governments’ audit, control and supervision

model of the Republic of Estonia and proposed by him six foundational principles for developing an optimal model of an audit, control and supervision system of local government are worthy to discuss and suitable for implementing not only for the Estonia. Author is of concluding opinion that does exist a possibility to design, arrange and maintain theoretically well founded and practically reasonably functioning integral and coherent audit, control and supervision system, but does not exist possibility to offer uniform, standard solution fitting to the municipal sector in general, because different models do apply to huge, big, middle-sized, small and tiny municipalities. Although this article is based on the context of the Estonia, the subject thereof should offer sufficient ground for analogy and comparison with smaller societies in the similar development stage. The author estimates the subject to be scientifically topical, especially in the context of state sciences, in the world, in the European Union and in the Estonia. However, the topic is definitely important in Estonia, as the Republic of Estonia is in the sphere of influence and, simultaneously, the influencer of three interactive processes: 1. integration with the European Union; 2. finding the model functional in the field of audit, control and supervision in the European Union, including local governments; 3. formation of the situation following the expansion of authority of the SAO. In a situation where three very important processes interlocking with the subject have started, it is essential that the following could be done at a very early stage: 1. An integral overview is obtained of the legal-political and institutional situation in the field of the ACSS of LOG; 2. The main problems of the ACSS of LOG are systemically identified; 3. the most appropriate theoretical model of the ACS of LOG is devised for the Estonia to ensure the coverage of all fields and aspects but exclude any unjustified duplication of institutional activities by functions; 4. Based on the devised model, requirements and recommendations together with a schedule (position) are devised in order to protect the interests of the Republic of Estonia in the European Union,

especially in developing the model of audit, control and supervision system for the local government; 5. The politicians, diplomats and officials representing the interests of Estonia in the European Union are consulted and provided with necessary relevant information about issues of the ACSS of LOG. However, it is obvious that the Estonian society will benefit therefrom only when politicians and officials both on state and LOG level do consider the problem worthy to be solved and commit themselves truly, not seemingly, as it has often been and still is the case.

Author is going to propose in nearest future a vision of an optimal model of the ACS of LOG, based on general philosophical basis and foundational principles described in this paper. Author is of strong opinion that optimal model of the ACS of LOG is great instrument to help politicians and LOG administrators in creating more and higher-quality public benefits for LOG residents. According to the estimate of the SAO 70% of public services to people are provided by local governments, (Oviir 2006, 29) but actually there are no scientifically collected data available regarding the share of LOG in the volume of public services rendered to the public by the state. However, the local government is inherently much closer and more important to the people than the state, which is why it is essential that the ACSS of LOG is appropriate and functional.

## References

### Articles in sets of articles and journals

1. **Johanson, Toomas.** Juhtimiskontrolli perspektiivid Eesti kohaliku omavalitsusüksuse juhtimismudelil. – Halduskultuur 2003, Tallinn: Tallinna Tehnikaülikooli humanitaar- ja sotsiaalteaduste instituut, 2004, 74–80.
2. **Johanson, Toomas.** Kohaliku omavalitsuse kontrollikeskkond. Halduskultuur 2001. Tallinn: Tallinna Tehnikaülikooli humanitaar- ja sotsiaalteaduste instituut, 2002, 60–66.
3. **Näpinen, Leo.** Exact Sciences and the Problem of Intergral Understanding of the Social Reality. Problemos 2004. Vilnius: Vilniaus universitetas, 2004, 1–10.
4. **Näpinen, Leo.** Ilya Prigogine's program for the remaking of traditional physics and the resulting conclusions for understanding social problems. TRAMES nr 2 vol 6(56/51). Tallinn: Estonian Academy of Sciences and Tartu University, 2002, 115–140.
5. **Näpinen, Leo.** Iseorganiseerumismõtlemine, selle omandamise vajadus Eesti ühiskonnas. Teaduslugu ja Nüüdisaeg IX: Teadusfilosoofia ja teadusmetodoloogia Eestis: Olukord ja perspektiivid. Tallinn: Teaduste Akadeemia Kirjastus, 1994, 158–180.
6. **Schmidt, Günter.** Some preliminary thoughts on how legislation can provide rules to enhance culture of public administration and what organizations can do to implement standards. Halduskultuur 2003. Tallinn: Tallinna Tehnikaülikooli humanitaar- ja sotsiaalteaduste instituut, 2004, 14–22.

### Articles in magazines and newspapers

1. **Kallas, Siim.** Verduni Palve. Postimees 2006, nr. 242(4817), 18.

### Electronical sources

1. **Council of Europe. (CE)** European Charter of Local Self-Government. Available: [WWW]http://conventions.coe.int/Treaty/EN/Treaties/Html/122.htm, 29. 10. 2006.
2. **Eesti Reformierakonna, Eesti Keskerakonna ja Eestimaa Rahvaliidu koalitsioonilepe: (KL)** Koalitsioonileppe lisa 1: Valitsusliidu juhtimine. 12.04.2005. Available: [WWW]http://www.keskerakond.ee/index.php?main=136, 02. 11. 2006.
3. **European Commission. (EC)** White Paper. European Governance. Available:

- [WWW] [http://europa.eu.int/eur-lex/en/com/cnc/2001/com2001\\_0428en01.pdf](http://europa.eu.int/eur-lex/en/com/cnc/2001/com2001_0428en01.pdf)
4. **Joamets, Kristi.** Riiklik järelevalve vajab suuremat tähelepanu. Riigikogu toimetised nr. 8/2003. Available: [WWW] <http://www.riigikogu.ee/rva/toimetised/rito8/artiklid/24joamets.htm>, 15. 10. 2006.
  5. **Kekic, Laza.** The Economist Intelligence Unit's index of democracy. Available: [WWW] [http://www.economist.com/media/pdf/DEMOCRACY\\_INDEX\\_2007\\_v3.pdf](http://www.economist.com/media/pdf/DEMOCRACY_INDEX_2007_v3.pdf), 23.11.2006.
  6. **Kõrge, Jüri.** Riigieelarvest omavalitsustele toimetulekutoetusteks antud raha kasutamine: nr. OSIII-2-6/06/17. Available: [WWW] [http://www.riigikontroll.ee/fake\\_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669](http://www.riigikontroll.ee/fake_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669), 15. 10. 2006.
  7. **Metsalu, Ines.** Euroopa Komisjoni abiprojekt HACSO Sonda vallas: nr. OSI-2-6/06/39, Available: [WWW] [http://www.riigikontroll.ee/fake\\_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669](http://www.riigikontroll.ee/fake_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669), 15. 10. 2006.
  8. **Mäeltsemees, Sulev.** Estonia 1994. Available: [WWW] <http://unpan1.un.org/int-radoc/groups/public/documents/UNTC/UNPAN003969.htm>, 15. 10. 2006.
  9. **Oviir, Mihkel.** Ettekanne Riigikogus teemal „Ülevaade riigi vara kasutamise ja säilimise kohta 2005. aastal. 08.11.2006. Riigikogu X koosseisu VIII istungjärgu stenogramm. Available: [WWW] <http://web.riigikogu.ee/ems/stenograms/2006/11/m06110807.html>, 09. 11. 2006.
  10. **Pelisaar, Georg.** Eesti edu vundament võib vankuma hakata. Riigikogu Toimetised nr. 10/2004. Available: [WWW] <http://www.riigikogu.ee/rva/toimetised/rito10/artiklid/08pelisaar.htm>, 15. 10. 2006.
  11. **Randma, T., Annus, T.** Haldusreformi mündid. lk 136, lk 135–144, Riigikogu Toimetised nr. 2/2000. Available: [WWW] <http://www.riigikogu.ee/rva/toimetised/rito2/artiklid/21randmaannus.htm>, 15. oktoober 2006.
  12. **Roots, Harry.** Organisatsioonikultuur ja juhtimisstiil. Riigikogu toimetised nr. 8/2003. Available: [WWW] <http://www.riigikogu.ee/rva/toimetised/rito8/artiklid/22roots.htm>, 15. 10. 2006.
  13. **Sõerd, Aivar.** Riigi 2005. aasta majandusaasta koondaruande kinnitamine. 08.11.2006. Riigikogu X koosseisu VIII istungjärgu stenogramm. Available: [WWW] <http://web.riigikogu.ee/ems/stenograms/2006/11/m06110807.html>, 09. 11. 2006.
  14. **Sutrop, Margit.** Kas Eesti jagab Euroopa väärtusi? Riigikogu Toimetised nr. 11/2005. Available: [WWW] <http://www.riigikogu.ee/rva/toimetised/rito11/artiklid/02sutrop.htm>, 16. 10. 2006.
  15. **Suur, Neeme.** Kohalike omavalitsuste koostis Eestis. Ettekanne Helsingi konverentsil: Kohalike omavalitsuste roll naftalekete vastu võitlemisel Balti merel. Available: [WWW] <http://www.ell.ee/4267>, 16. 10. 2006.
  16. **The Committee of Sponsoring Organizations of the Treadway Commission (COSO).** Enterprise Risk Management – Integrated Framework. Available: [WWW] [http://www.coso.org/Publications/ERM/COSO\\_ERM\\_ExecutiveSummary.pdf](http://www.coso.org/Publications/ERM/COSO_ERM_ExecutiveSummary.pdf), 02. 11. 2006.
  17. **The Committee of Sponsoring Organizations of the Treadway Commission (COSO).** Internal Control — Integrated Framework. 2001. Available: [WWW] [http://www.coso.org/publications/executive\\_summary\\_integrated\\_framework.htm](http://www.coso.org/publications/executive_summary_integrated_framework.htm), 02. 11. 2006.
  18. **The IIA.** Available: [WWW] [http://www.theiaa.org/index.cfm?doc\\_id=269](http://www.theiaa.org/index.cfm?doc_id=269), 16. 10. 2006.
  19. **Oviir, Mihkel.** Ülevaade riigi vara kasutamise ja säilimise kohta 2005. aastal.



Available: [WWW][http://www.riigikontroll.ee/fake\\_index.php?lang=et&uri=%2Farvamus.php%3Fdokument%3D68](http://www.riigikontroll.ee/fake_index.php?lang=et&uri=%2Farvamus.php%3Fdokument%3D68), 29.10. 2006.

**Laws and regulations**

1. Arhiiviseadus. (Archives Act) (RT I 2004, 28, 188)
2. Eesti Vabariigi Põhiseadus. (The Constitution of the Republic of Estonia) (RT I 2006, 14, 111)
3. Euroopa kohaliku omavalitsuse harta ratifitseerimise seadus. (European Charter of Local Self-Government Ratification Act) (RT II, 01.01.1994, 95)
4. Halduskoostöö seadus. (Administrative Co-operation Act) (RT I 2006, 59, 440)
5. Keskkonnatasude seadus. (Environmental Fees Act) (RT I 2005, 67, 512)
6. Kohalike maksude seadus. (Local Taxes Act) (RT I 2004, 45, 319)
7. Kohaliku omavalitsuse korralduse seadus. (Local Government Organisation Act) (RT I 2006, 32, 244)
8. Õiguskantsleri seadus. (Legal Chancellor Act) (RT I 2006, 7, 42)
9. Raamatupidamise seadus. (Accounting Act) (RT I 2005, 61, 478)
10. Riigikontrolli seadus. (State Audit Office Act) (RT I 2005, 32, 235)
11. Sotsiaalhoolekande seadus. (Social Welfare Act) (RT I 2004, 89, 605)
12. Struktuuritoetuse seadus. (Structural Assistance Act) (RT I 2006, 7, 42)
13. Tallinna põhimäärus. (Statutes of Tallinn) (RT I 2005, 61, 478)
14. Tulumaksuseadus. (Income Tax Act) (RT I 2006, 63, 468)
15. Valla- ja linnaelarve seadus. (Rural Municipality and City Budgets Act) (RT I 2003, 88, 588)
16. Vabariigi Valitsuse seadus. (Government of the Republic Act) (RT I 2006, 14, 111)
17. Välisabi taotlemise kord. (Procedure for Applying for Foreign Aid) (RT I 2006, 25, 190)

# Audit in Small Local Government Units: The Case of Estonia

Raivo Linnas

## Abstract

The author of this paper considers the issue of audit, particularly internal audit, in small local government units. The author argues that an internal audit functioning in a small local government unit without optimal integration into a coherent integral system of audit, control and supervision does not have the relevant possibilities of fulfilling all of its expected responsibilities and helping local political decision makers and managers to achieve their set goals, objectives and targets in a timely manner as well as meeting the expectations of its citizens. The author argues that there is little to no place at all for internal audit in tiny local government units because of the limited nature of their resources. The additional drain on the limited financial and human resources of a region will decrease the administrative capacity of its local government units and by this means operates as a negative, not a positive factor in serving local inhabitants. This is not only the case of Estonia and states in transformation, but more generic phenomenon. Academic literature does confirm that situation of LGU-s does not depend only on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country.

**Key words:** Audit, Internal Audit, Governance, Local Government, Estonia.

## Aim and Content of the Article

The author of this paper considers the issue of audit, particularly internal audit, in small local government units. This is an interesting and complex object of research because the audit profession has been challenged as never before during the past few years. Accounting standards are biased, financial reporting is too complex and financial reporting is evolving to another level not only in the USA and European Union but throughout the world. In addition, general management, particularly core business-line management fields, are more and more supported by services 'in the rear' or 'secondary' functions like internal audit, quality assurance, compliance assurance, risk management, and/or prevention of conflict of interest functions that can cause confusion in management, a lack of clarity, and duplication in areas of responsibility as

well as an increase in management and administrative costs. Furthermore, the fields of responsibility of CEO-s, CFO-s, risk managers, auditors, quality assessors and compliance officers are changing and getting more complex, and the self-governments of municipalities and societies where local government units exist are in the process of permanent change.

The aim of this article is to present analytical overview of the state of the local government sector and audit of local government sector in Estonia, discuss and present some options for the future development of external and internal audit in small LGUs like Estonia and discuss strengths and weaknesses of options offered by the author. The author does hope that this article will help politicians, public servants and researchers find optimal solutions for improvement of audit effectiveness in local government sector.



This article consists of chapters: Method, Options for the Future Development of External and Internal Audit in Small LGUs, the State of the Local Government Sector in Estonia, Audit and Local Government in Estonia, What Are the Strengths and Weaknesses of the Abovementioned Options for Estonia and Conclusions.

## Method

Audit in local government unit is to be treated as interdisciplinary object of research and due that ideas those of the author are based on different theories. Mainly on Systems Theory, Organizational Theory, Theory of Complex Self-organizing Systems, Self-government Theory, Functionalist theories and Theory of the State. The author performed research based on the qualitative approach to methodology and used qualitative methods of collecting, processing and interpreting data. The author performed a structural search of the relevant theoretical publications and other sources of information and data (such as laws and other legal norms, standards, official documents, verbatim reports of constitutional institutions, academic dissertations, websites of international organizations, public journals and newspapers), and validated, analysed and synthesised the information collected. The sources of information the author used were qualitatively analyzed for semantics and content.

## Options for the Future Development of External and Internal Audit in Small LGUs

The Audit Commission defines corporate governance as *"the framework of accountability to users, stakeholders and the wider community, within which organisations take decisions, and lead and control their functions, to achieve their objectives."* (AC 2003, 4) **Thus, external audit and internal audit are core components of governance.** *"Good govern-*

*ance can be seen in the quality of decisions and that effective decision making is based on 'hard' information from robust systems and processes that are used effectively by leaders in a culture that supports challenge and scrutiny."* (AC 2003, 33) **Thus, external audit and internal audit are significant success factors of good governance.**<sup>1</sup> According to Gonzalez de Asis and Acuña-Alfaro (2002, 1) *"when local governments lack sufficient capacities, the participation of local civil society can promote good local governance. In fact, for good governance to be sustainable, it requires partnerships between government and civil society."* Civic participation mechanisms at the local level can be participatory workshops, information and citizens complaints offices, sectoral working groups, public hearings for accountability, public hearings for budgeting, citizen oversight committees, radio audiences, tripartite control committees, e-citizens and ombudsneighbor (Gonzalez de Asis and Jairo Acuña-Alfaro 2002, 7). Civil society organizations and inhabitants of local communities can take a part in conduction of internal audit and external audit of LGU as well.

Audit, the avoidance of corruption, control, supervision, quality assurance, compliance, the prevention of conflicts of interest, and risk management activities as an end in themselves and as abstract research objects are rather clear and easily determinable objects to observe, analyse and treat. Taking into account that *"audit is not an end itself"* (INTOSAI 1998) and taking a wider view in the new paradigm, this subject will be more complex and complicated to treat. According to Linnas, the Audit, Control and Supervision System (hereinafter ACSS) of an LGU is a

<sup>1</sup> According to Gonzalez de Asis and Acuña-Alfaro (2002, 4) local governance is the processes and institutions by which authority in a local municipality is exercised for the common good. This exercise of authority includes three points: the process by which those in authority are selected, monitored, and replaced; the capacity of the local government to manage its resources effectively, and to implement sound policies; and the respect of citizens and the local government for the institutions that govern economic and social interactions between them.

complex and complicated system consisting of many elements and subsystems (internal audit, external audit, supervision, ICS, etc.) that are simultaneously a subject and an object of the system (Linnas 2007, 288). Furthermore, Linnas states that *"internal audit is a subsystem of the ACSS and an element of internal control system, but also an influencer of the internal control system and subject for the external and internal supervision as well."* As a result, this subject is more confusing indeed, because one has to take into account the connections between its elements and subsystems, as well as the connections between an ACSS and a particular environment. Let us imagine that an internal audit unit or internal auditor is a well-experienced, skilled and high-qualified professional in governance, management, risk management, audit, quality assurance and the other relevant fields of expertise of a modern internal auditor. Thus, obviously one very important element or subsystem of an ICS is reliable and effective, benefiting the entire organization. Nevertheless, this does not mean that the other elements or sub-systems of an ICS are relevant and functioning. Furthermore, external supervision activities may be less extensive if there is a strong internal audit unit or an excellent internal auditor who is independent and an objective equal partner in management. The lack of such a strong internal audit unit or an excellent internal auditor means that the ICS lacks one significant element or sub-system. However, this does not mean that an ICS is weak and irrelevant itself. In such cases, supervision over LGUs should be more focused and extensive. Thus, it is inevitable that internal audit, control and supervision be treated as a system which is uniform, cohesive and whole (a holistic approach), and where its elements and subsystems are in constant interaction (Linnas 2007, 288). This cohesive whole may serve as an excellent system, even if an element or sub-system is not present at all. If there is a lack of some sub-systems of an LGU's ACSS, then other elements or sub-systems have to compensate for this missing part in sufficient degree. Any proposed solution should be very carefully analysed, evalu-

ated and assessed taking into account all the relevant aspects of the environment's characteristics for that particular society.

What are the possible scenarios and options for solving the problems (low qualifications, a lack of available professionals, independence, and financial and human resources, etc.) of trying to run an internal audit activity in a small LGU? One can find a few incremental, moderate or radical changes as alternative options as follows: 1) The merger of small LGUs (a radical change). 2) Starting wide-range co-operation between LGUs in the field of an internal audit's activities (the creation of joint audit units at the county associations of LGUs or joint outsourcing of internal audit activities; a medium change). 3) The creation of audit units at county governors' offices and the enlargement of the audit capacity, mandate and scope of the county governors' offices (A radical change that will move the focus from an internal audit unit of an LGU to the external audit unit of a county governor's office). 4) Strengthening the audit capacity of the State Audit Office (strengthening an external audit, a medium change). 5) Widening outsourced audit activities, including internal audit activity, but under a principally changed keystone (An LGU as an auditee should not be able to decide who will be its auditor, whether or not to accept or refuse audit results, or make or refuse to make payment for an audit or audit report; a radical change). 6) A change in the principles and procedures of appointing the members of audit committees of LGU councils (a radical change). 7) A change from an appointment-based approach to an election-based approach in staffing ACLGUCs and the post of internal auditor in LGUs (a radical change). 8) A combination of the abovementioned options. It is possible to implement each option on this list, but there is a different likelihood of each coming into actuality during the next decade. These options are not very specific for Estonia and countries in transition, but they have more generic sphere of application. Local government sectors differ from each other all over the world, but some trends are common: a mismatch between the responsibilities and

sources of finance, life under permanent change, reform and merger processes, and the increasing share of networking and co-operation between LGUs. Academic literature does confirm that situation of LGU-s does not depend only on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country. At present, there is one more common characteristic – internal audit activity does not operate very well in many different countries.

The author will treat issue of Integrated Model of Audit, Control and Supervision of Local Government Units more deeply in his next article.

### The State of the Local Government Sector in Estonia

According to Mäeltseems, the most acknowledged expert on local government sector issues in Estonia:

“The position of local self-government in the society varies from country to country and understanding it requires knowledge of relevant legislation, especially the constitution. Local self-government is thoroughly and well regulated by the Constitution of the Republic of Estonia compared to constitutions of other countries; foreign experts have also remarked about it. Local self-government is mentioned in about 25 articles of the Constitution; yet, chapter 14 and articles 154–160 specifically regulate the institution.” (Mäeltseems, 2006a).

In addition, Mäeltseems also states the following:

“the difference between the terms administrative-territorial division and administrative-territorial organisation needs to be explained since they are often used incorrectly or even as synonyms. According to the Territory of Estonia Administrative Division Act adopted in 1995:

1) The administrative division of the territory is the division of the territory of Estonia into counties, rural municipalities and cities;

2) Administrative-territorial organisation is the division of the territory of Estonia into administrative units that are units based on administrative division, the status, name and boundaries of which are determined by law and other legislation, and in the territory of which state administration or self-governmental administration is carried out.” (Mäeltseems, 2006b)

Estonia is divided into 15 counties. There is no regional-level government (MI, 2005, 20), but there were 227 LGUs (33 towns and 194 rural municipalities) as of January 1<sup>st</sup>, 2007 (MI, 2007). All LGUs – towns and rural municipalities – are equal in their legal status (MI 2005, 2). The size of LGUs in Estonia is quite varied, but all of them are small or very small.<sup>2</sup> 32 LGUs have a population of under 1000 inhabitants, only 3 have a population over 50 000 (MI, 2005, 3) and half have less than 2000 inhabitants (MI). Nevertheless, Estonia is not a very rare case. According to Oulasvirta (2003, 340), most (57%) LGUs in Finland are small as well (2000–10000 inhabitants). The average surface area of local governments is 180 km<sup>2</sup> (Suur, 2006). According to Söder (2006) in 2005, “*The volume of local governments’ consolidated assets amounted to 42 billion kroons, liabilities to 8 billion kroons, and net assets to 34 billion kroons as at the end of the year. The total consolidated net gain constituted 1 billion kroons.*”<sup>3</sup> Oviir (2006), argues “*that 90% of LGU-s in Estonia are extremely small and due that, it is difficult for them to find and maintain well-qualified accountants, information technologists, lawyers, and other specialists. There just are no such people, and there is no point in giving*

<sup>2</sup> It is very difficult to determine what qualifies an LGU as a small one, because this cannot be determined by only one or two quantitative characteristics. However, according to the US EPA (2004, 5), a small local government is a local government that provides municipal services to 3,300 or fewer permanent residents.

<sup>3</sup> 1 EUR =15.6 kroons (EEK).

the local governments a thrashing for not having them, because it is likely they will not have them in the future, either.”<sup>4</sup> Since Estonia regained independence in 1991, its LGUs have had more and more tasks and functions heaped upon them, but in most cases there has never been enough money to fulfil them all (Mäeltseemes, 1994; Pelisaar, 2004). According to Ryyänänen (2003, 255, 256), Haveri (2003, 319) and other academicians, the situation is similar in Finland as well. This long lasting situation along with the initiative of the Riigikogu and the Government of Estonia (RTI, 15.07.2004, 56, 399) to promote the merger of LGUs is ‘pushing’ LGUs more and more towards merging in order to solve these problems as well as others.

Taking into account all the relevant factors, one can conclude that small LGUs do not have sufficient capacity and the resources needed to establish internal audit units within their jurisdictions that can conduct audits in accordance with internationally recognized standards. **Thus, one can deduce that internal audit activities without support of external audit, control and supervision activities cannot serve as proper and effective tools supporting good governance in small LGUs.** According to USAID (1995) “to be successful, democratic local governance must develop on two discrete levels. First, the national government must create laws and policies that empower local communities to conduct their own public affairs. Second, local actors – government officials, NGO leaders, and entrepreneurs – must acquire the skills, institutions, and material resources that will allow them to practice self-governance. The first level refers to the ‘enabling environment;’ the second level refers to ‘capacity building.’” Thus, state government and local government

have to act in tight co-operation with civil society to increase capacity of audit, control and supervision in LGUs.

### Audit and Local Government in Estonia

According to Nicolaisen (2006), the audit profession has been challenged as never before during the past few years because accounting standards are biased, financial reporting is too complex, financial reporting is evolving to another level and “it’s tough in this complicated world for smaller businesses, whether they’re private or public, to get all the right information at the right time, so that they can prepare their financial statements accurately and so that auditors can audit them with confidence.” Auditing is under permanent change (Caplain, 2005; E&YA, 2005, 6; E&YF, 2007, 6; Fogarty, Graham, and Schubert, 2006; McConnell and Banks, 2003; Ramos, 2003). Auditing as an issue of academic research and day-to-day function in businesses and local government units<sup>5</sup> (hereinafter LGU) is a rather more complicated issue than one can expect on the basis of a theoretical approach. Internal auditors’ work is in a state of change (D’Arcy, 2007, 36) and their area of responsibility in day-to-day life has been unclear up until today (Banham, 2004; Caplain, 2005). One can hardly find an argument against Caplain’s statement that “Everyone has his or her own view of internal audit. ... There are many misconceptions and unrealistic expectations about the role of internal audit.”

According to INTOSAI<sup>6</sup> Lima Declaration (1998), “The concept and establishment of audit is inherent in public financial administration as the management of public funds represents a trust.” Audit as an object of research and audit activity as an inherent part of an organization’s life is well defined all over the world, but there are still some mate-

<sup>4</sup> Oviir (2006): “As long as our country is dotted with thimble-sized communes, the state should offer them support so that they would be able to fulfil certain basic functions. ... I would like to stress it once again: there are approximately 220 local governments in Estonia and 30 of them do not have any problems. Tallinn has no problems, Tartu has no problems, maybe Pärnu has none, and so on, but 190 local governments are facing serious predicaments.”

<sup>5</sup> Hereinafter, a local government unit (LGU) means a rural municipality or town.

<sup>6</sup> INTOSAI – International Organization of Supreme Audit Institutions.

rial differences<sup>7, 8, 9, 10</sup> in its definitions and treatment (Nieuwlands, 2006) by academicians, politicians, public administrators and audit professionals of different states and regions across the globe.<sup>11</sup> Estonia's legislative body, the *Riigikogu*, defines an internal audit as an 'activity' focused on the 'assessment' and 'analysis' of the existence and efficiency of an internal control system (hereinafter ICS). The scope of the Estonian definition of an internal audit is very narrow in comparison with that determined by the IIA and the IIA UK&I and is actually out of touch with the modern approaches to an internal audit. According to Clause 54<sup>3</sup> (1) of the Statute of the City of Tallinn, the scope of activities of the internal audit service of the City of Tallinn is also narrowly focused on an ICS. In contrast, §46 of the Statute of the City of Tartu sets the scope of activities of Tartu's internal audit service on almost the same scope as that defined by the IIA and the IIA UK&I. According

to Clause II (5) of the Bylaw of the Internal Audit Service of the City of Pärnu, the scope of activities of Pärnu's internal audit service is wider there than in Tallinn, but nevertheless, it is not in complete accordance with the international standards mentioned earlier.<sup>12</sup> Thus, the legal definition of an internal audit in Estonia should be reviewed and revised.

There is no legal obligation to establish an internal audit unit or appoint an internal auditor in LGUs in Estonia.<sup>13</sup> According to Clause 92<sup>2</sup> (3) of the Government of the Republic Act, the Government of Estonia is responsible for establishing the general rules for the conduct of internal audits, including provisions for reporting, but only for government agencies and state agencies administered by government agencies (RT I 2007, 66, 408). Nevertheless, one can find some clauses in the Local Government Organization Act (hereinafter LGOA) that enact issues concerning internal [Clause 22 (1) 1]] and external auditing [Clause 22 (1) 18; Clause 39<sup>1</sup>(2); Clause 48 (1)–(7)].<sup>14</sup> More clauses regulating internal audit activity in other laws of Estonia can be found; for example, Clause 26 (3) 3) of the Rural Municipality and City Budgets Act and

<sup>7</sup> According to The Institute of Internal Auditors (hereinafter IIA), an Internal Audit Activity means "A department, division, team of consultants, or other practitioner(s) that provides independent, objective assurance and consulting services designed to add value and improve an organization's operations. The internal audit activity helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

<sup>8</sup> The IIA UK&I has defined internal audit as follows: "Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

<sup>9</sup> According to Clause 92<sup>2</sup> (1) of the Government of the Republic Act, "internal audits are activities involving assessment and analysis of the existence of an internal control system in an agency of executive power, the efficiency of the system and its compliance with the requirements established by legislation." (RT I 2006, 14, 111)

<sup>10</sup> According to The Institute of Internal Auditors (IIA), "Assurance services involve the internal auditor's objective assessment of evidence to provide an independent opinion or conclusions regarding a process, system, or other subject matter. The nature and scope of the assurance engagement are determined by the internal auditor."

<sup>11</sup> According to The Institute of Internal Auditors (IIA), "Consulting services are advisory in nature, and are generally performed at the specific request of an engagement client. The nature and scope of the consulting engagement are subject to agreement with the engagement client."

<sup>12</sup> Here, it is noteworthy that these services are actually 'called' 'internal audit services' only in the translation from Estonian into English. In their original languages these units are called *sisekontrolli teenistus* (Internal Control Service) or *teenistusliku järelevalve teenistus* (Supervisory Control Service).

<sup>13</sup> This argument concerns an internal audit unit as stated by the IIA, not the internal audit commissions of LGU councils (*Revisjonikomisjon*) pursuant to the laws of Estonia.

<sup>14</sup> Pursuant to Clause 48 (3) the audit committee shall monitor: 1) the conformity of the activities of the rural municipality or city government with the regulations and resolutions of the council; 2) the accuracy of accounting of rural municipality or city administrative agencies and agencies under the administration of a rural municipality or city administrative agencies, and the purposeful use of rural municipality or city funds; 3) the timely collection and registration of revenue and the conformity of expenditure with the rural municipality or city budget; 4) the performance of contracts entered into by the rural municipality or city; 5) the lawfulness and purposefulness of the activities of the rural municipality or city government and the administrative agencies thereof. Pursuant to Clause 48 (4) the audit committee shall monitor the agencies specified in subsection (3) of Clause 48 pursuant to the procedure provided by the statutes of the rural municipality or city and on the basis of its work schedule, or as required by the council.

Clause 14 (3) of the Accounting Act. Concerning the legal basis of internal and external audit issues in the LGUs of Estonia, one has to keep in mind three particularities. First, according to Clause 14 (3) of the Accounting Act,

“In addition to the other cases provided by law, the annual report of an accounting entity shall be audited if on the balance sheet date of the accounting year the accounting entity exceeds the limits of at least two of the three following criteria: sales revenue (net turnover), in the case of a company, or income, in the case of other accounting entities: 10 million kroons; balance sheet total: 5 million kroons; number of employees: 10. An accounting entity which is a consolidating entity pursuant to Subsection 27 (1) of this Act shall determine whether an audit is compulsory on the basis of the consolidated indicators.”

Thus, not all public and private entities, including some LGUs, in Estonia have a compulsory responsibility to contract an internal or external audit of annual accounts and reports.<sup>15</sup> Second, an internal audit activity, defined in the LGOA as an activity conducted by the internal audit commission of an LGU's council<sup>16</sup> [called a *Revisjonikomisjon (Revision Commission)*], does not match the exact meaning of an internal audit in many aspects as defined and principles of action stipulated by the IIA or by the IIA UK&I. Nevertheless, it is enacted in the statutes of towns where an internal audit unit exists, or in the statutes of the internal audit services themselves, that they shall act according to the standards of the INTOSAI and IIA. Third, independent internal audit units<sup>17</sup> in LGU administrations exist in only a few of the biggest towns of Estonia [in the City of Tallinn and its city districts (§ 54<sup>3</sup> of the Statute of the City of Tallinn), in the City of Tartu (§ 46 of the Statute of the

City of Tartu), in the City of Pärnu (Statute of the Internal Audit Service) etc.]. **Thus, the political, legal, cultural and historical aspects of the environment are those which do not support an internal audit activity in the majority of LGUs in Estonia.**

There is no official or unofficial body which is responsible for the methodological and professional assistance of LGUs in internal audit issues in Estonia. According to Clause 65 (1) of the Government of the Republic Act, the area of governance of the Ministry of Finance shall include co-ordination of the implementation of the ICS of the Government and the organisation of internal audits of the central government. The ICS and internal audit of the local government sector are out of its scope. According to § 9 of the State Audit Office Act, the SAO shall co-operate with local government units and the Government of the Republic in order to improve internal control and internal audit, but the scope of this law is only ‘co-operation’ (RT I 2007, 16, 77). In addition, there is no official or unofficial body which is responsible for the education and training of public sector auditors, both internal and external, in Estonia. **Thus, there is no methodological and other professional support for the internal auditors of LGUs and no official body responsible for issuing professional certificates for public internal auditors in Estonia.** This means that there is no ‘seedbed’ for the internal auditors of the public sector. The Parliament of Estonia, the *Riigikogu*, has to decide which body, whether the State Audit Office, the Ministry of Finance or Estonian Chapter of the IIA, will be responsible for internal audit issues over the public, central government and local government sectors.

According to attribute standard 1100 of the *International Standards for the Professional Practice of Internal Auditing (hereinafter ISPPA) of the IIA*, an internal audit activity should be independent<sup>18</sup> and internal

<sup>15</sup> This is a very reasonable circumstance that avoids the loss of value of an audit and an audit into a useless formal bureaucratic procedure.

<sup>16</sup> Hereinafter, a council means a council of a rural municipality or a town.

<sup>17</sup> Not internal audit commissions in council of LGUs.

<sup>18</sup> Independence – The freedom from conditions that threaten objectivity or the appearance of objectivity. Such threats to objectivity must be managed at the individual auditor, engagement, functional and organizational levels. (IIA)



auditors should be objective<sup>19</sup> in performing their work. According to the State Audit Office of Estonia, “in several cases, the internal audit committee had failed to perform the objectives provided by law and its role was mainly formal” (SAO 2006, 46). According to Linnas (2007, 286), “an internal audit service, even if any does exist, of LOG (Local Government – Author) is in both objective and subjective situation of a conflict of interests, as their activities are directly steered by the will of the political powers in office via a local council or government.” **Thus, the majority of audit commissions of LGU councils (hereinafter ACLGUC) in Estonia do not fully meet the meaning of independence as stated above and cannot be expected to conduct audits as objectively as one might expect.** The situation of internal audit units in city administrations is slightly better, because the staffs of these services consist of officials who are not acting politicians, but civil servants instead. The head of the internal audit service of the City of Tallinn is under the direct management of the city secretary, who used to be the non-political head of the administration. Thus, in the City of Tallinn, at least in a formal legal manner, internal audit activities are in accordance with the ISPPIA1110.<sup>20</sup> This situation is not as clear in the City of Tallinn’s district administrations. In the City of Pärnu, the head of the internal audit service is accountable directly to the Mayor. The issue of positioning the head of the internal audit unit in the local government’s administrative organization is not very clear. It is the utmost challenge to determine whether it is better that an internal audit unit of a town or rural municipality is under the

direct management of and accountable to the municipality government (political management), to the mayor (politician) or to the head of administration (administrative non-political manager). That is dependent on a complex set of characteristics, including political, ethical, economic, cultural and historical factors. It is more important to have a situation where the ACLGUC is headed by politicians in opposition and staffed in the majority with opposition politicians, so experienced audit practitioners and internal audit units in town and rural municipality administrations can conduct audits in accordance with the principal hard and soft norms of the ISPPIA.

It is very hard if not impossible to conduct internal audits in small LGUs in accordance with the attribute standards ISPPIA1200,<sup>21</sup> ISPPIA1210,<sup>22</sup> and ISPPIA1220.<sup>23</sup> Why is this so? First, because internal auditors have to play a number of roles such as an auditor, adviser, advocate, coach, educator, assessor, communicator, etc. The field of internal and external audit is going to be much more complex because of relatively new and unclear issues of reporting on Enterprise Risk Management (ERM) (Banham, 2004), the Sarbanes-Oxley Act of 2002 (SOX) (McConnell and Banks, 2003; Vorhies, 2005; Lebovits, 2006), Good Governance (Rosario and Holl, 2005) and Good Corporate Governance, Social Responsibility or Corporate Social Responsibility (Nieuwlands, 2007), Sustainable Growth and Corporate Sustainability Reporting<sup>24</sup> (Ballou, Heitger, and Landes, 2006); as well as issues of ethics (Lebovits), combined

<sup>19</sup> Objectivity – An unbiased mental attitude that allows internal auditors to perform engagements in such a manner that they have an honest belief in their work product and that no significant quality compromises are made. Objectivity requires internal auditors not to subordinate their judgment on audit matters to that of others. (IIA)

<sup>20</sup> According to ISPPIA1110, the chief audit executive should report to a level within the organization that allows the internal audit activity to fulfil its responsibilities. According to ISPPIA1110.A1, an internal audit activity should be free from interference in determining the scope of internal auditing, performing work, and communicating results.

<sup>21</sup> According to ISPPIA1200, engagements should be performed with proficiency and due professional care.

<sup>22</sup> According to ISPPIA1210, internal auditors should possess the knowledge, skills, and other competencies needed to perform their individual responsibilities. The internal audit activity collectively should possess or obtain the knowledge, skills, and other competencies needed to perform its responsibilities.

<sup>23</sup> According to ISPPIA1220, internal auditors should apply the care and skill expected of a reasonably prudent and competent internal auditor. Due professional care does not imply infallibility.

<sup>24</sup> Corporate sustainability reporting (CSR) involves reporting financial and non-financial information to key stakeholders on the company’s operational, social and environmental activities and its ability to deal with related risks (Ballou, Heitger, Landes, 2006).

assurance (Lukeman, 2007, 36), etc. According to Ballou et al., "CPAs within organizations will play a key role by providing and measuring the social and environmental information, using their skills to improve its quality and facilitate its use to make sound business decisions in areas such as investment appraisal, budgeting and strategic planning." Second, the work of auditors will be more and more under pressure and the expectations of managers and stakeholders will increase (Rosario and Holl, 2005; Ballou, Heitger, and Landes, 2006; Green, 2006; Vorhies, 2006). Therefore, the level of knowledge, competences and skills of auditors has to rise (Winters, 2004) and change as well. According to Linnas, "Audit (including internal audit), control (including internal control) and supervision (internal and external supervision) are interconnected in a complex, non-linear manner... (Linnas, 2007, 228) The audit, control and supervision of LOG (Local Government – Author) units (organs, constituents) form a uniform cohesive whole (holistic approach) and are in constant interaction, which is why it is impossible to refer to a permanent equilibrium when speaking about the ACSS (Audit, Control and Supervision System – Author), although the balance of the organism (ACSS) as a whole and fixed proportions of its organs-constituents (audit, control, supervision) may be the desired result." (Linnas 2007, 290) Third, not only are accounting- and auditing-related issues changing endlessly, but local governments (Aarrevaara, 2003, 298; Helander, 2003, 290; Pihlajaniemi, 2003, 264, 268; Ryyänänen, 2003, 256; Woolas, 2005; Dexia 2006, 7) and societies (Kettunen, 2003, 277, 287; Walker, 2005, 81) where LGUs exist are in the process of permanent change as well. Both LGUs and internal audits in LGUs are an integral part of society where the key factor is the people themselves. This means that an internal audit in an LGU should be treated as a social system (Linnas 2007, 290), its development/change processes should be treated as a social process, and its key factor should be the people of the LGU in question (Linnas 2007, 290). Social systems and processes are very

complex (Wallerstein, 1998, 5; Näpinen, 2002, 130, 131), they operate under the influence of self-organizing processes (Heyligen, 2002, 23; Näpinen, 1994, 164) and work in open systems (Prigogine 2000, 895), sometimes called a world-system (Wallerstein, 1974, 347; Straussfogel, 1997, 123) or eco-social system (Lemke 1995, 16). In social systems, individual information (such as individual values, norms, conclusions, rules, opinions, ideas and beliefs) changes dynamically because of the new experiences of individuals (Fuchs and Hofkirchner, 1999, 4). Forth, because small LGUs do not have a sufficient amount of financial (Haveri 2003, 321; Pihlajaniemi 2003, 268; Oviir 2006; SAO 2006, 8; Linnas 2007, 284) and human resources (Haveri; Pihlajaniemi; Oviir) to hire, educate, train and keep in office experienced, skilled and well-qualified persons. According to PCAOB (2007, 34), "smaller, less complex companies can face challenges in recruiting and retaining individuals with sufficient experience and skill in accounting and financial reporting." The smallest LGU in Estonia has only 101 inhabitants in its administrative territory. It is obvious that it is nearly impossible to find a head of the municipal administration, much less a person suitable for internal audit activities. Gonzalez de Asis and Acuña-Alfaro (2002, 10) argue that the smaller size of the local level is an advantage for creating a systemic strategy of cooperation between civil society and government, that will make the latter more responsive to the needs and demands of individuals or groups in the community. The author of this article is rather critical on this argument.

It is very challenging to conduct internal audits in small LGUs in accordance with the performance standard *ISPPIA2000* as well.<sup>25, 26</sup>

<sup>25</sup> According to Performance Standard *ISPPIA2000*, a chief audit executive should effectively manage an internal audit activity to ensure it adds value to the organization.

<sup>26</sup> *ISPPIA2130* states that an internal audit activity should assess and make appropriate recommendations for improving the governance process in its accomplishment of the following objectives: promoting appropriate ethics and values within the organization; ensuring effective organizational performance management and accountabil-

Why? The author will use supportive arguments of the Public Company Accounting Oversight Board (hereinafter PCAOB)<sup>27</sup> to bolster his point. According to the PCAOB, in smaller less complex companies senior management is often involved in many day-to-day business activities and performs duties that are important for effective internal control (PCAOB 2007, 7). The extensive involvement of senior management such daily activities and the fewer levels of management that exist in smaller companies can provide additional opportunities for management to override controls or intentionally misstate financial statements (PCAOB). The PCAOB further states that smaller companies, by their nature, have fewer employees, which limits the opportunity to segregate incompatible duties (PCAOB). The risk of a management override of controls exists in all organizations, but the extensive involvement of senior management in day-to-day activities and the fewer levels of management in smaller companies can provide additional opportunities for management to override their controls (PCAOB). Internal audit committees (*Revisjonikomisjon*) of LGU in Estonia are usually appointed by the political powers in office (Metsalu 2006, 2) and it is not a rare situation when a council, and thus its internal audit committee as well, may consist of only members of one political party (Kettunen 2003, 275; Linnas 2007, 286) or members of the sitting coalition. The audit committees (*Revisjonikomisjon*) of LGU councils in Estonia are put together in an undemocratic manner of governance (SAO 2006). According to Allar Jõks, former Chancellor of Justice of Estonia, in Estonia party affiliation is taking terrifying dimensions,

ity; effectively communicating risk and control information to appropriate areas of the organization; effectively coordinating the activities of and communicating information between the board, external and internal auditors and management.

<sup>27</sup> The arguments of the PCAOB are very useful, because they concern the problems of small listed companies. Listed companies should always be, as they were in the past, the flagships of corporate governance, accounting, auditing, risk management and internal control. Thus, if small listed companies have problems in these particular issues, then small local governments are at even greater risk and trouble.

preference of private interests against public interests is rather a rule and clan economy needs to be handled. In situations like this it is too much to expect that the ACLGUC or internal auditor of an LGU's administration to improve the governance process, promote appropriate ethics and values within the organization, and ensure effective organizational performance management and accountability if the pragmatic interests of the local politicians in power are not in line with the objectives of the ACLGUC. Nevertheless, such a situation is in complete accordance with Estonian law because according to Clause 48 (1) of the LGOA, a council shall form an audit committee of not less than three members for the duration of its term of office. In addition, according to Clause 48 (2) of the LGOA, the chairman and members of an audit committee shall be elected from among the council's members. **Thus, the legal, political, economic and demographic environment in Estonia does not support the prudent, independent, objective and effective operation of internal audit activities.**

The external evaluation of LGUs by the state is not efficient in Estonia (Linnas 2007, 286–287). Nevertheless, this is not only the case in Estonia, but it is also exists in Finland (Oulasvirta 2003, 346), Israel (Friedberg 1999, 11), the United Kingdom (Woolas 2005), and in others as well. Thus, external audit capacity should be improved, but there are always financial limits. External audit activity also does not help very much, because outsourced external audits almost always depend only on the customer of the services (auditee) as regards the expected result (Linnas 2007, 286) and this can affect their temporal and content-related scope as well as the main issues treated. Consequently, there is an inherent conflict of interest, because an external auditor cannot be truly independent and objective in his or her audit work if the payment for his or her job depends solely on the expectations and will of the auditee.

Taking into account all the arguments described in this and the previous two chapters together, one can be confident in the opinion that an internal audit functioning solely with-

out optimal integration in a coherent integral system of audit, control and supervision in a small LGU does not have the possibility of fulfilling all its expected responsibilities and helping the LGU's political decision makers and managers achieve their set goals, objectives and targets in a timely manner as well as meeting the expectations of its citizens. Even more, there is no space at all in tiny LGUs for internal audit because having an internal auditor or internal audit team in the organization of an LGU with insufficient or limited resources is an additional, potentially unbearable, burden on its resources. The diverting of extra financial and human resources will decrease the administrative capacity of the local government unit and by this means operates as a negative factor in the serving of its citizens.

#### **What Are the Strengths and Weaknesses of the Abovementioned Options for Estonia?**

The merger of small LGUs is the most radical change. It creates a significant source for developing the capability and performance of internal audit activities in LGUs in Estonia. Whereas these LGUs are small by their population, area, personnel, budget and the fact that internal migration is redistributing the population to the detriment of the smaller ones, the merging of these smaller LGUs is an imminent necessity. The author is of the opinion that the administrative territory of an LGU in Estonia should match the administrative territory of a county in size.<sup>28</sup> There is space in Estonia for about 15 LGUs under this scheme. These 15 LGUs will in turn have the relevant resources to cope with the responsibilities and demands of modern society. The Estonian Parliament and Government of the Republic are 'pushing' this idea, but with no significant success. One reason for the lack of progress is the resistance of local politicians and civil servants. A second reason is the fear

of restricting the constitutional rights of citizens to self-governance. A third reason is the fear of citizens of losing access to local public services in their locale. This scenario has more strengths than weaknesses.

Starting wide-range co-operation between LGUs in the field of internal audit through the creation of joint audit units at the county associations of LGUs or the joint outsourcing of internal audit activities is a medium change scenario. This might turn out to be the favourite scenario for many reasons as there are a number of supportive legal, political, financial, cultural and historical factors in Estonia. According to §12 of the LGOA and to §2 of the LGAA, LGUs in a county may form a county association of LGUs to foster the balanced and sustainable development of the county, to preserve and promote the cultural traditions of the county, to represent the county and the members of the association, to protect the common interests of its members, to promote co-operation between the local governments in the county and to create possibilities for improved performance of the functions of its members as prescribed by law. There is a regional association in each county that unites almost all the LGUs within them (MI 2005, 20). There are two national associations of LGUs in Estonia: the Association of Estonian Cities and the Association of Municipalities of Estonia (MI). These two cooperative bodies established a joint body, the Co-operation Assembly of Associations of Local Authorities, to conduct negotiations with the central government of Estonia (MI). Many small LGUs in Estonia buy public services from neighbouring LGUs on a contractual basis (MI). The co-operation and networking of LGUs is a regular occurrence in Finland (Aarrevaaara 2003, 302; Haveri 2003, 316; Heuru, 2003, 258; Niemi-Iilahti 2003, 284; Helander 2003, 295; Ryyänen 2003, 256), a country, which is a paragon of good governance for the politicians and civil servants of Estonia. According to Aimo Ryyänen (2003, 256), "*economic difficulties have compelled the municipalities, as a rule, to arrange their functions more and more sub-regionally.*" Oulasvirta (2003, 340) stated that municipalities "*with*

<sup>28</sup> Thus, LGUs will serve as bodies of local self-governance and counties as representative bodies of the central government on the spot.

*between 2000–10000 inhabitants, they have established so-called joint local authorities to handle tasks that need a wider population base to function efficiently.”*

The creation of audit units at county governors' offices and enlarging the audit capacity, mandate and scope of county governors' offices is a radical change that will shift the focus from the internal audit units of LGUs to the external audit units of county governors' offices. This scenario is realistic enough because the Prime Minister of Estonia, Andrus Ansip, and former Minister for Regional Affairs, Vallo Reimaa, intended to change the areas of responsibility of county governors' offices in Estonia. County governors' offices will have to serve more as representative and supervisory bodies of the central government in the future. Currently, there is an internal audit unit or an internal auditor in 12 of 15 county governors' offices. Thus, there is a reasonable possibility of placing an external audit activity under the county governors' offices area of responsibility. This will decrease the need for an internal audit activity within LGUs. However, this scenario has one significant threat. In Estonia today, it is not uncommon that county governors are politically biased as their posts are allocated according to political affiliation or other political reasons and one's competence is of secondary importance (Linnas 2007, 286). Due to this circumstance, county governors may not be independent in their duties. Increasing the power of county governors over LGUs is not an idea that is favoured by some national-level politicians, local politicians and civil servants.

Strengthening the audit capacity of the State Audit Office is a medium change that will strengthen its external audit capacity over LGUs' performance. It is a medium change because the SAO of Estonia has had limited authority to audit LGUs since 01.01.2006 (RT I 2005, 32, 235). Nothing but the SAO's scope of audit has to be made broader. This scenario will decrease the need for internal audit activities within LGUs. However, widening the SAO's scope of audit over LGUs is not a well-liked idea for some national-level politi-

cians, local politicians and civil servants.

Widening outsourced audit activities, including internal audits, under a principally changed keystone is a radical material change. The main idea of this option is to change the situation in a manner allowing for the elimination of conflict of interests as a source of a lack of independence in contracted audits.<sup>29</sup> An LGUs' council, government and administration, as representatives of an auditee, should not have the right to decide who will be their auditor, whether or not to accept or refuse audit results, or make or refuse to make a payment for an audit or audit report. New situation will make the auditor independent from the will of the auditee, creating a clear non-conflict of interest objective situation.<sup>30</sup> This scenario is more unrealistic, because it has to receive the wide support of politicians, civil servants, chartered accountants, businessmen and civil servants since such a change has to be state-wide and not only applied to the local government sector. This scenario does have one significant risk as well. Small LGUs do not have sufficient amount of resources for contracting high-level-quality internal audit experts to conduct internal audits. While the *Riigikogu* will enforce an act that will make internal audits as compulsory obligation for all LGUs, this will cause situation, where LGUs will pay to outsourced internal auditors money for 'stamping', but will not gain any actual value of that. High-level-quality internal audit experts will not follow 'petty cash'.

Changing the principles and procedures of the appointment of the members of the ACLGUC is a radical change. The essence of this option is that the chairman and a majority of members of the audit committee of an LGU council will be persons from the opposition. The legal situation in Estonia allows for this scenario; nevertheless, the chairman of the ACLGUC has to be a member of council. Thus, if the council consists of only coalition party members, this scenario will not work.

<sup>29</sup> Look at the Enron and the WorldCom cases.

<sup>30</sup> However, this does not mean that an auditor will be objective in her or his work.

Consequently, there is a need for change in the LGOA. Implementation of this scenario needs the good political will of the politicians and citizens of a particular LGU. This option will increase the independence of an ACLGUC and makes the role of an ACLGUC more trustworthy and effective.

Changing the appointment-based approach to an election-based approach in staffing ACLGUCs and the internal auditor of LGUs is a very radical change. This scenario means that an auditor of a town or rural municipality and members of ACLGUCs should be elected by the citizens of a rural municipality or town like the members of council.<sup>31</sup> This scenario is more like unrealistic, because it requires a couple of laws be repealed or even a new law to be implemented (Law of Election of ACLGUC and the Internal Auditor of a Rural Municipality or Town) and because of that it needs to gain the wide support of members of parliament, local politicians and civil servants. This is a huge challenge for Estonia's society at the moment, but common situation in USA. However, this particular scenario does match very much with modern theories of civil society and good governance.

## Conclusions

Local government sectors differ from each other all over the world, but some trends are common: a mismatch between the responsibilities and sources of finance, life under permanent change, reform and merger processes, and the increasing share of networking and co-operation between LGUs. Academic literature does confirm that situation of LGU-s does not depend only on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country. At present, there is one more common character-

istic – internal audit activity does not operate very well in many different countries. According to Friedberg (1999), "for the last three decades public and internal audit in local government in Israel has continued to be impotent. They do not currently fulfil their function." The case of Israel is telling, but not rare. Because of before mentioned trends some options offered by the author as possible solutions to overcome this shortage are suitable not only for Estonia. The author offers some more or less radical options to improve audit situation in LGUs. These options are: 1) The merger of small LGUs. 2) Starting wide-range co-operation between LGUs in the field of an internal audit's activities. 3) The creation of audit units at county governors' offices and the enlargement of the audit capacity, mandate and scope of the county governors' offices. 4) Strengthening the audit capacity of the State Audit Office. 5) Widening outsourced audit activities, including internal audit activity, but under a principally changed keystone. 6) A change in the principles and procedures of appointing the members of audit committees of LGU councils. 7) A change from an appointment-based approach to an election-based approach in staffing ACLGUCs and the post of internal auditor in LGUs. 8) A combination of the abovementioned options.

**The author of this article is confident of the opinion that it is inevitable that internal audit, control and supervision will be treated as a system which is uniform, cohesive and whole (the holistic approach); where elements and subsystems are in constant interaction (Linnas 2007, 290).** This cohesive whole may serve as an excellent system, even if one element or sub-system is lacking, such as an internal audit unit/internal auditor, or some other elements of an ICS or supervision system. If there is a lack of some element or sub-system of an ACSS of an LGU, then other elements or sub-systems have to compensate for this particular lack in sufficient degree. However, different models of ACSSs in LGUs apply to different political, legal, historical, cultural and economic environments and to different sizes of municipalities (Linnas 2007, 289).

<sup>31</sup> This is similar to the USA, where a City Controller is elected by the citizens of a city. In the USA, a City Controller is independent of the Mayor and City Council, whose operations the City Controller audits. The term of office of the City Controller is four years, and is not subject to term limitation. Office of the Controller – City of Philadelphia. Available at [WWW]http://www.philadelphiacontroller.org/aboutdet.asp?ID=9, 03.01.2008.

## References

- Aarrevaara, Timo. (2003) Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 298–306.
- Audit Commission, The (AC). (2003) Corporate Governance: Improvement and trust in local public services. Available at [WWW]http://www.audit-commission.gov.uk/Products/NATIONAL-REPORT/7374209E-8060-4218-B4B2-2CCF2FD490C5/CorporateGovernance.pdf
- Ballou, Brian; Heitger, Dan L.; Landes, Charles E. (2006) The Future of Corporate Sustainability Reporting. December. Available at [WWW]http://www.aicpa.org/pubs/jofa/dec2006/ballou.htm, 23.04.2007.
- Banham, Russ. (2004) Enterprising Views of Risk Management. Available at [WWW]http://www.aicpa.org/pubs/jofa/jun2004/banham.htm, 23.04.2007.
- Caplain, Bruce. (2005) Jump-Start Success. Available at [WWW]http://www.aicpa.org/pubs/jofa/feb2005/caplain.htm, 23.04.2007.
- D'Arcy, Simon. (2007) In Nail Baker's article "Joined Up Assurance." Internal Auditing & Business Risk: December 2007. Available at [WWW]http://www.iaa.org.uk/en/other/document\_summary.cfm/docid/6825E8A1-1F7A-439F-8244BD5E953F665C, 30.12.2007.
- Dexia (2006) Sub-national public finance in the European Union. Trends 2000/2005. Economic Outlook. Available at [WWW]http://www.ccre.org/docs/note\_conjuncture\_en.pdf, 29.12.2007. EPA US (2004
- Ernst and Young Australia (E&YA). (2005) Trends in Australian and New Zealand Internal Auditing. Second Annual Benchmarking Survey 2005. Available at [WWW]http://www.iaa.org.au/pdf/InternalAudit-BenchmarkingSurvey\_ebookey2005.pdf, 03.01.2008.
- Ernst and Young Finland (E&YA). (2007) Trends in Finnish Internal Auditing Finnish Internal Audit: Benchmarking Survey II. Available at [WWW]http://www.ey.com/global/download.nsf/Finland/Trends\_in\_Finnish\_InternalAuditing/\$file/TrendsInFinnishInternalAuditing.pdf, 03.01.2008.
- Fogarty, John A.; Graham, Lynford; Schubert, Darrel R. (2006) Assessing and Responding to Risks in a Financial Statement Audit. Available at [WWW]http://www.aicpa.org/pubs/jofa/jul2006/fogarty.htm, 23.04.2007.
- Friedberg, Asher. (1999) Evaluating The Effectiveness Of Public And Internal Audit In Local Government – The Case Of Israel. Available at [WWW]http://www.asosai.org/journal1999/evaluating\_the\_effectiveness.htm, 30.11.2006.
- Fuchs, Christian. Hofkirchner, Wolfgang. (1994) Information in Social Systems. Available at [WWW]http://igw.tuwien.ac.at/peterf/IuG1\_SS/InformationinSocial-Systems.htm, 29.12.2007.
- Gonzalez de Asis, Maria. Acuña-Alfaro, Jairo. (2002) Civic Participation in Local Governance. Available at [WWW]http://www.worldbank.org/wbi/governance/pdf/fy-02brief/civic\_local\_annex.pdf, 09.03.2008.
- Green, John W. (2006) Section 404 for Small Caps. Available at [WWW]http://www.aicpa.org/pubs/jofa/mar2006/green.htm, 23.04.2007.
- Haveri, Arto. (2003) Intermunicipal Cooperation as a Part of Local Governance. Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 316–325.
- Helander, Voitto. (2003) Public Sector Reforms and the Third Sector. Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 290–297.

- Heuru, Kauko. (2003) Development of Municipal Administration in Finland. Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 257 – 262.
- Heyligen, Francis. (2002) The science of self-organization and adaptivity. [WWW]http://pespmc1.vub.ac.be/Papers/EOLSS-Self-Organiz.pdf, 12.12.2007.
- Institute of Internal Auditors, The (IIA). (2007) International Standards for the Professional Practice of Internal Auditing. Available at [WWW]http://www.theiaa.org/guidance/standards-and-practices/professional-practices-framework/standards/standards-for-the-professional-practice-of-internal-auditing/, 30.12.2007.
- Institute of Internal Auditors – UK and Ireland, The (IIAUK&I) Available at [WWW] http://www.theiaa.org/index.cfm?doc\_id=269, 29.12.2007.
- International Organization of Supreme Audit Institutions (INTOSAI). (1998) Lima Declaration. Available at [WWW]http://www.intosai.org/en/portal/documents/intosai/general/lima\_declaration/index.php?article\_pos=2, 01.01.2008.
- Jõks, Allar. (2008) Kellele kuulub Eesti riik? Postimees Nr. 56 (5235), 07.03.2008.
- Kettunen, Pekka. (2003) How Democratic are the Finnish Local Governments? Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 271–278.
- Lebovits, Neil S. (2006) Beyond Sarbanes-Oxley. Available at [WWW]http://www.aicpa.org/pubs/jofa/aug2006/lebovits.htm, 23.04.2007.
- Lemke, Jay. L. (1995) Discourse, Dynamics, and Social Change. Available at [WWW] http://academic.brooklyn.cuny.edu/education/jlemke/cult-dyn.htm, 29.12.2007.
- Linnas, Raivo. (2007) Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments. (Based on the Case of the Estonia). Kunnallistieteellinen Aikakauskirja/Finnish Local Government Studies Nr. 3, 2007. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 282–294.
- Lukeman, David. (2007). In Nail Baker's article "Joined Up Assurance." Internal Auditing & Business Risk: December 2007. Available at [WWW]http://www.iaa.org.uk/en/other/document\_summary.cfm/docid/6825E8A1-1F7A-439F-8244BD5E953F665C, 30.12.2007.
- McConnell, Donald K. Jr.; Banks, George Y. (2003) How Sarbanes-Oxley Will Change the Audit Process. Available at [WWW] http://www.aicpa.org/pubs/jofa/sep2003/mcconn.htm, 23.04.2007.
- Metsalu, Ines. Euroopa Komisjoni abiprojekt HACSO Sonda vallas: nr. OSI-2-6/06/39, Available at [WWW]http://www.riigikontroll.ee/fake\_index.php?lang=et&uri=%2Faudit.php%3Fdokument%3D669, 15.10.2006.
- Ministry of Interior (MI). (2005) Local Government in Estonia. Available at [WWW] http://www.siseministeerium.ee/public/LGinEstonia2005\_20070322090339.pdf, 30.12.2007.
- Ministry of Interior (MI). (2007) Kohalik omavalitsus haldussüsteemis. Available at [WWW]http://www.siseministeerium.ee/5945, 15.08.2007.
- Mäeltsemees, Sulev. (1994) Available at [WWW]http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN003969.htm, 30.11.2007.
- Mäeltsemees, Sulev. (2006a) Local Self-government: Definition, its Position in Public Administration and Historical Development. An article in the encyclopedia about Estonia Estonica. [WWW]http://www.estonica.org/eng/lugu.html?menyy\_id=1255&kateg=39&nimi=&alam=48&tekst\_id=1256, Available 29.12.2007.



- Mäeltsemees, Sulev. (2006b) Local Self-government: Administrative-territorial Division and Organisation. An article in the encyclopedia about Estonia *Estonica*. [WWW]http://www.estonica.org/eng/lugu.html?menyy\_id=1263&kateg=39&nimi=&alam=48&tekst\_id=1264, Available 29.12.2007.
- Nicolaisen, Donald T. (2006) In an exit interview with the Chief Accountant of the SEC by Geoffrey Pickard. A Future That Matters. Available at [WWW]http://www.aicpa.org/pubs/jofa/feb2006/pickard.htm, 23.04.2007.
- Niemi-lilahti, Anita. (2003) Citizen Empowerment – a Challenge for Local Democracy in Finland. Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 279–289.
- Nieuwlands, Hans. (2006) The Role of Auditing in Public Sector Governance. Presentation at Academic Seminar on “Internal Audit and Supervision Models and Internal Control Systems in Public Sector”, Friday, August 25<sup>th</sup> 2006 in the Tallinn University of Technology, House of Humanities.
- Nieuwlands, Hans. (2007) Auditing Sustainable Development. Internal Auditor 91 Volume 64; Issue 2. Available at [WWW]http://www.gpconsultinglimited.com/news/news.html, 02.01.2008.
- Näpinen, Leo. (1994) Iseorganiseerumismõtlemine, selle omandamise vajadus Eesti ühiskonnas. Teaduslugu ja Nüüdisaeg IX: Teadusfilosoofia ja teadusmetodoloogia Eestis: Olukord ja perspektiivid. Tallinn: Teaduste Akadeemia Kirjastus, 1994, lk 158–180.
- Näpinen, Leo. (2002) Ilya Prigogine’s program for the remaking of traditional physics and the resulting conclusions for understanding social problems. *Trames*, 2002, 6(56/51), 2, 115–140.
- Oviir, Mihkel. (2006) Presentation at the Riigikogu on the overview of the use and preservation of state assets in 2005, shorthand report from the 8th session (8.11.2006) of the 10th composition of the Riigikogu. Available at [WWW]http://web.riigikogu.ee/ems/stenograms/2006/11/m06110807.html, 30.12.2007.
- Oulasvirta, Lasse. (2003) Local Government Finance and Grants in Finland. Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 340–348.
- Pelisaar, Georg. (2004) Eesti edu vundament võib vankuma hakata. Riigikogu Toimetised 10/2004. Chancellery of the Riigikogu, Tallinn, 2004. Available at [WWW]http://www.riigikogu.ee/rva/toimetised/rito10/artiklid/08pelisaar.htm, 29.12.2007.
- Pihlajaniemi, Toivo. (2003) The Changing Roles of the State and Municipalities. Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteen yhdistys ry, 263–270.
- Prigogine, Ilya. (2000) The networked society. *Journal of World-Systems Research*, 6, 892–898.
- Public Company Accounting Oversight Board (PCAOB). (2007) Preliminary Staff Views – An Audit of Internal Control That Is Integrated with An Audit of Financial Statements: Guidance for Auditors of Smaller Public Companies. Available at [WWW]http://www.pcaobus.org/Standards/Standards\_and\_Related\_Rules/AS5/Guidance.pdf, 30.12.2007.
- Ramos, Michael. (2003) Auditors’ Responsibility for Fraud Detection. Available at [WWW]http://www.aicpa.org/pubs/jofa/jan2003/ramos.htm, 23.04.2007.
- Rosario, Ric R. Holl, Suzanne M. (2005) Stay Out of Trouble. Available at [WWW]http://www.aicpa.org/pubs/jofa/aug2005/rosario.htm, 28.12.2007.
- Ryynänen, Aimo. (2003) Modification of Finnish Local Government – Between Continuity and Change. Finnish Local Govern-

- ment Studies/Kunnallistieteellinen Aikakauskirja Nr. 4, 2003. Tampereen Yliopisto: Kunnallistieteiden yhdistys ry, 255–262.
- Suur, Neeme. (2006) Kohalike omavalitsuste koolitus Eestis. Ettekanne Helsingi konverentsil: Kohalike omavalitsuste roll naftalekete vastu võitlemisel Balti merel. Available at [WWW]http://www.ell.ee/4267, 16.10.2006.
- State Audit Office/Riigikontroll (SAO). (2006) Ülevaade riigi vara kasutamise ja säilimise kohta 2005. aastal. Available at [WWW]http://www.riigikontroll.ee/fake\_index.php?lang=et&uri=%2Favamus.php%3Fdokument%3D68, 29.10.2006.
- Straussfogel, Debra. (1997) A system perspective on world-systems theory. *Journal of Geography* 96, 119–126.
- Söder, Aivar. (2006) Presentation on the consolidated report of the financial year 2005 at the Riigikogu, shorthand report from the 8th session (08.11.2006) of the 10th composition of the Riigikogu. Available at [WWW]http://web.riigikogu.ee/ems/stenograms/2006/11/m06110807.html, 29.12.2007.
- USAID. (1995) New Partnerships Initiative: Local Democratic Governance. [WWW]http://www.usaid.gov/pubs/npicorept/npicorept-npi-dem.htm, 09.03.2008.
- U.S. Environmental Protection Agency (EPA). (2004). Small Local Governments Compliance Assistance Policy. Environmental Protection Agency: Office of Enforcement and Compliance Assurance. June 2004. Available at [WWW]http://epa.gov/compliance/resources/policies/incentives/smallcommunity/smalllocalgovca.pdf, 01.01.2008.
- Vorhies, James Brady. The New Importance of Materiality. (2005) Available at [WWW]http://www.aicpa.org/pubs/jofa/may2005/vorhies.htm, 23.04.2007.
- Walker, David M. (2005) The Government Accountability Office Report GAO-05-325SP: 21st Century Challenges: Re-examining the Base of the Federal Government. Available at [WWW]http://www.gao.gov/new.items/d05325sp.pdf, 30.12.2007.
- Wallerstein, Immanuel. (1974) *The Modern World-system: Capitalist Agriculture and the Origins of the European World Economy in the Sixteenth Century*, New York: Academic Press.
- Wallerstein, Immanuel. (1998) *The Heritage of Sociology, The Promise of Social Science*. Available at [WWW]http://fbc.binghamton.edu/iwprad3.htm, 13.09.2006.
- Winters, Bruce I. (2004) Choose the Right Tools for Internal Control Reporting. Available at [WWW]http://www.aicpa.org/pubs/jofa/feb2004/winters.htm, 23.04.2007.
- Woolas, Phil. (2005) Inspection of Local Services: Launch of Inspection Consultation Document. Speech by Phil Woolas MP, 28 November 2005. Available at [WWW]http://www.odpm.gov.uk/index.asp?id=1161895, 30.11.2006.

**Laws, other legal norms and standards**

Accounting Act (AA)/Raamatupidamise seadus. (RT I 2007, 58, 380)

Bylaw of Internal Audit Service. Pärnu City. Confirmend by the Pärnu City Government, Decree No.18, 16.01.2006. Available at [WWW]http://www.parnu.ee/index.php?id=400, 01.01.2008.

Government of the Republic Act (GRA)/Vabariigi Valitsuse seadus. (RT I 2007, 66, 408)

Local Government Associations Act (LGAA)/Kohaliku omavalitsuse üksuste liitude seadus. (RTI, 28.11.2002, 96, 565)

Local Government Organisation Act (LGOA)/Kohaliku omavalitsuse korralduse seadus. (RT I 2007, 44, 316)

Promotion of Local Government Merger Act (PLGMA)/Kohaliku omavalitsuse üksuste ühinemise soodustamise seadus. (RTI, 15.07.2004, 56, 399)

*Article 2 cont0*

Raivo Linnas, Audit in Small Local Government Units: ..., Kunnallistieteellinen aikakauskirja 1/08

Rural Municipality and City Budgets Act (RMCBA)/Valla- ja linnaelarve seadus. (RT I 2003, 88, 588)

State Audit Office Act (SAOA)/Riigikontrolli seadus. (RT I 2007, 16, 77)

Statute of the City of Tallinn/Tallinna põhiäärus. (Tvk m 13.12.2007 nr 43)

Statute of the City of Tartu/Tartu Linna Põhiäärus. Available at [WWW][http://www.tartu.ee/index.php?page\\_id=1379&lang\\_id=1&menu\\_id=2](http://www.tartu.ee/index.php?page_id=1379&lang_id=1&menu_id=2), 31.12.2007.

# Legal Framework and Present State of External Control and Supervision of Local Self-Government Units in Estonia

Raivo Linnas

## Abstract

The author of this paper considers the issue of legal regulation and the present state of external control and supervision of local self-government units in Estonia, giving an overview of the legislative framework underpinning the key control and supervisory bodies of LGUs, highlighting the present situation of external control and supervision of LGUs and giving some suggestions on developing this field in Estonia. The author argues that the external control and supervision system of LGUs in Estonia is 1) definitely based on a solid and adequate constitutional and legal framework; 2) in full accordance with the European Charter of Local Self-Government in this particular respect; 3) not understood, treated, designed and maintained like an integral, coherent holistic system or organisation; 4) a comprehensive, complex, mixed system, which has sub-systems and elements acting in an uncoordinated manner resulting in a low capacity; 5) and somewhat biased in favour of the state in respect of *ex ante* control. One can also come to one more conclusion (the 6<sup>th</sup>) – the control and supervision of LGUs executed by the state (administrative, constitutional, governmental, judicial, political) in Estonia is generally public, transparent and democratic enough, but should be more developed and better administered in the future. LGUs need external control and supervision with a capacity high enough to protect the interests of the inhabitants of a particular LGU. The author is of the opinion that reaching this target in Estonia needs an optimum balance between the fundamental constitutional rights of local self-government and protection of the inhabitants' interests in municipalities by state institutions. There is no common model of external control and supervision of the local self-government sector in the world, but it is very common that central governments are trying to take tighter control of local self-government units. The increasing power of state control and supervision of LGUs does not depend on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country. Consequently, the case of Estonia is not only country-specific, but has a more generic meaning in contemporary good governance.

Keywords: Control, Estonia, Governance, Inspection, Local Government, Monitoring, Supervision.

### Brief Introduction to the Topic of Control and Supervision

The concepts of 'control' and 'supervision' are not new and seem to be as old as human civilization.<sup>1</sup> One can find clear evidence of the preliminary characteristics of control, inspection, monitoring, and supervision activities from ancient Greek times (Xenophon), as well as from the times of Jean Baptiste Colbert (1619–1683), one of the greatest ministers of Louis XIV. However, according to Davis, Downe and Martin (2001, 2), the preoccupations of nineteenth-century inspection were very different to those of today.

The typology and taxonomy of control<sup>2</sup> and supervision<sup>3</sup> can be constructed in many different equal ways. Typology depends primarily on the basic viewpoint and particular interest of the observer. Different authors use different terms like inspection, monitoring,<sup>4</sup> overlook and scrutiny to express the meaning of control and supervision processes and activities. Terms such as 'external scrutiny' and 'external inspection' often have the same meaning as term 'external control' or 'external supervision', if one compares the meaning of these three definitions by their main inherent components. One can easily discover that in the academic world, supervision is defined by scholars of different branches of science using the terms control, inspection, scrutiny, surveillance<sup>5</sup> and monitor. One can also very easily ascertain that control activity is defined via supervision, inspection, audit, monitoring and scrutiny as well. Thus, there is no single common definition of control and supervision in the academic world.

The picture is even more complicated in the sphere of politics, management and administration. One can conclude based on an overview of the literature and policy document research that there is the situation that different politicians and practitioners of public management do not have any major differences between control, inspection, monitoring, scrutiny and supervision activities. Only the definitions and terms in day-to-day usage are different because of a number of subjective reasons. It is very common that supervi-

sion as a process consists of audit and control as the tools of supervision and *visa versa*. Supervision and control are complex and complicated matters of research because the line between these terms is not clear and sharp, while their methods and tools are often the same. A typical situation in real political and administrative life is that one can not easily understand whether one or another process or activity is control or supervision because at present there is always a mix of different methods and tools similar to both such as audit, investigation, inspection, surveillance, evaluation, etc. In this very particular aspect of treatment and understanding, the difference between control and supervision in Estonia is a complete match with the generic situation in the world at large.

Different countries have different approaches to the external control and supervision<sup>6</sup> (hereinafter called ECS) of local self-government units (hereinafter called LGUs),<sup>7</sup> but some characteristics are common to a number of countries. First, external control and supervision systems (hereinafter called ECSS) are sophisticated combinations of different types of control and supervision sub-systems.<sup>8</sup> Secondly, the relative importance and relations between the different sub-systems and elements of ECSS is varied.<sup>9</sup> Thirdly, the philosophical basis for the theoretical treatment and concept of the practical application of the ECSS of LGUs are very different even in the same organization (a confederation of states, federal state, union of states, the European Union, etc.).<sup>10</sup> Fourthly, due to the legal framework, political reality, historical and cultural context, and economic situation of the different institutions responsible for executing ECS activities over LGUs, they perform their tasks and duties with different authority, devotion, scope, regularity, thoroughness and focus. Fifthly, in many countries the state authorities executing control and supervision<sup>11</sup> over LGUs are entitled with a large frame of powers and there exists a trend to increase this power.<sup>12,13</sup> Sixthly, in small states,<sup>14</sup> the state-level controllers and supervisors responsible for executing ECS activities over LGUs may be under the control of a few specific interest

groups and as a result the autonomy and sovereignty of LGUs is crucial for the sake of a democratic society. Seventhly, complete centralized control is impossible in any complex system (Mathews, 1996, 41). Eighthly, state-level administration systems and local government-level administration systems form a holistic, integral and complex public administration system in society.<sup>15</sup> On the one hand, LGUs are more prone than national governments to be influenced by special interest groups and they are less able to stand up to rich, powerful individuals (IDB, 6). On the other hand, rural municipalities and cities influence the day-to-day life of inhabitants even more than the activities of the central government. Consequently, LGUs need external control and supervision which has the relevant capacity to ascertain and assure everyone that the constitutional rights and freedoms as well as any other interests of the residents of any LGU in the state are available. Nevertheless, the constitutional rights of local self-government should be granted and the external control and supervision of LGUs shall be exercised in such a way as to ensure that the intervention of the controlling or supervising authority is kept in proportion to the importance of the interests that it is intended to protect.

The author would like to emphasize that the brief introduction above is not nor should not be understood as a complete overview or as a sufficient topology of the topic. Getting a complete, systemic and coherent overview and entire topology of the matter of control and supervision is outside of the scope of this article. The author would also like to emphasize that in the context of this article it is not of the utmost importance to determine and define prompt monosemantic meaning of the terms 'control' and 'supervision' and label these items with a 'final' title. However, a more homogeneous determination, definition and treatment of subjects such as control, supervision and review (inspection, monitoring, over-seeing, overseeing, scrutiny and surveillance) in the nearest future would be of great help to scholars, politicians and public servants in the context of better understanding each other across the entire European Union.

The author has consciously simplified the subject at hand in order to avoid diluting the main focus of this particular article, and is going to treat the subject of control and supervision together as an intermittent (regular or irregular) or continuous process started or task carried out by an organization, or politically and legally authorized controller/supervisor, to assure that the organization in question is liable and expected to carry out its obliged and expected tasks (controllee/supervisee) and fulfils them in accordance with the predetermined standards and expected norms of performance and operation.<sup>16</sup> ECS means that the institution executing control or supervision activities over another institution is an external, not internal actor (member or structural part of the organization) in relation to it.<sup>17</sup> Even though this chapter is not directly linked to the case of Estonia, the brief introduction above is intended to give the reader a short, quick overview of the wider context of the matter under treatment for the sake of a better understanding of the rest of the paper.

### **Legal Framework of External Control and Supervision of LGUs in Estonia**

The previous chapter highlighted the complex landscape of the subject of control and supervision in the world. This chapter considers the legislative framework underpinning the key bodies of control and supervision as well as the implications of these on the conduct of the ECS of LGUs in Estonia.

Pursuant to Clause 8 (1) of the European Charter of Local Self-Government (hereinafter called Charter; EC 1985), any administrative supervision of local authorities may only be exercised according to such procedures and in such cases as are provided for by the Constitution or by statute. Pursuant to Clause 8 (2) of the Charter, any administrative supervision of the activities of the local authorities shall normally aim only at ensuring compliance with the law and with constitutional principles. Administrative supervision may however be exercised with regard to expediency

by higher-level authorities in respect of tasks the execution of which is delegated to local authorities. Furthermore, pursuant to Clause 8 (3) of the Charter, administrative supervision of local authorities shall be exercised in such a way as to ensure that the intervention of the controlling authority is kept in proportion to the importance of the interests which it is intended to protect. Pursuant to §154 of the Constitution of the Republic of Estonia (hereinafter called CRE) "*all local issues shall be resolved and managed by local governments, which shall operate independently pursuant to law. Duties may be imposed on a local government only pursuant to law or by agreement with the local government. Expenditure related to duties of the state imposed by law on a local government shall be funded from the state budget.*" Therefore, all fundamental rights and freedoms in respect of the autonomy of local self-government are granted on the level of the Constitution in full accordance with the principles of local self-government of the Charter in Estonia.<sup>18</sup>

In the case of Estonia, pursuant to the Preamble of the CRE, the state exists for the Estonian nation, language and culture 'through the ages'. Thus, most important (to avoid saying that the only) reason for the CRE to exist is for the establishment and existence of the Estonian state. It is very clearly stated in §14 of the CRE that "*the guarantee of rights and freedoms is the duty of the legislative, executive and judicial powers, and of local governments.*" Furthermore, pursuant to Article 4 of the CRE, "*the activities of the Riigikogu, the President of the Republic, the Government of the Republic, and the courts shall be organised on the principle of separation and balance of powers.*" One can see that nothing concerning the separation of duties and the balance of powers between the central government and local self-government is stipulated in this very fundamental article of the CRE. Pursuant to Clause 6 (4) of the LGOA, local governments fulfil the state functions which are assigned to them by law or which arise from a contract between an authorised state body and a specific council. Thus, according to the spirit of the CRE, the

central and local governments form a holistic integral organization in Estonia and the local self-government sector is one particular level of the holistic public administration organization in a state.<sup>19</sup> Hence, the absolute abstract autonomy of LGS as an end in itself, without the context of the most important purpose of a nation-state and without the main purpose<sup>20</sup> of LGS within the state, would not be a relevant object of treatment in actual socio-political life, may be misleading and does not match the paradigm of the Charter as well.<sup>21</sup> Consequently, the autonomy of the local self-government sector should be treated first of all in light of the main purpose of the nation-state; then afterwards in light of the interests of the local inhabitants and finally in light of the autonomy of local self-government as an end in itself. This particular aspect is very important to remember especially in the case of a politically unitary nation-state.

An essential subject of **political control** (mainly *ex ante* control) in Estonia is parliament *Riigikogu*,<sup>22</sup> but the expedient subjects of political control are the President of the Republic,<sup>23</sup> Government of the Republic<sup>24</sup> and ministries<sup>25</sup> as well. An Estonian particularity is that on the state level, political leaders belonging to the government coalition channel the execution of power into a coalition council (*ex ante* political control) which is not provided for by the constitution<sup>26</sup> (Linnas 2007, 284). The Government of the Republic has a strong tool of political control (*ex ante* control) of LGUs in the form of the allocation of funds from the state budget to local government-sector budgets. For example, according to Clause 8 (9) of the RMCBA, the Government of the Republic has the right, on the proposal of the Minister of Finance, to suspend making payments from the budget equalisation fund to a local government if it is taking a loan, unless a copy of the loan agreement is submitted to the Ministry of Finance, or the issue of debt instruments, unless it is registered with the Financial Supervision Authority, becomes known to the Ministry of Finance. The issuance of payments shall be suspended until the submission of a copy of the loan agreement or registration of the issu-

ance of debt instruments. The right to suspend such payments from the budget equalisation fund to a local government is a rather big issue under question in the context of the autonomy of LGS. The author is of the opinion that all decisions concerning the allocation of funds from the state budget to the total budget of an LGS or a budget of a particular LGU and the suspension of financing of an LGS' total budget or the budget of a particular LGU from the state budget shall be done by parliament in a democratic parliamentary state. This is largely supported by Ezugbaia and Melkadze (2002, 117), who argue that "... *In many European states supervision is maintained under the expediency motivation, especially in the financial field. This directly contradicts the requirement of paragraph 2 of Article 8 of the European Charter, under which any administrative supervision of the activities of the local authorities shall normally aim only at ensuring compliance with the law and with the constitutional principles.*" Other subjects executing ECS over LGUs are the Chancellor of Justice;<sup>27</sup> courts, including the Supreme Court of Estonia; National Electoral Committee; Prosecutor's Office;<sup>28</sup> State Audit Office<sup>29</sup> and County Governors.<sup>30</sup>

Pursuant to §139 of the CRE, the Chancellor of Justice (hereinafter called CJ) shall be, in his or her activities, an independent official who shall review the legislation of the legislative and executive powers and of local governments for conformity with the CRE and the laws (constitutional review, **constitutional control**; *ex post* control). The CJ shall analyze proposals made to him or her concerning the amendment of laws, the passage of new laws, and the activities of state agencies, and, if necessary, shall present a report to *Riigikogu*. Pursuant to §142 of the CRE, if the CJ finds that legislation passed by the legislative or executive powers or by a local government is in conflict with the CRE or a law, he or she shall demand the body which passed it bring the legislation into conformity with the CRE or the law within twenty days. If the legislation is not brought into conformity with the CRE or the law within twenty days, the CJ

shall request the Supreme Court to declare the legislation invalid.

The legal framework for **judicial control** and **supervision** (*ex post* control and supervision) has been enacted on both the constitutional and legal levels. Pursuant to §146 of the CRE, justice shall be administered solely by the courts. The courts shall be independent in their activities and shall administer justice in accordance with the Constitution and the laws. There are a number of laws covering the issues of judicial *ex post* control and supervision over LGUs in Estonia. In this article, judicial supervision is of marginal importance and is not a focus of treatment, because no court has the right to act on its own initiative in protecting the rights, freedoms and interests of anyone in Estonia.<sup>31</sup> However, according to Jean-Marie Woehrling (2005, 2), "*a state based on the rule of law implies the capacity of citizens to submit administrative actions to judicial control. Moreover, judicial control appears to be an indispensable instrument to enhance the quality of administrative action and ensure good governance.*"

Another supervisory subject executing **legal supervision** (*ex post* supervision) of local government is the National Electoral Committee (hereinafter called NEC), which serves as the second level of appeal in electoral complaints. Pursuant to Clause 17 (1) of the Local Government Council Election Act (hereinafter called LGCEA), the function of the National Electoral Committee is to ensure the uniformity of the conduct of council elections, instruct other electoral committees, exercise supervision of their activities and perform other functions arising from law. Pursuant to Clause 17 (2) of the LGCEA, the NEC has the right, among other rights, to issue precepts for the elimination of deficiencies of an act or resolution of an LGU's electoral committee; suspend an act or the validity of a resolution of an LGU's electoral committee; declare a resolution of an LGU's electoral committee invalid and, if necessary, issue a precept for a new resolution to be adopted. In general, the NEC has two types of actions. During LGU council elections, the NEC serves as the second level of appeal for electoral complaints. During the



time between elections, the NEC processes complaints about the premature termination of a council member's authority, suspension of a council member's authority and the replacement of a council member by an alternate council member.

**Economic control** (*ex post* control) in Estonia is the responsibility of the State Audit Office (hereinafter called SAO, CRE §132), which is an independent state body in its activities. Pursuant to §133 of the CRE, the SAO shall audit, among other issues, the use and disposal of state assets which have been transferred to the control of local governments. Pursuant to Clause 7 (1) 3) of the SAOA, the SAO shall exercise economic control over LGUs. The SAO exercises control of LGUs with respect to the following persons and areas: local governments in their possession, use, and disposal of municipal assets; foundations and not-for-profit associations in which a local government participates as a founder or member; companies controlled by local governments and the subsidiaries of such companies (SAOA Clause 7 (2)). The SAO shall exercise economic control over local governments in so far as they use movable and immovable property of the state transferred to their possession, allocations for specific purposes, subsidies granted from the state budget, and funds allocated for the performance of state functions (SAOA Clause 7 (2')). Pursuant to Clause 7 (4) of the SAOA, the SAO shall audit the use of European Union funds allocated through local governments and the performance of obligations to the European Union assumed in connection with such funds. With regard to the end users of the European Union funds and persons who have obligations to the European Union, the National Audit Office has the right to perform procedural acts in order to ascertain the validity of the circumstances which were the basis for the receipt of such funds and the legality of their use as well as the performance of the obligations.

Different ministries and government agencies have to exercise different type of ECS in very different fields (mostly administrative, financial and legal control, and supervision).

For example, projects funded by the European Union are audited by an authorized auditor appointed by an authorized body of the European Union (RT I, 2006, 7, 42), but also by the SAO (RT I, 2005, 32, 235; RT I, 2006, 25, 190), the Ministry of Finance (RT I, 2006, 7, 42; RT I, 2006, 25, 190) and the Ministry of the Interior (RT I, 2006, 25, 190).<sup>32</sup> According to Clause 8 (7) of the RMCBA, LGUs are required to register both public and closed issues of debt instruments with the Financial Supervision Authority. The closed issues of debt instruments by rural municipalities or cities shall be registered under the conditions and in compliance with the rules of procedure for the registration of public issues provided for in the Securities Market Act (*ex ante* control). Pursuant to Clause 8 (8) of the RMCBA, the Financial Supervision Authority shall inform the Ministry of Finance of an issue of debt instruments by a rural municipality or city within five days of the registration of the issue. According to Clause 77 (1) 6) of the GRA, the State Chancellery shall manage issues relating to state and local government insignia pursuant to the laws and legislation of the Government of the Republic and pursuant to Clause 77 (1) 10) of the GRA, co-ordinate the training and evaluation of state and local government officials.<sup>33</sup> The State Archivist executes the archival supervision (RT I, 2004, 28, 188) of LGUs. The Environmental Investment Centre is responsible for controlling the expedient use of the funds allocated to LGUs via environmental investment projects that are financed by the income gained from environment usage (RT I, 2005, 67, 512). According to Clause 1 (1) of the POA, the Prosecutor's Office (hereinafter called PO) is a government agency within the Ministry of Justice which participates in the planning of the surveillance necessary to detect and combat criminal offences, directs pre-trial criminal procedure and ensures the legality and efficiency thereof, represents public prosecution in court and performs other duties assigned to it by law. The Government of the Republic shall appoint the Chief Public Prosecutor to office on the proposal of the Minister of Justice after considering the opinion of

the Legal Affairs Committee of *Riigikogu* (Clause 16 (1) of the POA) and the Government of the Republic shall appoint the leading public prosecutor to office on the proposal of the Chief Public Prosecutor (Clause 16 (2) of the POA). Prosecutors have a legal assurance of independence because the Chief Public Prosecutor and the leading prosecutor shall be appointed to office for a term of five years (Clause 17 (1) of the POA). This list is not exhaustive, but illustrative enough.

A very particular and in some extent central subject of state control (administrative control, legal control) and supervision (administrative and legal) over LGUs at the regional level used to be county governor (Hereinafter called CG) and his/her office. Pursuant to Clause 85 (1) of the GRA, a county governor has the right to exercise supervision over the legality of the legislation of a specific application of local governments and local government councils of the county in question and, in cases and to the extent provided by law, also over the legality and purposefulness of the use of state assets in the use or control of local governments (*ex post* control and supervision). Pursuant to Clause 85 (4) of the GRA, if a county governor finds that the legislation of a specific application of a local government council or government is, in full or in part, in conflict with the Constitution, a law or other legislation issued pursuant to law, he or she may submit a proposal in writing to bring the legislation of the specific application or a provision thereof into conformity with the Constitution, the law or other legislation within fifteen days. If the council or government of LGU does not or refuses to bring the legislation of a specific application or a provision thereof into conformity with the Constitution, a law or other legislation within fifteen days after receipt of the written proposal, the county governor shall file a protest with an administrative court pursuant to the procedure prescribed in the Code of Administrative Court Procedure. Pursuant to Clause 85 (5) of the GRA, if a county governor files a petition with the Chancellor of Justice pursuant to §14 and §160 of the CRE and §12 of the Chancellor of Justice Activities Organisa-

tion Act to control the conformity of legislation of a general application or a provision thereof of a local government body with the Constitution or other law, the county governor shall, on the same day, also send a copy of the petition to the local government body which passed the legal instrument. Pursuant to Clause 85 (6) of the GRA, if the county governor discovers that the local government has possessed, used or disposed of state assets unlawfully or non-purposefully, he or she shall file a report with the SAO, or with an investigative or other competent agency, and forward, together with the report, documents and other materials at his or her disposal which prove this accusation. Pursuant to Clause 85 (7) of the GRA, a county governor or an official authorised by a county governor's order has the right to control the performance of state functions assigned to local governments by law or assumed by local governments by an administrative contract. According to Clause 8 (5) of the RMCBA, an LGU government is required to forward a copy of any LGU council resolution it makes on the taking of a loan or other proprietary obligation to the county governor within three days of its entry into force.

How the legal framework described in this chapter is implemented in actual life in the public sector, particularly in the local government sector in Estonia, will be presented in the next chapter. However, taking a look into the abovementioned legal framework, one can come to five clear conclusions. The external control and supervision system of LGUs in Estonia is 1) definitely based on a solid and adequate constitutional and legal framework; 2) in full accordance with the European Charter of Local Self-Government in this particular respect; 3) not understood, treated, designed and maintained like an integral, coherent holistic system or organisation; 4) a comprehensive, complex, varied system, with sub-systems and elements acting in an uncoordinated manner and as a result it actually has a low capacity; 5) somewhat biased in favour of the state in respect of *ex ante* control. However, one can come to one more conclusion (the 6<sup>th</sup>) – the control and supervision

of LGUs executed by the state (administrative, constitutional, governmental, judicial, political) in Estonia is in general and by large sufficiently public, transparent and democratic enough. According to Shann Turnbull (2007a, 5), Principal of the International Institute for Self-governance, "... *law makers and Regulators do not have the intellectual tools to design efficient and effective regulation.*" A strong ethical environment is a key component of good governance, which is widely perceived as being essential in ensuring sustainable and effective performance in local authorities (SBE 2007, 9). Consequently, one cannot rely too much only on the idea of a never-ending improvement of the legal framework and strengthening of ECS activities, but more attention and effort have to be put on promoting ethical values in the public sector and all of society. However, the present situation of ECSS evidently confirms that when the constitutional and legal framework is solid and adequate, the concept of ECSS of LGUs should be more developed; ECSS should be treated as holistic complex system and the existing ECSS of LGUs should be better administered, particularly in respect to coordination.

### State of External Control and Supervision of Local Self-Government Units in Estonia

The previous chapter highlighted the legislative framework underpinning the key ECS bodies and the implications of these for the conduct of control and supervision of LGUs in Estonia.<sup>34</sup> This chapter considers the present state of ECS of LGUs in Estonia through the subjects of control and supervision.

**Political control**, like other types of control and supervision, has positive and negative sides. Political control can be maintained through tight political controls imposed through regulations (Rodan 1998, 17) and other institutions,<sup>35</sup> political censorship (Rodan 1998, 18), counterinsurgency (Hippler 2006, 47), appointments of high-ranking civil servants, appointment and removal power

(Stephenson 2007, 42), supervisory and directive authority (Stephenson 2007, 42), agency organization (Stephenson 2007, 42), judicial deference to agency decisions (Stephenson 2007, 42), judicial review (Pulido 2006), legal doctrine (Jacobi and Tiller 2005, 1), decisions regarding resource allocation,<sup>36</sup> influencing LGU politicians or public servants, highlighting values publicly, etc. However, in Estonia, according to Ülle Madise (2007), "*when political parties in the parliament have — without a doubt — tried to increase their advantages in maintaining and regaining power, politically independent constitutional institutions have worked against this.*" Another possibility of decreasing the power of political control executed on the state level by state-level politicians in other levels is to limit their scope of activity. In Estonia, a member of the Riigikogu cannot serve as a member of a local government council and several laws prohibit hiring the members of a management board or management body of a political party to work in certain positions (Madise 2007).

One considerable phenomenon (to avoid saying impropriety) concerning ECS in Estonia is a very high level and growing trend of a sense of corporatism in political and social life. Most dangerous for democracy are non-constitutional bodies such as a council of coalition, which hijacks the government and parliament's constitutional rights of decision making. Likewise, "*innovations in political control technology are powerful new tools at the disposal of states in need of technical fixes for their most pressing and intractable social and political problems*" (EPDGR 1998, 3). However, Gary Rodan (1998, 1), professor of politics at Murdoch University in West Australia, argues "*the advent of information technology (IT) has generally been heralded as a force for the breakdown of authoritarian political control.*" According to Stephenson (2007, 2), "*except in special cases, majoritarian values are best served by a degree of bureaucratic insulation from political control.*" How to reach this situation is a very tricky question, particularly in the context where state-level control and supervision is a growing trend not only in Estonia, but all over the

world. One can get a hint from Rait Maruste, a judge of the European Court of Human Rights, (2007), who argues that *"a true and functioning constitutional democracy is based first of all on thinking, values, good will and practice, faith and experience. These are categories that take much longer and greater effort to evolve than economic wealth or formal lawfulness."*

The supervision done by the CJ is often based on a single complaint,<sup>37</sup> although the CJ also performs independent systemic risk-based supervision (Linnas 2007, 286). According to Indrek Teder (2008), the Chancellor of Justice of Estonia, many LGUs in Estonia do not have the capacity to carry out public functions in the expected amount and at level of quality expected, but there are too many small LGUs in Estonia for the Office of the CJ to be able to supervise all of them. According to Allar Jõks, former Chancellor of Justice of Estonia (2007), *"addressing the Chancellor of Justice is not a judicial remedy but, rather, a last resort after all judicial remedies have been exhausted."* Furthermore, Allar Jõks (2007) argues that *"the language of the Chancellor of Justice and the Supreme Court is limited to interpretation of the Constitution and has to proceed from this interpretation as its set task. The language of politics is almost unlimited."* Yet, Kaarlo Tuori (2007) warns *"judiciary ultimately monitors the observance of constitutional basic-rights provisions, but is not subject to democratic control, because it lacks democratic legitimacy."* Furthermore, Tuori (2007) argues that constitutional rights may accelerate development toward a judiciary state.

There has not been very much research done on the autonomy of administrative and judicial control and supervision of LGUs in Estonia, but the most important subjects of constitutional and judicial control and supervision (the Supreme Court and the CJ) are highly respected in society and execute their tasks and obligations with dignity. According to Vallo Olle (2007), *"the judicial practice of the Supreme Court in the area of suffrage – and, naturally, not in that area alone – has definitely strengthened a democratic state-*

*hood of Estonia based on the rule of law. The positions expressed by the highest national court in defence of the principles of local government autonomy and the representativeness of its representative body are of lasting value for the guarantee of this constitutional institution that is closest to its citizens."* However, Maruste (2007) states that *"especially disturbing is the grounding of judicial protection of rights and freedoms only, or largely, in the paradigm of formal lawfulness. Basing the protection of rights and freedoms on formal lawfulness means having regard for the arguments of one side only, state authority, as law is nothing other than an instrument of power."* According to Wolfgang Drechsler, professor of Tallinn University of Technology (2007), *"municipal autonomy and the central state are suspended in a necessary institutional tension, and thus the demand for the Supreme Court<sup>38</sup> to protect the municipalities, which are the weaker side, is and will always be there."* Katrin Saaremäel-Stoilov (2007) points out that *"the Supreme Court of Estonia has dealt with social-state-related cases extremely carefully, mindful of all the dangers that could emanate from such claims, and it has used most of the judicial tools at its disposal to protect itself from the double-edged sword. This has led to a moderate level of judicial protection of social rights and leaves most of the questions for the legislator to solve."<sup>39</sup>* Thus, the Supreme Court as an institution made up of human beings can be under its own control to some extent even has all the legal guarantees for independence. Pursuant to §146 of the CRE, justice shall be administered solely by the courts. The courts shall be independent in their activities and shall administer justice in accordance with the Constitution and the laws. However, there are still relevant possibilities to influence their work with other political measures. According to Taavi Annus (2007), factors restricting the freedom of a constitutional court are the political convictions and ideologies of the judges, politics inside the court, the influence of other political institutions on the courts and the influence exerted on the courts by interest groups and the public. In Estonia, the eco-

conomic and administrative affairs of courts are under the responsibility of the Ministry of Justice. Thus, there cannot be a one hundred percent assurance that the judicial control and supervision of LGUs is without any degree of political bias. However, in this article judicial supervision is a marginal, not a focal subject of treatment.<sup>40</sup> In addition, Estonians are generally very conservative plaintiffs and do not like settle arguments in court. However, only an administrative court can give a legal opinion on a decision or omission of council of an LGU. Thus, one cannot downgrade the role of administrative courts in Estonia. There is another aspect of the performance of judicial control over the activities of the central and local governments as well. Mollah (2006, 16) argues *"in all the law of judicial control perhaps the central topic is the question how far the courts will go in investigating the motives and merits of government action."*

*Riigikontroll* (SAO of Estonia), the economic controller of the public sector, plays a major role in supplying *Riigikogu* and the public with independent and objective feedback on the effectiveness of the choices made and on any shortcomings identified (Oviir 2007). According to Mihkel Oviir, the Auditor General of the Republic of Estonia (2007), *"it should be stressed that the chief purpose of economic control is to provide an overview of the actual situation. In addition, the assessments and conclusions of an independent external auditing body should provide the audited entity with a good basis for quality decisions and enhance the reliability of the audited entity in the eyes of third parties."* The activity of the SAO is not aimed just at representing the interests of the public administration before municipal administrations (Oviir, 2007). The control powers of the SAO do not extend to assessing the effectiveness of local government management, organization and activities (Oviir 2007). Here it is worthy to remember that *Riigikontroll* acts only as an external auditor providing independent and objective information first of all to *Riigikogu* and society at large. Municipal councils and governments are very free to decide whether to follow the recommendations of SAO or not.

Consequently, *Riigikogu* cannot be understood to be a controller over the LGS in the principal meaning of control.<sup>41</sup> A special audit department (with 12 auditors as of 30.01.2009) to audit LGUs was set up on January 1<sup>st</sup>, 2006, but due to the large number of entities within the scope of SAO auditing, very limited resources for the performance of LGU audits is available and subsequently a risk-based approach is used; the auditing of an LGU or an activity or issue of an LGU takes place once every 3 to 5 years (Linnas 2007, 286).<sup>42</sup> In essence, the audits performed by the SAO are rather superficial. They do not go very deep into problems and reasons behind them (Linnas 2007, 286).

The National Electoral Committee plays an important role in safeguarding democracy in society. In the case of Estonia, the NEC has no regional offices, but rural municipality or city electoral committees are formatted by LGU councils. The chairman of a rural municipality or city electoral committee shall be the corresponding rural municipality or city secretary and the members of the rural municipality or city electoral committee shall be appointed by the council on the proposal of the rural municipality or city secretary. Thus, the most important role in the electoral process is played by local politicians. The NEC has no power to invalidate a resolution of an LGU council that might be against the law and this particular decision is in effect up to the resolution of a court (Rask 2007). County governors play the role of "middleman", but sometimes a county governor exercising supervision of a particular LGU is a party-mate of the majority party on the council of the LGU in question and may not act as objectively as expected by the law. According to the data provided by the Elections Department of *Riigikogu*, the NEC in its supervisory process over LGUs has conducted the following actions: in 2000, 1 supervision; in 2001, 1 supervision and 1 complaint; in 2002, 4 supervisions and 18 complaints; in 2003, 11 complaints; in 2004, 2 supervisions and 14 complaints; in 2005, 1 supervision and 30 complaints; in 2006, 1 supervision and 8 complaints; in 2007, 1 supervision and 4 com-

plaints; and in 2008, 1 supervision and 1 complaint. Thus, the role of the NEC in the ECS activities of LGUs remains less numerous regarding the number of control and supervisory cases in comparison with the activities of other subjects responsible for ECS over LGUs. However, the significance of the NEC in the ECSS of LGUs cannot be underestimated. Ezugbaia and Melkadze (2002, 117) argue that *"during the process of implementation of the European Charter of Human Rights, serious problems could be encountered in the field of the mechanisms for democratic transformation and the purpose of state supervision of local authorities."*

Even the Chief Public Prosecutor and other prosecutors in Estonia have legal guarantees for independence and objectivity in the performance of their duties, the Prosecutor's Office is under the political and financial control of the Government of the Republic via the Ministry of Justice.<sup>43</sup> It is not uncommon to have a situation where the PO will not commence or conduct a criminal procedure without the preliminary approval of the Minister of Justice or will terminate criminal proceedings under pressure of the Minister of Justice.<sup>44</sup> The proper and prudent function of the PO is of crucial importance because of two significant reasons. First, the local government sector has a higher level of risk of corruption, conflict of interests and misuse of public resources than the state sector in Estonia. Second, political parties and their financiers are very keen to realise their selfish financial interests via LGUs and therefore they protect the corrupt politicians and public servants of LGUs who are very loyal to them using different political, administrative and legal measures. The author suggests that in a parliamentary democratic state the Chief Public Prosecutor and the Prosecutor's Office should be out of direct political, economic and administrative *ex ante* control of the Ministry of Justice and the Government.<sup>45</sup>

The Ministry of Finance exercises supervision and audit, controls and reviews foreign aid-related funds and those allocated for specific purposes as well as the purposeful and lawful usage of the assistance granted, but its

capability in performing those tasks is restricted due to limited resources (Metsalu 2006, 3). However, the Government of the Republic has no solutions to prevent local governments from encountering solvency problems, to deal with local governments that have already encountered such financial difficulties, and to organize financial supervision of the financial situation of local governments (Metsalu 2006, 3). Here it is very hard to find an easy, legally correct and fair solution between the interests of the state and LGS. The author is of the opinion that local self-government units have to have autonomy in taking loans, but at same time the state has to have instruments to protect the financial interests of the state as a holistic organisation in general. According to Sellers and Lidström (2007, 17–18), *"lower local capacities and in some instances more supervision make local government in these systems more state-dependent."* Consequently, it is important to keep an optimal balance between the two different poles of society: the state and LGS. Solutions for strengthening the administrative capacity of LGUs in Estonia are evidently needed.

The supervision of LGUs exercised by a county governor is only supervision over the legitimacy of individual acts adopted by the councils and governments of the local government units of the given county, and, in the cases and to the extent provided by law, also over the legitimacy, purposefulness and expediency of state assets put in use by local government units, but not over the expediency, efficiency and effectiveness of activities and financing (Linnas 2007, 286). County governors have a conflict of interest because they serve as a representative and supervisory body of government and represent the interests of LGUs against the state government as well. County governors have to be released from this conflict of interest situation. This means that the tasks of entire, coherent and systemic regional development should be transferred from county governors to the associations of LGUs acting on the territory of the counties in question. The actual administrative capacity of a county governor in supervising the lawfulness of local government activities is

*Article 3 cont0*

Raivo Linna, Legal Framework and Present State..., Kunnallistieteellinen aikakauskirja 2/09

**Table 1.**

<b>Field of supervision executed by County Governors over the LGUs in Estonia<sup>46</sup></b>	<b>No of proceedings in 2003</b>	<b>No of proceedings in 2006</b>
Legality of legislation of specific application of local governments and local government councils.	313	1317
Legality and purposefulness of the use of state assets in the use or control of local governments.	32	0
Land readjustment.	6	1533
Land restitution.	9711	4048
Legality of privatisation of dwellings owned by local governments.	22	24
Legality of privatisation of non-living space owned by local governments.	6	3
Return, distribution and use of funds earned from privatization of municipal assets.	3	24
Performance of agricultural reform.	0	14
Determining value of property and compensation.	919	430
Return of unlawfully expropriated property.	368	148
Performance of family doctors.	373 <sup>47</sup>	311
Quality of social services and other aid. Purposeful use of funds allocated for social aid from the state budget.	305 <sup>48</sup>	200
Educational and development activities in children's facilities.	See footnote 1. <sup>49, 50</sup>	182
Educational and development activities in vocational education facilities.	See footnote 1.	9
Educational and development activities in secondary schools and gymnasiums.	See footnote 1.	222
Purposeful use of funds allocated to youth work from the state budget.	353 <sup>51</sup>	179
Performance of duties and tasks by public libraries.	14	5
General and detailed planning.	449	1003
Fulfilment of requirements of passenger carrier licences and line licences of public and light transport, fulfilment of public service agreements and contracts of public and light transport, fulfilment of administrative agreements and contracts of public and light transport.	289 <sup>52</sup>	171
Fulfilment of requirements of Compulsory State Defence Tributes Law.	0	0
Other supervision.	132 <sup>53</sup>	3499
<b>In total</b>	<b>13295</b>	<b>13322</b>

often unsystematic, inconsistent and insufficient (Linnas 2007, 286). (See table 1 and table 2)

A county governor may be unobjective and politically biased, as the posts of county governors are allocated according to political affiliation or other political reasons and one's competence is of secondary importance (Linnas 2007, 286). Furthermore, county governors are in a permanent situation of political pressure and uncertainty because of long-lasting discussions over their role and scope of responsibilities. County governors used to be seen as respectable representatives of the central government in the regions, but at the moment they are somewhat heads of department of the Ministry of the Interior. Arno Almann, professor of EBS (2007), argues that the organization of public administration should be handled *"as a complete system with relations and balance among various administrative levels, and where the changes planned in the functions, organisation, and legal status of the parts of the system cause changes in the system as a whole as well."* Linnas (2007, 290) gets more specific arguing that the audit, control and supervision of LGUs form a uniform cohesive whole. Taking together these two views and the actual (and possible future) role of a county governor and his/her office, one can conclude that a county governor can play a key role in that. A county governor may be seen as a central body responsible for the co-ordination of ECS of LGUs if the county governor's role as a state supervisor will be very clearly stated.<sup>54</sup> This concept supports the ideas expressed earlier by Almann and Reimaa. Almann (2007) argues that state supervision has to be developed as a state guarantee of a balanced, complete system and the activities of bodies engaged in supervision have to be co-ordinated. Reimaa (2007) argues that in the course of regional administration, the current county governments should in the future become above all an institution which performs state supervision. The author is of the opinion that a county governor as an institution in the ACSS of LGUs in the regions should be preserved as central actor; the process of lessening the role and status of the

Table 2.

Inducements for exercising general supervision by county governments over LGUs in 2003	No of cases in 2003
Application of an individual.	238
Article in a newspaper.	4
Application of the Land Board.	30
Application of the Chancellor of Justice.	5
Initiative of a County Government.	17
Application of the Ministry of Defence.	2
Application of the Ministry of Finance.	2
Application of the Ministry of the Environment.	1
Application of a Member of the Council of an LGU.	3
Application of an LGU.	8
Application of the National Electoral Committee of Estonia.	2
Any other entity.	1

county governors' institution should be stopped and the authority, responsibilities and tasks of county governors in executing ACS of LGUs should be strengthened in level with the law.

Brodies LLP Management Consultancy (2007, 6) argue that *"there is a lack of coordination and cohesiveness across external scrutiny bodies, there is duplication in the information required to be submitted for different scrutiny exercises, there is a lack of coordination around the timing of scrutiny exercises and there are inconsistencies in external scrutiny approaches in Scotland."* This picture is not country specific for Scotland, but is similar to Estonia as well. According to Raivo Linnas (2007, 287), *"it can be concluded that legal framework gives an authority and responsibility for guard, control, assess and audit the operations of LOG (Local*



Government – the Author) *for number of institutions, but audit, control and supervision activities of the legitimacy, efficiency, and effectiveness of the operation of LOG units are unsystematic, insufficient, politically biased, often in an objective situation of conflict of interests and do not form an integral and coherent system.*” Thus, in this particular respect, it does not make a difference whether a state is from Western or Eastern Europe, or a new or old member of the EU. To conclude this chapter the author will highlight two main conclusions: 1) In the case of axis *ex ante* control – *ex post* supervision executed by different state-level institutions over the LGS, *ex ante* political, legal and financial control are rather dominating over *ex post* supervision in Estonia. 2) Political parties, politicians, lawyers and managers of LGUs complain against the unlawful and disproportional execution of *ex post* administrative, constitutional, economic and legal control and supervision over LGS. Thus, there is an evident and clear conflict between the constitutional normative situation and cognitive behaviour of officials and academicians in day-to-day life. This is rather surprising that long-lasting passionate debates are focused on matters of little consequence and not on actually important issues for society and a truly significant aspect in the sense of ECS of LGS.<sup>55</sup> The origins of this phenomenon are to be objects of further research.

The author suggests that *Riigikogu*, the President, the CJ and the Supreme Court of Estonia have to focus their activities on defending both the constitutional rights and freedoms of the residents of LGUs and the LGUs themselves with *ex ante* political, legal and financial control activities, tools and mechanisms. There is a common assumption all over the world that the regulation and inspection regime is a mechanism for improvement, but the inspection and regulation bodies in Wales have diverse views about their impact on the improvement of public services (LGPS, 2005, 25). Thus, there is at present a real risk threatening the discovery of a quick, optimal and reliable solution to that. However, ECS should serve the inhabitants of

LGUs in a manner that LGUs are to operate in the best possible way for their inhabitants and in the context of modern local governance<sup>56</sup>. This is especially so in situations where the administrative capacity of an LGU is low, the political and other risks are high, and the associations of LGUs in the country are not sufficiently well-developed. Yet, Sellers and Lidström (2007; 6–7) state “*supervision from above without local capacities would produce a monopoly of policy and implementation for supralocal governments. Even weak local capacities along with strong supervision would leave local government dependent on initiatives from higher level units.*” Only under conditions of full local political and fiscal autonomy will local government possess strong capabilities without hierarchical supervision (Sellers and Lidström, 2007; 6–7). Thus, to avoid increasing domination of state over LGUs, capacity of self-governance of LGUs in Estonia should be strengthened via material reforms of local self-government functions, finance and administrative-territorial division.

### Conclusions and some ideas on possible development

The aim of this paper is to 1) give an overview of the legislative framework underpinning the key control and supervision bodies of LGUs in Estonia; 2) discuss the issue of legal regulation and the present state of external control and supervision over local self-government units in Estonia; and 3) give some theoretical and practical suggestions to develop this field in Estonia and the rest of world as well. The analysis of the different dimensions and relations between external and internal control and supervision as well as discussions on holistic ACSS are out of this paper’s focus.

The author argues that the external control and supervision system of LGUs in Estonia is based on a solid and adequate constitutional and legal framework and is in general sufficiently public, transparent and democratic enough. However, it is somewhat biased in

favour of the state in respect of *ex ante* political and financial control and should be more developed and better administered. The present situation of ECSS evidently confirms that even though the constitutional and legal framework is solid and adequate, the concept of ECSS of LGUs should be more developed and existing ECSS of LGUs should be better administered, particularly considering coordination.

A review of the academic and non-academic literature confirms that scientists, researchers and practitioners across the world are used to treating the matter of external control and supervision of local self-governments in a separate, non-holistic and unsystematic manner. The author suggests for the sake of better governance and local self-governance that the external control and supervision system of local self-government shall be understood and treated as an integral part of the audit, control and supervision system, which is holistic.

A worldwide trend is that central governments are trying to take tighter control over local self-government units. The increasing power of state control and supervision of LGUs does not depend on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country. Thus, Estonia is not a unique example, but rather a generic case in the context of contemporary public administration.

The author argues that an absolutely abstract autonomy of LGS as an end in itself, without the context of the most important purpose of a nation state and without the main purpose of the local self-government in the state, would not be a relevant object of treatment in actual socio-political life, may be misleading and does not match with paradigm of the Charter as well. The author suggests that the optimum balance between the fundamental constitutional rights of local self-government and protection of the interests of the inhabitants in municipalities by state institutions should be reached. A great help in that direction will be a better assurance of LGUs with optimal financial resources via an enlargement of their financial base and other

resources. The lessons learnt in light of the case of Estonia evidently show that one cannot rely too much on the idea of an accomplished legal framework and everlasting strengthening of control and supervisory activities, but more attention and effort have to be put on the strengthening of the administrative capacity of the local self-government sector and promoting ethical values in society.

Not very much research has been done on the autonomy of administrative and judicial control and supervision over LGUs in Estonia. Consequently, there is no possibility of comparing more deeply the case of Estonia with the cases of neighbouring countries. More research has to be done in this field. However, one can conclude that the situation in Estonia is very similar to other states, particularly in the point of view that though there is a somewhat biased *ex ante* political and financial control over the activities of LGS, even the autonomy of the local self-government sector is guaranteed in the constitution and laws.

## Endnotes

<sup>1</sup> This argument is supported by the socio-psychological and biological (human) stem of the control subject. Self-control and external control are socio-psychological factors of human beings' behaviour. In the very context of this particular article, human beings are the most important imperative factors of the subject of control and supervision in society. Human beings here should be understood as the imperative subject of control and supervision (both in the role of controller/supervisor and controlled/supervised) functions and system as well as the beneficiary (inhabitant/taxpayer/customer) of public management, including control and supervision functions, outcomes and impacts. According to Ayelet Fishbach and Yaacov Trope (2005, 257), externally imposed controls may operate as actual demands to act in a certain manner; they operate as primed mental representations of social demands. However, the author will not treat the subject of control in the context of psychology in this article, but rather in the context of state sciences, general management theory and general organizational theory.

<sup>2</sup> Control has different definitions, appears in several models, can be used in varying contexts and can be specified using different characteristics such as administrative control (USMG), bureaucratic control (Stephenson, 2007, 18; Weber), congressional control (Stephenson, 2007, 42), constitutional control (Pennings, 2003, 541; Pulido, 2006), democratic control, government control (Hippler, 2006, 41; Benjamin, 2003, 2012), judicial control (Bebr, 1962, 33 and 1981, 5), judicial-political control (Jacobi and Tiller, 2005), legal control (Wesley-Smith, 1999, 145; Vandall, 2006), national control (CDG, 2000, 65),

organizational control (Johansen, 2003, 2), political control (Bebr, 1962, 33; Hippler, 2006, 10; Stephenson, 2007, 1), presidential control (Stephenson, 2007, 6), private control (Benjamin, 2003, 2009; Viani, 2004, 217), public control (Benjamin, 2003, 2009), regulatory control, social control (Hippler, 2006, 17), state control (IMO; Viani, 2004, 217), statutory control (Jacobi and Tiller, 2005, 6; Huber, Shipan and Pfähler, 2001, 339), supervision control (FESA, 2005, 2), etc.

<sup>3</sup> Supervision is usually understood as a continuous control of the observation of legal requirements (FESA, 2005, 1). By its nature, supervision is a privilege of an independent authority and as such, is limited by the constraints of the force of its legal regulation (FESA, 2005, 1). Supervision, like control, has different definitions, appears in several models, can be used in different contexts and can be specified by subjects such as administrative supervision (CE, 2002, 13), constitutional supervision, democratic supervision (Pflimlin, 1996), expert supervision, financial supervision (CE, 2002, 13), functional-risk-focused supervision (FRS, 2007, Section 2124.01, page 6), inter-institutional supervision (Reed, 1995), judicial supervision (CE, 2002, 13), legal supervision (CE, 2002, 12), management supervision (Pflimlin, 1996), monitoring supervision (AMA-ASSN, 1999, 3), mutual supervision (Reed, 1995), political supervision (CE, 2002, 9, 13; Derthick, 1979, 63; Reed, 1995; Pflimlin, 1996), public supervision, state supervision, statutory supervision (Mollah, 2006, 21), strategic supervision (Pflimlin, 1996), technical supervision (Pflimlin, 1996, TSA), etc.

<sup>4</sup> EEA: "Monitoring – The provision of the necessary information about progress of implementation of a project, plan, etc. in order to ensure that project management and cooperation partners are able to follow the implementation of the projects and if necessary adjust activities, inputs and budgets, in order to obtain the objectives laid down for the project".

<sup>5</sup> EEA: "Surveillance – System that permits the continuous observation, measurement and evaluation of the progress of a process or phenomenon with the view to taking corrective measures."

<sup>6</sup> The purpose of state supervision is clearly and simply defined in Article 108 of the Bavarian Local Government Law as follows: "The supervisory authorities ought to advise, encourage and protect with understanding the municipalities in the performance of their tasks and they ought to reinforce the decision-making force and the responsibility for their own action of the municipality bodies." (Haschke, 1997)

<sup>7</sup> For example, according to Teresa Ter-Minassian and Jon Craig (1997, 29), "Country approaches to the control of subnational borrowing can be grouped into four broad categories, although most countries utilize a mix of them. ... The four "stylized" categories are (1) sole or primary reliance on market discipline; (2) cooperation by different levels of government in the design and implementation of debt controls; (3) rules-based controls; and (4) administrative controls."

<sup>8</sup> According to Sellers and Lidström (2007, 16), "Countries generally rely on various combinations of instruments to exercise control over localities. Belgium, Greece, Austria and Spain, rank high for both politico-administrative and fiscal supervision. Canada, Australia and the U.S., range relatively low in both. Countries between these two clusters, including all of the Scandinavian countries, have looked more to one than to the other type."

<sup>9</sup> Ezugbaia and Melkadze (2002, 109) argue that in a number of states control is associated with a full supervision both from the legal and the reasonability point of view, including the prior authorisation to act and the power to annul a local authority's decision.

<sup>10</sup> Direct central government controls are more common in unitary states than in federations (Ter-Minassian and Craig, 1997, 13).

<sup>11</sup> According to Dieter Haschke (1997), "State supervision is the term used to designate the state executive that supervises the local authorities' right to local autonomy and, where appropriate, limits it on the basis of the law. State supervision is thus the correlate of the local authorities' right to local autonomy. For state supervision the division of local authority activities into performing the tasks of the own and the transferred sphere of activity is important in that it results in the subdivision into legal supervision and expert supervision."

<sup>12</sup> In this aspect, the situation is very similar in Armenia (Arabyan, 2007, 15), Australia (Davis, Downe and Martin, 2001, 2), Latvia (IMF, 2001, 4), Norway (Sellers and Lidström, 2007), South Korea (Chong-Min, 2006, 14), the USA (CDG, 200, 37; Coleman and Colantuono, 2003, 20), and Uzbekistan (Bektemirov and Rahimov, 2001, 507). One can see that the increasing power of state control and supervision over LGUs does not depend on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country.

<sup>13</sup> This may lead to a violation of the sovereignty of local self-government (Arabyan, 2007, 15).

<sup>14</sup> This is not very unique particularly for small states, but may be present in huge countries as well. For example, see the recent history of the Russian Federation. Nevertheless, such a risk is more likely in small societies.

<sup>15</sup> According to Sepp, Noorkõiv and Haljaste (2006, 3), LGUs are to be understood in four dimensions: as a part of the state administrative system, as a supplier of local public services, as a territorial corporation, and as a satisfier of the interests, needs and expectations of domestic inhabitants. The author would like to emphasize that in the very context of this article an LGU should be understood first of all as a part of the public sector, which is a coherent administrative system in a state, and as a territorial corporation. Thus, solutions to be offered have to stand in that light. This does not mean that the other two dimensions are irrelevant to any extent.

<sup>16</sup> Thus, a supervisor shall exercise the supervision (*ex ante* and *ex post*) of the supervisee to ensure that the supervisee fulfils its statutory tasks, does not violate laws and regulations when carrying out its tasks, and does not overstep its scope of duties.

<sup>17</sup> Thus, the subjects that exercise ECS of local government units are authorized international organizations, authorized European Union organizations, constitutional entities of state, central government of state and its authorities, political parties, media, civil society organizations and inhabitants/voters living on the administrative territory of particular LGU, but not a council of a particular LGU and its bodies, municipal or town government, mayor of a town or rural municipality, administration of an LGU and internal auditor of an LGU.

<sup>18</sup> Pursuant to §157 of the CRE a local government shall have an independent budget for which the basis and procedure for drafting it shall be provided by law. A local government has the right, on the basis of law, to levy and collect taxes, and to impose duties. Pursuant to §160 of

the CRE, the administration of local governments and the supervision of their activities shall be provided by law. One particular aspect is worth to highlight. Pursuant to §104 of the CRE, the Local Government Election Act may be passed and amended only by a majority of the membership of *Riigikogu*, but to pass and amend the Local Government Organisation Act (hereinafter called LGOA) there are no particular restrictions. Thus, political attempts on the state level to change the organization of local government are easier to perform in comparison with attempts to change local government elections, order and principles.

<sup>19</sup> Here it is important to highlight that in some cases local government is one constituent subject on a lower level on the vertical hierarchy of an organization called the state, and in some cases as a horizontal partner of other constituents as well.

<sup>20</sup> According to Vallo Olle (2007), in Estonia, the Supreme Court has "clearly and unambiguously stated that, according to the Constitution, a local government is based on the idea of a community: the duty of which is to resolve the problems of the community and manage the life thereof," and Supreme Court "does not consider local government autonomy to be an end in itself; rather, it defines as the goal of local government autonomy the decentralisation of public authority and the serving of the interests of restricting the state's authority and the counterbalancing thereof."

<sup>21</sup> This does not mean in whatever respect that the autonomy of local self-government as a juridical matter of research for academicians in different fields of juridical research shall not still be under focus.

<sup>22</sup> Pursuant to the Article 59 of the CRE, legislative power is vested in *Riigikogu*. Pursuant to Article 65 of the CRE, *Riigikogu* shall pass the state budget and approve the report on its implementation.

<sup>23</sup> Pursuant to the §78 of CRE, the President of the Republic shall: proclaim laws, pursuant to §105 and §107 of the Constitution, make proposals to *Riigikogu* for appointments to the offices of Chief Justice of the Supreme Court, Chairman of the Board of the Bank of Estonia, Auditor General, Chancellor of Justice, and Commander or Commander-in-Chief of the Armed Forces, and on the proposal of the Supreme Court, appoint judges.

<sup>24</sup> According to §86 of CRE, executive power is vested in the Government of the Republic. According to § 7, the Government of the Republic shall execute the domestic and foreign policies of the state; administer the implementation of laws, resolutions of *Riigikogu*, and legislation of the President of the Republic; introduce bills; prepare the draft of the state budget and submit it to *Riigikogu*, administer the implementation of the state budget and present a report on the implementation of the state budget to *Riigikogu*; issue regulations and orders on the basis of and for the implementation of law and perform other duties which the Constitution and the laws vest in the Government of the Republic. (This list is not complete.)

<sup>25</sup> Pursuant to Clause 14 of Statutes of the Ministry of the Interior (SMI), the Ministry shall plan and co-ordinate the development of local governments; within its competence analyses, plans and co-ordinates the state's local government policy; participates in the formation of the income and expense basis of local government budgets and in the establishment of a development of a national support system for local budgets within its competence, assists in establishing links between local authorities,

their associations and civic associations, and the Government of the Republic.

<sup>26</sup> According to Linnas (2007, 284–285), "the coalition council issues political guidelines to both the legislative power the *Riigikogu* and the executive power the Government of the Republic. This means the leadership of the state is in the hands of few people who provide guidelines to the legislative power and the executive power as well and the legislative body does not have possibility to perform political control over the executive body. This means the role of the majority of members of the *Riigikogu* is mostly to follow orders."

<sup>27</sup> Pursuant to Chapter XII of the CRE, the Chancellor of Justice serves as the reviewer of compliance with the Constitution and laws, as the Ombudsman, and as a higher criminal prosecutor. The constitutional review activities of the Chancellor of Justice may be conditionally divided into *ex ante* and *ex post* control.

<sup>28</sup> Pursuant to Clause 1 (1) of the POA, the Prosecutor's Office is a government agency within the Ministry of Justice which participates in the planning of surveillance necessary to detect and combat criminal offences, directs pre-trial criminal procedure while ensuring the legality and efficiency thereof, represents public prosecution in court and performs other duties assigned to the Prosecutor's Office by law.

<sup>29</sup> According to Clause 6 (1) of the SAOA, the main function of the SAO is to exercise economic control (audit). According to Clause 6 (2) of the SAOA, in the course of an audit, the NAO may assess the following: 1) internal control, financial management, financial accounting and the financial statements of the audited entity; 2) the legality of economic activities, including the economic transactions of the audited entity; 3) the performance of the audited entity with regard to its management, organization and activities; 4) the reliability of the information technology systems of the audited entity.

<sup>30</sup> Pursuant to §84 of the GRA, county governors shall, among other tasks and obligations, co-ordinate the co-operation of the regional offices of ministries and other agencies of executive power and local governments in the county; inform the Government of the Republic, the Minister of Regional Affairs and local governments on regional policy and other issues concerning relations between executive power and the local governments; conclude, by authorization of the Government of the Republic, administrative contracts with local governments for the performance of their state obligations; monitor the activities of local governments on the basis of and pursuant to the procedure provided for in §85 of the GRA, and perform the functions of supervisory control pursuant to §98 of the GRA; and declare supplementary elections of local government councils and elections due to the merger of local governments.

<sup>31</sup> This is a rather positive situation in some respect. According to Md. Awal Hossain Mollah (2006, 9), Rajshahi University, "the role of judiciary in protecting the citizens against the excess of officials has become all the more important with the increase in the powers and discretion of the public officials in the modern welfare states. But the courts cannot interfere in the administrative activities of their own accord. They can intervene only when they are invited to do so by any person who feels that his right have been abrogated or are likely to be abrogated as a result of some action of the public official. Secondly, the courts cannot interfere in each and every administrative act, as too much of Judicial action may make the official

*too much conscious and very little of it may make them negligent of the rights of citizens."*

<sup>32</sup> For example, according to Clause 8 (1<sup>2</sup>) of RMCBA, when taking a loan with the purpose of bridge financing, an LGU government is required to apply for permission from the Minister of Finance to do so, unless the loan is taken from the state. According to Clause 8 (6) of RMCBA, an LGU government is required to present a copy of a loan agreement entered into to the Ministry of Finance within five working days as of the date on which the contract is entered into. In the case of the assumption of other obligations specified in Subsection (1) of this section (except the issue of debt instruments), the Minister of Finance has the right to request that the LGU government submit a copy of the agreement entered into within five working days as of the submission of the corresponding request.

<sup>33</sup> According to The State Chancellery of the Republic of Estonia, there were 5449 civil servants in 227 LGUs in Estonia as of 31.12.2007.

<sup>34</sup> LGUs in Estonia are not in a very good situation politically, financially and administratively. They are over-politicized (Strandberg, 2007). Their financial basis has increased (MI 2007, 9) and they merge relatively actively, but the number of LGUs with less than 1000 inhabitants is growing (MI 2007, 10) in Estonia. The county associations of local governments, on the other hand, are not sufficiently well-developed (Reimaa, 2007).

<sup>35</sup> What the author means by an institution's rule systems and rule structures is to enable actors to conceive, pursue, and express their interests and desires, as well as to also coordinate those desires with other individuals as defined by Sandholtz and Stone Sweet (2004, 235–236).

<sup>36</sup> In the case of Estonia, political control via budgeting is significantly effective, because according to the data provided by the Ministry of Finance of the Republic of Estonia in the report "Local Government Budget 2003–2007", the share of sustenance costs (staff, administrative and other costs) in the total expenditure of the local self-government sector was 70% in 2003, 75% in 2004, 72% in 2005, 68% in 2006 and 71% in 2007. Thus, the financial capacity (spare funds) remaining to provide public services to LGUs inhabitants is very weak in Estonia and any change in the allocation of supplementary funds from the state budget to the LGS total budget has a significant impact.

<sup>37</sup> County governments submitted 18 cases to the Chancellor of Justice of the Republic of Estonia in 2003.

<sup>38</sup> Wolfgang Drechsler (2007) treats the Supreme Court as a part of the central government.

<sup>39</sup> According to Katrin Saaremäel-Stoilov (2007), "The level of protection of the principle of the social state by the Supreme Court of Estonia is comparable to that offered by the German and South African constitutional courts, as both use a relaxed standard of review in social-rights-related cases."

<sup>40</sup> For example, county governments submitted 29 lawsuits against LGUs to the administrative court in Estonia in 2006. County governments submitted only 396 lawsuits against 61 LGUs in administrative courts in Estonia in 2007. However, there are more subjects having the right to submit lawsuits to the administrative courts against LGUs in Estonia. After all, the role of administrative courts in the ECS activities of LGUs remains less numerous in respect to control and supervisory cases in comparison with the activities of other subjects responsible for ECS over LGUs.

<sup>41</sup> According to Oviir (2007), "as regards supervision by the National Audit Office, it should be kept in mind that this does not constitute supervision in the traditional sense. The procedure conducted in the course of economic control by the National Audit Office does not result in a mandatory prescription or other immediate sanction or punishing act. The procedure merely results in an audit report containing observations, assessments, and recommendations for the elimination of shortcomings. Public disclosure of misconduct is the main 'sanction'."

<sup>42</sup> The SAO has performed at least 1 audit on the legality and compliance of annual accounts of each LGU of Estonia in 2007 or 2008, but this rather an exceptional, not a common situation in Estonia.

<sup>43</sup> The Ministry of Justice shall exercise supervisory control over the PO, but this control does not extend to the activities of the Prosecutor's Office in pre-trial criminal proceedings (Clause 9 (1) of POA).

<sup>44</sup> One illustrative case concerns the privatization of 66% of the shares of AS Eesti Raudtee (Estonian Railways Ltd) in 2001, when the PO and SAO had a heated discussion over the commencement of criminal procedures, because politicians exerted significant pressure on both of these institutions not to. This case is a very remarkable, though not the only example of such activities.

<sup>45</sup> This is particularly important in a very small society where party affiliation takes on terrifying dimensions (Jöks, 2008), where the preference of private interests over public interests is rather the rule than the exception (Jöks, 2008) and clan economy is symptomatic.

<sup>46</sup> The numbers presented in this table should be treated with a certain reservation and cannot be taken as use-proven solid academic facts. The methodology of data collection was not guaranteed to be understood and followed by each county government with equal accuracy and the data presented by county governments to the Ministry of the Interior was of inconsistent quality. Collecting and processing the data presented in this particular table was not a regular standardized activity of County Governments, but an *ad hoc* task initiated by the Ministry of the Interior. However, the data presented is useful and expressive information describing the actual state of the supervision activities done by the county governments of LGUs in Estonia.

<sup>47</sup> There were 742 family doctors under the supervision of county governors in 2003 in Estonia.

<sup>48</sup> There were 255 social care facilities under the supervision of county governors in 2003 in Estonia.

<sup>49</sup> The total number of proceedings (409) of supervision of educational and development activities includes proceedings performed over children's facilities, vocational education facilities and in secondary schools and gymnasiums.

<sup>50</sup> There were 1133 educational facilities under the supervision of county governors in 2003 in Estonia.

<sup>51</sup> There were 278 contracts for the use of funds allocated to youth work from the state budget under the supervision of county governors in 2003 in Estonia.

<sup>52</sup> There were 94 carrier licences, 28 line licences, 722 public transport lines, 108 public service contracts and 13 administrative contracts under the supervision of county governors in 2003 in Estonia.

<sup>53</sup> Supervision over sports issues.

<sup>54</sup> Doubtlessly, county governors cannot coordinate the work of the Supreme Court, courts, Chancellor of Justice and prosecutors, but county governors should coordinate the activities of control and supervision of LGUs to be

executed by government bodies within the county's administrative territory.

<sup>55</sup> One reason for that may be the long lasting economic situation in Estonia. In circumstances of a permanent shortage of funds, state-level and local self-government-level politicians often used to be party mates recognize in consensus that there are not enough sufficient funds to allocate for LGS from the state budget, but something has to be said to the residents of LGUs and the public. Politicians in turn try to find a way out of the unpleasant and difficult situation, switched focus from the real topic at hand to a problem of lesser importance. However, this is only the author's opinion, not a scientific fact.

<sup>56</sup> According to CDG (1997, 3), "*Democratic local governance is autonomous levels of local government, vested with authority and resources, that function in a democratic manner. That is, they are accountable and transparent, and involve citizens and the institutions of civil society in the decision-making process. Democratic local governance looks beyond local government administration and service delivery to institutions and structures that enable people to decide things and do things for themselves. It emphasizes the presence of mechanisms for fair political competition, transparency, and accountability, government processes that are open to the public, responsible to the public, and governed by the rule of law.*"

## References

### Academic books and journals

- Almann, Arno** (2007). The Area of Responsibility of a Local Government at the County Level and Possibilities for the Legal Organisation Thereof. *Juridica International*, 2007 II, 125–130.
- Annus, Taavi** (2007). Courts as Political Institutions. *Juridica International*, 2007 II, 22–30.
- Bebr, Gerhard** (1962). Judicial control of the European communities. Library of world affairs, No. 58. New York, Praeger, 1962.
- Bebr, Gerhard** (1981). Development of Judicial Control of the European Communities. The Hague: Nijhoff, 1981.
- Benjamin, Stuart Minor** (2003). Spectrum Abundance and the Choice Between Private and Public Control. *Spectrum Abundance and the Choice between Private and Public Control*. New York University Law Review, Vol. 78, December 2003.
- Derthick, M.** (1979). Policymaking for Social Security. Washington, D.C.: The Brookings Institution.
- Drechsler, Wolfgang** (2007). Safeguarding Municipal Autonomy by the Supreme Court. *Juridica International*, 2007 II, 111–115.
- Huber, John D. Shipan, Charles R. Pfahler, Madelaine** (2001). Legislatures and Statutory Control of Bureaucracy. *American Journal of Political Science*, 45 (April), 330–345.
- Jacobi, Tonja, Tiller, Emerson H.** (2005). Legal Doctrine and Political Control (June 21, 2005). Northwestern Public Law Research Paper No. 05–11.
- Johansen, Åge** (2003). Determinants of Performance Measurement in Norwegian Local Government: a Comparison of Political, Economic and Sociological Theories.
- Jõks, Alar** (2007). XI RIIGIKOGU STENOGRAMM. I ISTUNGJÄRK. Esmaspäev, 14. mai 2007, kell 15:00. pp1. 15:08 Järelevalve teostamine.
- Jõks, Alar** (2007a). The Chancellor of Justice's Role in Protecting the Constitution and Balancing the Legislature's Activity: Is the Chancellor of Justice Only a Prosecutor of the Supreme Court? *Juridica International*, II 2007, 14–21.
- Linnas, Raivo** (2007). Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments. (Based on the Case of the Estonia). *Kunnallistieteellinen Aikakauskirja/Finnish Local Government Studies Nr. 3*, 2007. Tampereen Yliopisto: Kunnallistieteiden yhdistys ry, 282–294.
- Madise, Ülle** (2007). Relationship of the State and Political Parties in Estonia. *Juridica International*, 2007 II, 101–110.
- Maruste, Rait** (2007). The Role of the Constitutional Court in Democratic Society. *Juridica International*, 2007 II, 8–13.
- Mathews, J** (1996). Holonic organisational architectures. *Human Systems Management*, 15, 27–54.
- Olle, Vallo** (2007). Settlement of Disputes Related to Election Rules for Local Gov-

- ernment Councils: Judicial Practice of the Estonian Supreme Court. *Juridica International*, 2007 II, 131–140.
- Oviir, Mihkel** (2007). Extension of the National Audit Office's Powers to Audit of Local Governments: Limitation or Constitutional Protection of Local Democracy? *Juridica International*, 2007 II, 116–124.
- Pennings, Paul** (2003). Beyond dichotomous explanations: Explaining constitutional control of the executive with fuzzy-sets. *European Journal of Political Research*, 42:4, 541–567.
- Pflimlin, Etienne** (1996). Technical/Democratic Supervision in European Co-operative Banks. *Review of International Cooperation*, Vol. 89, No.4, 27–33.
- Saaremäel-Stoilov, Katrin** (2007). How to Handle a Double-edged Sword Safely: Protection of the Elements of the Principle of the Social State in the Constitutional Jurisprudence of the Supreme Court of Estonia. *Juridica International*, 2007 II, 83–93.
- Sandholtz, Wayne, Stone Sweet, Alec** (2004). Law, politics, and international governance. In *The Politics of International Law*. Edited by Christian Reus-Smit. Cambridge: Cambridge University Press.
- Stephenson, Matthew C.** (2007). Optimal Political Control of the Bureaucracy. *Harvard Law School Faculty Scholarship Series*, Year 2007, Paper 5.
- Trope, Yaacov, Fishbach, Ayelet.** (2005) Going Beyond the Motivation Given: Self-Control and Situational Control over Behavior. In R. R. Hassin, J. S. Uleman and J. A. Bargh: *The New Unconscious*. New York: Oxford University Press, 537–563.
- Tuori, Kaarlo** (2007). Rights, Democracy and Local Self-governance: Social Rights in the Constitution of Finland. *Juridica International*, 2007 II, 70–73.
- Turnbull, Shann** (2001). The Science of Corporate Governance. Available at SSRN: <http://ssrn.com/abstract=316939>, 19.01.2008.
- Turnbull, Shann** (2007a). Correcting the failures in Corporate Governance Reforms. Working Paper. October 14, 2007. Available at SSRN: <http://ssrn.com/abstract=1021482>, 19.01.2008.
- Turnbull, Shann** (2007b). Streamlining Prudential Regulation with Self-Enforcing Co-Regulation. Available at SSRN: <http://ssrn.com/abstract=979531>, 19.01.2008.
- Vandall, Frank J.** (2006). Legal Control over the Supply of Handguns: An Analysis of the Issues, With Particular Attention to the Law and Economics of the *Hamilton v. Beretta* Suit against Handgun Manufacturers. *Pace Law Review*, 2006.

**Other sources**

- Arabyan, Knarik** (2007). Audit in the Local Self-Government System of the Republic of Armenia: Legislative frameworks and practices.
- Bektemirov, Kuvatbay, & Rahimov, Eduard** (2001). Local Government in Uzbekistan. Chapter 9 in *Local Governments in Eastern Europe, in the Caucasus and in Central Asia*.
- Brodies LLP Management Consultancy** (2007). External Audit and Inspection Arrangements in Scottish Local Government: Final Report.
- Chong-Min, Park** (2006). Local Governance and Community Power in Korea.
- Coleman, Michael, Colantuono, Michael G.** (2003). The Origin & Devolution of Local Revenue Authority.
- Commission of the European Communities (CE)** (2002). The operating framework for the European Regulatory Agencies.
- Council of Europe (CE)**. European Charter of Local Self-Government. Strasbourg, 15.X.1985.
- Davis, Howard, Downe, James, Martin, Steve** (2001). External inspection of local government. Driving improvement or drowning in detail?

- Ezugbaia, Zurab. Melkadze, Otar** (2002). Some Comments on the Implementation of the European Charter on Local Self-Government. Available at [WWW]http://www.geplac.org/publicat/law/glr02n1e/p\_97arte.pdf, 29.01.2008.
- Forum of European Supervisory Authorities for Electronic Signatures (FESA)** (2005). Cross-border supervision of certification service providers according to member states implementation of the Directive 1999/93/EC. February 18, 2005.
- Financial Market Authority (FMA)**. Available at [WWW]http://www.fma.gv.at/, 20.01.2008.
- Haschke, Dieter** (1997). Local Government Administration in Germany.
- Hippler, Jochen** (2006). Counterinsurgency and Political Control. US Military Strategies Regarding Regional Conflict. INEF Report 81/2006.
- Inter-American Development Bank (IDB)**. 6.1 History and structure. 6. Local Government.
- IMF** (2001). Report on the Observance of Standards and Codes (ROSC). Latvia. March 29, 2001.
- Local Government and Public Services Committee (LGPSC)** (2005). Regulation and Inspection of Public Services in Wales. May 2005.
- Metsalu, Ines** (2006). Euroopa Komisjoni abiprojekt HACSO Sonda vallas: nr. OSI-2-6/06/39.
- Ministry of the Interior (MI)** (2007). Lisa 2. Rahvastiku ja regionaalala hetkeolukorra analüüs. Siseministeeriumi valitsemisala arengukava 2008–2011.
- Pulido, Carlos Bernal** (2006). Links Between Constitutional Control and Political Control: the Case of Colombia. This Century's Review, 01.06. 2006.
- Rask, Märt** (2007). XI RIIGIKOGU STENOGRAMM. I ISTUNGJÄRK, Neljapäev, 31. mai 2007, kell 10:00, pp. 1. 10:06 Riigikohtu esimehe ettekanne.
- Reed, J.W.R.** (1995). Political Review of the European Court of Justice and its Jurisprudence.
- Rodan, Gary** (1998). The Internet and Political Control in Singapore.
- Standards Board for England (SBE)** (2007). Annual Report 2006–07.
- Sellers, Jefferey M. Lidström, Anders** (2007). Local Government and the Welfare State.
- Sepp, Veiko. Noorkõiv, Rivo. Haljaste, Karin-Liis** (2006). Kohaliku omavalitsuse üksuste haldussuutlikkuse hindamise meetodika.
- Strandberg, Marek** (2007). XI RIIGIKOGU STENOGRAMM, II ISTUNGJÄRK, Kolmapäev, 21. november 2007, pp. 6. 2008. aasta riigieelarve seadus.
- Teder, Indrek** (2008). Riigikogu 23.09.2008 stenogramm.
- Ter-Minassian, Teresa. Craig, Jon** (1997). Control of Sub-national Government Borrowing. In Teresa Ter-Minassian, ed., Fiscal Federalism in Theory and Practice: A Collection of Essays. International National Monetary Fund, Washington, D.C.
- U.S. Military Glossary (USMG)**.
- Viani, Bruno E.** (2004). Available at [WWW]http://works.bepress.com/cgi/viewcontent.cgi?article=1001&context=bviani, 208.01.2008.
- Wei, Song** (2007). Available at [WWW]http://www.veterinaria.org/revistas/redvet/n121207B/BA019.pdf, 21.01.2008.
- Woehrling, Jean-Marie** (2005). Judicial Control of the Administration in Europe: Progressive Construction of a Common Model. Available at [WWW]http://www.sigmaweb.org/dataoecd/33/40/35676763.pdf, 23.01.2008.



**""Article 3 cont0**

Raivo Linnas, Legal Framework and Present State..., Kunnallistieteellinen aikakauskirja 2/09

**Laws and regulations**

**Archives Act (AA)** (RT I 2004, 28, 188)

**Chancellor of Justice Act (CJA)**. (RT I 2003, 23, 142)

**Constitution of the Republic of Estonia, The (CRE)**. (RT I 2007, 33, 210)

**Government of the Republic Act (GRA)**. (RT I 2005, 73, 565)

**Local Government Council Election Act (LGCEA)**. (RT I 2004, 6, 32)

**Local Government Organisation Act (LGOA)**. (RT I 2005, 31, 230)

**Prosecutor's Office Act (POA)**. (RT I 2006, 21, 160)

**Rural Municipality and City Budgets Act (RMCBA)**. (RT I 2003, 88, 588)

**State Budget Act (SBA)**. (RT I 2004, 22, 148)

**National Audit Office Act (SAOA)**. (RT I 2003, 88, 588)

## **Integral Model of Audit, Control and Supervision of Local Self-Government**

### **ABSTRACT**

The author of this article considers the issue of audit, control and supervision of local self-government units in a new paradigm. The author argues that the treatment of audit, control and supervision activities of local self-government units in the present paradigm (treated separately from each other or only as a 'control or audit pyramid') has enough imperfections that it cannot be a reliable means of modern good governance anymore. The author presents some ideas for the operation of an integral system of audit, control and supervision of the local self-government sector, particularly focusing on small local self-government units. Even though the author's research is based on the case of Estonia, a small constitutional democratic liberal society with an open economy, his ideas are applicable to other democratic societies as well.

**Key words:** Audit, Control, Estonia, Local Self-Government, Supervision.

### **AIM AND PURPOSE OF THE ARTICLE**

The aim of this article is to discuss the matter of audit, control and supervision (hereinafter called ACS) of local self-government units (hereinafter called LGUs, the object of research) in a new paradigm and present some ideas for the operation of an integral system of audit, control and supervision (hereinafter called ACSS) of the local self-government (hereinafter called LG) sector, particularly focusing on small LGUs. The selected theme of research is real and relevant for Estonia, the European Union and the world as well. The challenges facing LG in the 21st century are complex and rapidly changing (Boland and Coleman, 2008: 313). LG itself (Aarrevaara, 2003: 298; Helander, 2003: 290; Pihlajaniemi, 2003: 264, 268; Rynnänen, 2003: 256; Woolas, 2005) and societies (Kettunen, 2003: 277, 287; Walker, 2005: 81) where LGUs exist are in the process of permanent change as well. Because of that ACS systems in LG as a matter of research are interesting and worthy of treatment.

### **METHOD**

The author relies on the philosophical basis presented by Raivo Linnas (2007) of the Tallinn University of Technology for designing and developing a solution for the ACSS of the LGS that is scientifically justified, as well as appropriate and functional in real life. ACS activities, relevant management and the control systems and organization of ACSS in the LGS is a diverse, complex, complicated and interdisciplinary matter of research. Therefore, the author used a multi-method research design to integrate the qualitative and quantitative methods of collecting, processing and interpreting data. A structural search of the relevant theoretical publications and other sources of information and data was performed. In particular, the focus of information sources were official reports, interim-reports, publications, the minutes and correspondence of institutions carrying out the

functions of external control, supervision and audit. The author used the results of a survey on the supervisory activities of 15 Estonian county governments (the sample consists of 100 percent of the population) performed by the Ministry of the Interior of Estonia in 2006 and another on judicial control performed by the administrative courts (the sample consists of 100 percent of the population) over the LGUs in Estonia. The information and data collected by the author was validated, analysed and synthesised. The sources of information the author used were qualitatively analyzed for semantics and content.

### **FAILURE OF THE PRESENT PARADIGM OF AN ACSS OF THE LOCAL SELF-GOVERNMENT SECTOR**

In the context of social sciences, state theory and public management, the primary issues are not inputs, subjects, processes, systems or outputs, but first of all outcomes and impacts (Linnas, 2007: 287). Both the academic and non-academic literature confirms that the activities of ACS in both the public and private sectors have a low capacity in the context of outcome and impact or have failed completely. For example, the external evaluation of LGUs by the state is not efficient in Estonia (Linnas, 2007: 286-287), Finland (Oulasvirta, 2003: 346), Israel (Friedberg, 1999: 11), the United Kingdom (Woolas, 2005), Sweden (Hanberger, 2009: 18) and in others states as well. The operational capacity and quality of external audit in Estonia is surely not missing completely, but due to the existence of a large number of small LGUs the lack of coordination between external auditors and the insufficient audit capability of external auditors, the amount of time between external audits in any particular LGU is about 4-5 years. For example, the State Audit Office (hereinafter called SAO) has performed at least 1 audit on the legality and compliance of annual accounts of each LGU of Estonia in 2007 or 2008, but this is rather the exception, not the rule in Estonia. However, contracted external auditors almost always depend only on the customer of their services (auditee) as regards the expected result. (Linnas, 2007: 286; 2008: 74)

For instance, internal control activity and internal control systems might be rather weak because small LGUs do not have a sufficient amount of financial (Haveri, 2003: 321; Pihlajaniemi, 2003: 268; Oviir, 2006; SAO, 2006: 8; Linnas, 2007: 284) and human resources (Haveri; Pihlajaniemi; Oviir) to hire, educate, train and keep in office experienced, skilled and well-qualified persons. Thus, internal control activities in most Estonian LGUs are at real risk and need the support of external audit, control and/or supervision.

According to Sterck, Scheers and Bouckaert (2005: 13), budgeting and accounting systems in the public sector are changing and as a result there is a need for new ways of audit and control. For example, in the case of Estonia, not all LGUs have a compulsory responsibility to contract an internal or external audit of annual accounts and reports, and there is no legal obligation to establish an internal audit unit or appoint an internal auditor in LGUs in Estonia (Linnas, 2008: 70). As a result, there are currently internal audit units in only a very few of the biggest towns.

In several cases, the audit commissions (*Revisjonikomisjon*) of LGU councils (political internal supervisory body and substitute for an internal audit committee) had failed to perform the objectives prescribed by law and their roles were mainly formal (SAO, 2006). Allar Jõks (2008), former Chancellor of Justice, argues that in Estonia party affiliation is taking on terrifying dimensions, where the preference of private interests over public interests is rather the rule than the exception, meaning that the clan economy needs to be handled. However, this is not only the case of Estonia. For example, according to John Fender and Peter A. Watt (2002: 283), local authorities in the UK may be run by self-interested groups insufficiently constrained by local politics as well. According to Swiderska, Roe, Siegele and Grieg-Gran (2008: 22), '*Representative democracy has often failed to represent people adequately in governance, which means that additional spaces may need to be created for direct participation (e.g., citizens' juries).*' Günter Schmidt (2003: 21) argues that '*...Administrative culture in the meaning of enhancing administrative output has to be kept under permanent control, and the best way of controlling is be done by the citizen (or the client).*' Consequently, the common approaches used in improving and developing the effectiveness of internal audit and supervision activities and systems of the LGS are not relevant means for evidential results in improving the effectiveness of internal audit and supervision activities and systems.

The operational capacity and quality of external control and supervision over the LGS are rather good in the case of Estonia. There are a fairly large number of organizations carrying out the tasks of administrative, constitutional, financial, judicial, legal, political and public external control and supervision. According to Linnas (2009: 141), the external control and supervision system of LGUs in Estonia is "*definitely based on a solid and adequate constitutional and legal framework*"; "*is in full accordance with the European Charter of Local Self-Government in this particular respect*" and the administrative, constitutional, governmental, judicial and political control and supervision over the LGS executed by the state in Estonia is "*in general and by large sufficiently public, transparent and democratic enough*". Nevertheless, the SAO argues that the control systems over the LGS in Estonia are inefficient or ineffective (SAO, 2006).

For instance, judicial supervision is rather marginal in Estonia. For example, county governments filed 29 lawsuits in the administrative court against LGUs in Estonia in 2006, and filed 396 lawsuits against 61 LGUs in the administrative court in 2007. However, there are more subjects that have the right to file lawsuits in the administrative court against LGUs in Estonia. After all, the role of administrative courts in the external control activities of LGUs remains less powerful in respect of control and supervisory cases in comparison with the activities of other subjects responsible for ECS activities over LGUs.

The supervision done by the CJ is often based on a single complaint, although the CJ also performs independent systemic risk-based supervision. For example, in Estonia in 2006, 207 cases were opened by the CJ to scrutinise the legality and constitutionality of legislation, bylaws and other rules of a similar nature, as well as of the constitutionality

and legality of the regulations of local councils or of the executive boards of those councils (45 cases: 5 on the basis of county governors' petitions, 39 on individuals' petitions and 1 on the CJ's own initiative) (OCJ, 2007: 63, 250, 251). 55 cases opened by the CJ in 2006 were in the area of local government organisation law (OCJ, 2007: 247). However, Indrek Teder, the CJ of Estonia (2008), argues that there are too many LGUs in Estonia for his office to have effective constitutional control over them all.

Supervision over the LGS done by county governors is only supervision over the legitimacy of individual acts adopted by the councils and governments of the local government units of a given county, and, in the cases and to the extent provided by law, also over the legitimacy, purposefulness and expediency of putting state assets to use by the LGU in question. The actual administrative capacity of a county governor in supervising the lawfulness of local government activities is often unsystematic, eclectic and insufficient (Linnas, 2007: 286). Some results characterising the performance of county governors are presented in Tables 1 and 2.

<b>Field of supervision executed by county governors over LGUs in Estonia<sup>1</sup></b>	<b>No. of proceedings in 2003</b>	<b>No. of proceedings in 2006</b>
Legality of the legislation of the specific application of local governments and local government councils.	313	1317
Legality and purposefulness of the use of state assets in the use or control of local governments.	32	0
Land readjustment.	6	1533
Land restitution.	9711	4048
Legality of the privatisation of dwellings owned by local governments.	22	24
Legality of the privatisation of non-living space owned by local governments.	6	3
Return, distribution and use of funds earned from the privatization of municipal assets.	3	24
Performance of the agricultural reform.	0	14
Determining the value of property and compensation.	919	430
Return of unlawfully expropriated property.	368	148
Performance of family doctors.	373 <sup>2</sup>	311

Quality of social services and other aid; Purposeful use of funds allocated for social aid from the state budget.	305 <sup>3</sup>	200
Educational and child raising activities in children's facilities.	4 <sup>5</sup>	182
Educational and child raising activities in vocational education facilities.	-	9
Educational and child raising activities in secondary schools and gymnasiums.	-	222
Purposeful use of funds allocated for youth work from the state budget.	353 <sup>6</sup>	179
Performance of duties and tasks by public libraries.	14	5
General and detailed planning.	449	1003
Fulfilment of the requirements of passenger carriers licences and line licences of public and light transport, fulfilment of public services agreements and contracts of public and light transport, fulfilment of administrative agreements and contracts of public and light transport.	289 <sup>7</sup>	171
Fulfilment of the requirements of the Compulsory State Defence Tributes Law.	0	0
Other supervision.	132 <sup>8</sup>	3499
<b>Total</b>	<b>13295</b>	<b>13322</b>

Table 1. Data concerning the performance of county governors over the LGUs in different fields of supervision in Estonia.

<b>Inducements of the exercising of general supervision by county governments over LGUs in 2003</b>	<b>No. of cases in 2003</b>
Application of an individual	238
Article in a newspaper	4
Application of the Land Board	30
Application of the Chancellor of Justice	5
Initiative of a County Government	17
Application of the Ministry of Defence	2
Application of the Ministry of Finance	2

Application of the Ministry of the Environment	1
Application of a Member of the Council of an LGU	3
Application of an LGU	8
Application of the National Electoral Committee of Estonia	2
Any other entity	1

Table 2. Data concerning inducements of the exercising of general supervision by county governments over LGUs in Estonia in 2003.

According to the data provided to the author by the Elections Department of the *Riigikogu*, the Estonian National Electoral Committee (ENEC) in its supervisory process over LGUs has handled cases as follows: in 2000, 1 supervision; in 2001, 1 supervision and 1 complaint; in 2002, 4 supervisions and 18 complaints; in 2003, 11 complaints; in 2004, 2 supervisions and 14 complaints; in 2005, 1 supervision and 30 complaints; in 2006, 1 supervision and 8 complaints; in 2007, 1 supervision and 4 complaints; and in 2008, 1 supervision and 1 complaint. Thus, the role of the ENEC in ECS activities of LGUs remains less numerous in respect of the number of control and supervisory cases in comparison with activities of other subjects responsible for ECS over LGUs.

A review of the academic and non-academic literature confirms that scientists, researchers and practitioners are used to treating the matter of audit, control and supervision of private, non-governmental and public organizations in a separate, non-holistic and unsystematic manner in a paradigm of mathematics-based sciences (exact sciences). Few authors have treated the issues of ACS in pairs (internal audit – external audit, control – supervision) or like a “control or audit pyramid”. However, approaches like a “control pyramid”<sup>9</sup> (Sterck, Scheers and Bouckaert, 2005: 15) or an “audit pyramid” still have principal limits and are not holistic solutions. The “control pyramid” approach focuses only on different control subsystems and the “audit pyramid” approach focuses only on the audit subsystem of an ACSS.

Summing up the present chapter one can conclude that each activity and subsystem of ACSS has a number of evident deficiencies and insufficiencies. There are many different theoretical and practical reasons for that, but the principal factor is an incorrect paradigm of treatment of this particular object of research. Accordingly, one can conclude that the treatment of ACS activities of LGUs in the present paradigm has enough imperfections that it cannot be a reliable means of modern good governance anymore. This statement is definitely relevant to Estonia.

### **THE NEW PARADIGM OF THE ACSS OF THE LGUS**

In this chapter the author considers the issue of the ACS of LGUs in a new paradigm. What is the new paradigm? According to Sepp, Noorkõiv and Haljaste (2006: 3), LGUs are to be understood in four dimensions: as a part of the state administrative system, as a supplier of local public services, as a territorial corporation, and as a satisfier of the

interests, needs and expectations of domestic inhabitants. Thus, an LGU functions together and simultaneously as an institution, an organization and a system. In the context of the Agency Theory, an LGU, acting via a municipal council and government, serves as an Agent (manager), while its residents and state government institutions serve as Principals (Owners).<sup>10</sup> Herewith, all links and relations between the inhabitants of an LGU and the state, between the inhabitants of an LGU and the LGU itself, and between an LGU and the state are affected and influenced by the factors described by the Agency Theory. LGUs and the ACSS of LGUs are complex and complicated organisations as well. Therefore, LGUs and the ACSS of LGUs are to be the subjects of the Theory of Complex Self-Organizing Systems, The Theory of Living Organisms, The Organizational Theory and other theories as well. In the actual life of each society one cannot see such an idealistic state of any organization like that portrayed by conventional organization theory or such perfect relations between a principal and an agent as described by the Agency Theory. Therefore, the new paradigm offered by the author is based on different theories and paradigms, which support, not constrain or exclude the function and effect of each other.

According to the author's earlier work, designing and developing an integrated ACSS of LGUs that is scientifically justified, as well as appropriate and functional in real life, should be based on a philosophical platform that stands on at least 7 pillars: 1. The paradigm of the laws of nature; 2. The holistic approach; 3. The paradigm of self-organization; 4. The reciprocal balance approach; 5. The uniqueness principle; 6. The paradigm of uncertainty; and 7. The compatibility approach (Linnas, 2007: 290).

### ***The paradigm of the laws of nature***

In the scientific, vocational, professional, and special literature, LGUs and the ACSS of LGUs are mainly treated as mechanical systems that people may study, analyse, construct, actuate and bring to a halt, but where the human being is not considered as an inseparable, inherent component. Using the paradigm of mathematics-based sciences (exact sciences) is, of course, possible and necessary, but the question is whether such an approach is the only possible direction considering that the aim of this article does not only lie in finding a solution to an abstract theoretical problem. Social systems are a subclass of naturally constituted dissipative systems (Harvey and Reed, 1994; Nicolis and Prigogine, 1989; Gunaratne, 2003: 436; 2005: 754). Most fundamental differences between technological and social systems are: 1. Technological systems are put together from component parts that are largely self-contained (closed systems) and are almost open in closed systems, but social systems are open systems that function in other open systems. 2. The functioning of technological systems is almost always deterministic, predictable and certain, but the operations of social systems are not-deterministic, unpredictable and uncertain. (Prigogine, 1983; Prigogine and Stengers, 1984; Näpinen, 1994: 179; Gunaratne, 2003: 426) The author is aware that while some parts of the universe may operate like machines (Prigogine and Stengers, 1984) and in present era of nanotechnology and biorobotics differences between technological systems and social systems are rapidly vanishing, LGUs are still run, audited, controlled and supervised by human beings, not human beings acting like robots or cyborgs. Therefore, an LGU and an



ACSS of an LGU should be treated as an organism rather than a mechanism. For example, Joseph A. Schumpeter treated business, economic and industrial entities like living organisms, calling those bodies 'business organisms' (Schumpeter, 1939: 272), 'economic organisms' (Schumpeter, 1939: 265, 351, 370) and 'industrial organisms', accordingly (Schumpeter, 1939: 358).

According to the Self-Government Theory, people are sovereign rulers in a democracy (Solum, 1989: 73). Consequently, taking into account that Estonia is a democratic state and the inhabitants of each LGU in Estonia are sovereign, it is inevitable that one has to take into account people as the main actors in this very social system. Thereby, the ACSS of LGUs is a system where people with their needs, desires, demands and behaviour are actors and a key factor (the human-centered approach). Therefore, the human-centred approach is an unavoidable precondition in the handling of social issues and social systems. It is significant and relevant for any size LGU, but particularly so for small LGUs. For example, in the smallest LGUs in Estonia (such as the rural municipalities of Ruhnu<sup>11</sup> and Piirissaare<sup>12</sup>), the number of inhabitants is so small that each person has the greatest value from the political or administrative point of view. For example, the replacement of the chairman of council or mayor of an LGU may cause a complete change in its management and organizational culture, control environment, risk appetite and administrative capacity. Or the resignation of a member of council or government of a small LGU can easily cause a situation where there is no suitable person to replace the vacancy with. Moreover, the needs, desires, demands and behaviour of a person changes from day to day because of innumerable factors. That is why treating an ACSS just like a mechanical system without social or human factors does not produce a reasonable solution suitable for implementation in real life (the paradigm of the laws of nature, human-centered approach).

### ***The holistic approach***

According to Ludwig von Bertalanffy, the creator and chief exponent of the General Systems Theory, real systems are open to and interact with their environments and they can acquire qualitatively new properties through emergence, resulting in continual evolution. According to Matei and Matei (2008: 34), the architecture of the European governance model will be that of a complex system with a mixed architecture, emphasizing connections with different intensities among its various levels: European, regional, national, etc. State-level administration systems and local government-level administration systems form a holistic, integral and complex public administration system in society (Linnas, 2009: 143). Accordingly, a state-wide ACSS of an LGS should be treated as a whole, and the ACSS of each municipality has to be treated as a whole as well (the holistic approach). Each particular LGU as a living organism-like system and ACSS as a social system, in turn, comprise complex subsystems and components. Besides, each subsystem (systems of internal audit, external audit, internal control, external control, internal supervision and external supervision) comprises more subsystems and elements as well. That is why the holistic and system approaches are to be in the mind of any researcher, civil servant or politician while treating an issue of the ACSS of an LGS in whole or of a particular LGU.

### ***The paradigm of self-organization***

According to Leo Näpinen (1994: 179), society is an unpredictable self-organizing organism. The ACSS of an LGU belongs within the context of social phenomena (Linnas, 2007: 289). However, as a state and an LGU as an organization, institution or system inevitably consist of human beings, they are social or eco-social systems. Social systems and processes are very complex (Wallerstein, 1998: 5; Näpinen, 2002: 130, 131), they operate under the influence of self-organizing processes (Prigogine and Stengers, 1984: 22; Heylighen, 2002: 23; Näpinen, 1994: 164) and work in open systems (Prigogine, 2000: 895), sometimes called a world-system (Wallerstein, 1974: 347; Straussfogel, 1997: 123) or eco-social system (Lemke, 1995: 16). According to the Theory of Complex Self-Organizing Systems, in systems (this includes living organisms, ecosystems and social or eco-social systems) there are no isolated controlling agencies and causality has rarely provided adequate accounts because they consist of many interacting parts. In social systems, individual information (such as individual values, norms, conclusions, rules, opinions, ideas and beliefs) changes dynamically because of the new experiences of individuals (Fuchs and Hofkirchner, 1999: 4). According to Work (1998), a society as a whole system is a rather horizontal playing field with autonomous yet interrelated actors, sectors and geographic areas. Therefore, it is unrealistic to imagine that one person or a single agency can have complete control over all of a system and that only one interacting part can cause precisely expected results in the system as a whole. Therefore, it is especially important to make sure that the LGS as a whole and each municipality separately are treated not as an isolated and rigid system that is always in balance regardless of time, but on a philosophical basis proceeding from the paradigm of self-organisation.

### ***The reciprocal balance or reciprocal compensation approach***

This particular principle is the easiest to explain in theory, but not so easily implemented in the actual life of a state or an LGU. The idea of this approach is simple. A cohesive whole may serve as an excellent system, even if subsystem or an element is not present at all. For example, if there is a lack of some subsystems or an element of any subsystem or an element is malfunctioning, then the malfunctioning subsystem or the malfunctioning element can be balanced by the functioning of another subsystem or element (the reciprocal balance or reciprocal compensation or reciprocal support approach). However, this is in theory. In practice, one can face some difficulties in implementing the reciprocal support approach in real action, because of different legal, administrative, political and organisational factors. However, this does not at all mean that the reciprocal compensation approach does not work in actual day-to-day life. Let us imagine that an internal audit unit or internal auditor of an LGU is a well-experienced, skilled and high-qualified professional. Thus, obviously one very important subsystem or element (it depends on the particular case) of an ACSS is reliable and effective. Therefore, external ACS activities may be less extensive.

**Vj g'Wpks wgp gu'Rt kpek r g''**

The importance of sensitivity to specific contextual challenges and the history of a specific locality in the designing or reforming of local governance institutions are addressed by Howard and Sweeting (2007: 653). Pekka Kettunen and Tarmo Kungla (2005: 375) argue on the basis of evidence from Estonia and Finland that the European impact on sub-national governance seems to be strongly circumscribed by national, bureaucratic and professional forces. According to Timo Aarrevaara (2003: 305), each state creates an administrative system based on its own culture and history. The LGS of each particular country is substantially different from the LGS of any other country and different municipalities of the same LG system have very different characters. Accordingly, each LGU and its ACSS should be handled like a unique organism. Consequently, each LGU should be analysed, evaluated and assessed thoroughly before taking any actions concerning the structure and organisation of the ACSS. The Uniqueness Principle means that one cannot presume *a priori* that there exists a certain and confident possibility of offering a uniform and standard solution of ACSS that fits the LG sectors of every state and to all LGUs of one state, though this is not an entirely excluded option. However, a general philosophical basis can be common and universal.

***The paradigm of uncertainty***

According to Prigogine (2000: 895-896), “*a society is a nonlinear system; what one person does influences the action of others. Thus nonlinearity increases with the size of the society*”. “*The deterministic processes can be seen only in isolated, artificial systems.*” (Prigogine, 1983) “*In large societies it becomes increasingly difficult to maintain the spontaneous activity of members of that society.*” (Prigogine, 1983) According to Gunaratne (2003: 437), complex systems are both nonlinear and adaptive. Their asymptotic behaviour patterns are often unpredictable (e. g., weather, public opinion, epidemics, the stock market), although short-term prediction may be possible. Society, LGUs and ACSSs are constantly changing in time and space. According to Leo Näpinen, society is an unpredictable self-organizing organism, and “*The self-organisation processes in society are not among those processes that are planned ahead and subject to set objectives, but among those that come into being unexpectedly and notwithstanding of the conscious activities of people.*” (Näpinen, 1994: 179) The basics and administrative arrangement of an LGU and ACS phenomena are univocally and clearly indefinable, constantly changing with time and located in an open environment (a non-linear relationship, the paradigm of uncertainty), which is why it is impossible to refer to a permanent equilibrium when speaking about ACS systems. According to the Institutional Theory, institutions are governance structures based on rules, norms, values and systems of cultural meaning. According to neo-institutionalism, the explanation of human behaviour within organisations has to encompass formal rules alongside the role of informal norms, symbols, myths, belief systems and arrangements forming the culture of the organization. An LGU has only one purpose: to give the inhabitants within its purview the possibility of self-governance. The inhabitants of an LGU are actual physical human beings made of flesh and blood. Thus, they have their own particular needs, desires, demands, behaviour and informal norms, symbols, myths and belief systems. Therefore, there is always the possibility that the reigning coalition may change coalition partners or may be replaced as well. One can argue relying on Gunaratne (2003: 437) that

ACSSs are permanently under conditions of uncertainty, indeterminacy and self-organization. Accordingly, relations, dependencies and impacts between the subsystems and elements of an ACSS cannot be studied as linear processes. This leads us to at least two principal conclusions: 1. Nothing concerning the reliability, operativeness, efficiency and effectiveness of an ACSS as an integral whole or an ACSS of a particular LGU is certain in day-to-day life. 2. So far as one cannot treat social processes like linear processes, one also cannot believe that any input leads to an exactly timed and determined output. Even though some outputs can be determined, there is almost no likelihood of believing that any outcome is deterministic, certain and predictable.

### ***The compatibility approach***

LG sectors differ from each other all over the world, but some trends are common: a permanently changing environment (Kettunen, 2003: 277, 287; Sterck, Scheersand and Bouckaert, 2005: 13; Steyvers et al., 2008: 141); a mismatch between the responsibilities and sources of finance (Mäeltsemees, 1994; Haveri, 2003: 319; Ryyänen, 2003: 255, 256); life under permanent change, reform and merger processes (Heuru, 2003: 258; Steyvers et al., 2008: 135; Van de Walle, Van Roosbroek and Bouckaert, 2008: 50); and the increasing share of networking (Aarrevaara, 2003: 302; Kettunen and Kungla, 2005: 357; Steyvers et al., 2008: 134) and co-operation between LGUs (Haveri, 2003: 316; Heuru, 2003: 258; Niemi-Iilahti, 2003: 284; Helander, 2003: 295; Oulasvirta, 2003: 340; Linnas, 2008: 77). The academic literature confirms that the situation of LGUs does not depend only on the political order, degree of democracy, liberalism, welfare and socio-cultural environment of a country (Linnas, 2008: 77). However, there still remains a number of differences between states and LGUs in states. For example, in the case of Estonia, according to the preamble of the Constitution of the Republic of Estonia (hereinafter called CRE), the state exists for the Estonian nation, language and culture 'through the ages'. Thus, the only reason for the establishment and existence of the Republic of Estonia is the existence of a national state. The LGS is one level of a multi-level holistic public administration organization in a unitary state. Due to that, the autonomy of an LGU should be treated first of all in light of the main purpose of a national state; afterward, in light of the interests of local inhabitants and only then, in light of the autonomy of local self-government as an end in itself. Thus, the full autonomy of an LGU as an end itself, without the context of the most important purpose of a national state, would not be a relevant object of treatment in actual socio-political life. However, states have the unavoidable and obligatory task of acting as a guarantor and guardian in granting all constitutional rights and freedoms to each and every inhabitant of any LGU within its boundaries. However, what is evidently suitable for leading countries for public administration (e.g., Australia, Canada, Denmark, the Netherlands, New Zealand, the UK, the USA) is not by default suitable for Estonia and *vice versa*. Arising from Estonia's political, legal, historical and cultural peculiarities, the impact of the public, primarily voters, on the political elite is almost negligible between elections. This is why one has to keep in mind that the control performed by voters and other public subjects over the administrators of LGUs is much feebler than in many other countries. Accordingly, when trying to develop an optimal solution of ACSS, both the wider and narrower political, economic, legal, cultural and historical context of the

environment has to be taken into consideration (the compatibility approach). According to Linnaas (2007: 289), different models of ACS of LGUs apply to different political, legal, historical, cultural and economic environments. Also according to Linnaas (2007: 289), different models of ACS of LGSs apply to huge, big, middle-sized, small and tiny municipalities. Regardless of that, the philosophical platform for designing an optimal model of the ACSS of an LGS has to be uniform and in a proper paradigm. There is no doubt that Estonia needs the introduction and application of a new paradigm of ACSS of LGUs. However, any proposed solution should be very carefully analysed, evaluated and assessed taking into account all the relevant aspects of the environment's characteristics for that particular society.

### **SOME IDEAS FOR THE OPERATION OF AN ACSS UNDER A NEW PARADIGM**

To better understand the ideas presented by the author, the different sectors (audit, control and supervision subsystems) of audit, control and supervision systems may be understood as sectors with changeable dimensions, where the shape of a globe or circle will remain its primary dimension. If one sector (audit, control or supervision) changes its own dimension, some other sectors have to change their dimensions as well. Here, we will not pay any attention to the general size of a particular globe or circle, because this is not important in our representative explanation imagery. How big each of the other parts will be depends very much on how operative the other subsystems and elements of the ACSS of this particular LGU, county, state or union of states are. There might be a number of reasons for the different levels of operational capacity and quality of subsystems and elements of the ACSS of this particular LGU. However, the focus of this chapter is on what to do, if some subsystems or elements are not at present at all (it does not matter why) or they are malfunctioning. The author explains his idea more deeply on the basis of four different theoretical options presented afterwards in this chapter (See Table 3).<sup>13</sup> The possible combinations of different options of the functional/operational capacity and quality of ACSS subsystems and elements are significantly larger, but the four options presented by the author are good enough to support the explanation of his ideas.

<b>Function</b>	<b>Option 1</b>	<b>Option 2</b>	<b>Option 3</b>	<b>Option 4</b>
Internal Audit	0	0	4	5
Internal Control	2	5	5	5
Internal Supervision	2	0	5	5
External Audit	0	2	0	5
External Control	5	5	2	5
External Supervision	5	5	2	5

Table 3. Different options of ACSS composition.

In the theoretical case presented in Option 1 of the ACSS composition of a particular LGU, one can see that the internal and external audit functions are completely missing; the operational capacity and quality of the internal control function, internal control systems and internal supervision are rather weak and the operational capacity and quality of external control and supervision are rather excellent. In such cases it is important to strengthen the operational capacity of external control and supervision. This means that the most important institutions of political, administrative, constitutional and legal control and supervision have to focus more on the issues concerning the activities of all LGUs or a particular LGU. Equally, democratic public supervisors and controllers have to sharpen their eyes.

In the theoretical case presented in Option 2, one can see that internal audit and supervision functions are completely missing and the operational capacity and quality of the external audit function is rather weak or during a particular period of time is rarely present. Internal control, external control and external supervision are performed excellently. In cases like Option 2 it is important to strengthen the operational capacity of external audit and The Government of the Republic has to draw, implement and maintain a sufficiently coordinated plan of political and administrative control as well as a supervision plan for the ministries and county governors over this particular LGU. This plan should be coordinated with the Chancellor of Justice as well. The Chancellor of Justice has to focus on the medium term and the annual working plans of the CJ on the LGUs where internal control systems are weak, municipal councils and governments are consistently composed of members or representatives of only one party or interest group or where the county governor is related to the political leaders of the LGU. The Ministry of Justice and the Prosecutor's Office have to focus on the plans of surveillance necessary to detect and combat criminal offences in the LGUs which have a high risk level of corruption, theft and misuse of public assets. The Ministry of Finance has to strengthen the exercise of financial supervision, control and review over foreign aid-related funds and those allocated for specific purposes and the purposeful and lawful usage of the assistance granted to LGUs with no internal audit and supervisory functions. The Environmental Investment Centre should strengthen its control activities over the expedient use of the funds channelled to LGUs via environmental investment projects that are financed by the income gained from environmental usage in LGUs with a higher level of risk. In cases such as Option 2, it is very important that the municipal council *in corpore* or at least the governing coalition finds the political will, managerial professionalism and statesman-like conduct to put in place a mayor or municipal government *in corpore* with well-experienced, skilled and highly qualified professionals. Different democratic public supervisors and controllers such as voters, non-governmental organisations, parties in opposition and the media have to sharpen their eyes and watch over the LGUs with higher risk levels as well. According to Vallo Olle (2002: 9-10), direct democracy as a phenomenon in the municipal sector is nothing new to Estonia, because this was in actual practice during the second half of the nineteen twenties and first half of the thirties. Olle also argues that practicing direct democracy in exercising local governance in Estonia is not just hypothetical, but a useful, real and realistic option.

In Option 3, one can see that external audit functions are completely missing or the period of time between external audits in a particular LGU has been long. The operational capacity and quality of the external control and supervision function are rather weak. Internal audit, internal control and internal supervision are well or excellently performed. In cases such as Option 3, it is an unavoidable task to strengthen the operational capacity and quality of internal audit, control and supervision activities of the LGU in question; develop purposeful, systematic and reliable internal control systems of the LGU and try to direct the attention of those external supervisors and controllers who are not politically biased, do not have a conflict of interest or suffer from a lack of resources on it. A situation like that is an extreme challenge for the coordinators of audit, control and supervision activities and for members of a particular municipal council and government. However, one has no right to discard this theoretical possibility only because it seems to be too challenging for practical use.

In Option 4 one can see that the operational capacity and quality of all levels (international, federal, state, regional and local self-government) and all types of audit, control and supervision activities are well or excellently performed. This does not mean that all aspects of all levels and all kinds of audit, control and supervision activities are in full service in the field of public management and administration of a particular LGU or that all different institutions responsible for carrying out political, constitutional, judicial, administrative, financial or legal control over the LGS are focused persistently on a single or few LGUs. Because of a different composition of subjects in ACS, it is possible that some of them do not exercise their functions during a particular period of time over a particular LGU at all. However, at the same time, other ACS subjects could perform their ACS duties over a particular LGU. As a result, there might be a situation where the ACS functions over a particular LGU might still be rather good or even excellent. The example presented in Option 4 does not mean that in actual life one cannot see situations where a number of internal and external auditors, controllers and supervisors are accidentally or persistently focused on a particular LGU, group of LGUs or fields of activities of an LGU. For example, a sporadic concentration of internal and external audit, control and supervision activities may be seen in very big municipalities concerning huge amounts of public money flows, municipalities at particular risk of corruption, etc. After all, it is indispensable to take into account the strong economic control performed by the state over the LGS (Heuru, 2003: 261; Mäeltsemees, 1994; Olulasvirta, 2003: 341; Pihlajaniemi, 2003: 267). When handling cases such as Option 4, one has to keep in mind the need to look very carefully at the reasonable, efficient and effective allocation and use of human, financial and other resources with the aim of avoiding an unnecessary administrative load (Sterck, Scheers and Bouckaert, 2005: 13, 15) and disturbance of the performance of the government and administration of the LGU in question under sharp oversight, a waste of state budget resources and weakening of ACS functions in other types of higher risks. Option 4 is the most challenging for coordinators of ACS activities in all levels of the public management hierarchy.<sup>14</sup> Nevertheless, in light of the new public administration model in globalization and Europeanization (Laakso, 2003: 311; Pihlajaniemi, 2003: 264; Matei and Matei, 2008: 34), situations such as Option 4 may be more and more realistic in actual life.

## DISCUSSION ON ARGUMENTS SUPPORTING OR COUNTERACTING THE NEW PARADIGM

Different countries have different approaches to the supervision and control of LGUs. States generally rely on various combinations of instruments to exercise control over localities (Sellers and Lidström, 2007: 16). According to Sellers and Lidström (2007: 16), *'Belgium, Greece, Austria and Spain rank high for both politico-administrative and fiscal supervision. Canada, Australia and the U.S. range relatively low in both. Countries between these two clusters, including all of the Scandinavian countries, have looked more to one type than to the other.'* For example, according to Teresa Ter-Minassian and Jon Craig (1997: 29), *'Country approaches to the control of subnational borrowing can be grouped into four broad categories, although most countries utilize a mix of them. ... The four 'stylized' categories are (1) sole or primary reliance on market discipline; (2) cooperation by different levels of government in the design and implementation of debt controls; (3) rules-based controls; and (4) administrative controls'*. In many countries state authorities executing control and supervision of LGUs are entitled with a wide array of powers and there exists a trend to increase this power. In this aspect the situation is very similar in Armenia (Arabyan, 2007: 15), Australia (Davis, Downe and Martin, 2001: 2), Latvia (IMF, 2001: 4), Norway (Sellers and Lidström, 2007), South Korea (Chong-Min, 2006: 14), the USA (Coleman and Colantuono, 2003: 20), and Uzbekistan (Bektemirov and Rahimov, 2001: 507). This may lead to a violation of the sovereignty of local self-government (Arabyan, 2007: 15). According to Ter-Minassian and Craig (1997: 13), direct central government controls are more common in unitary states than in federations. Since Estonia is a unitary state, there is a risk that the appropriate balance between LGS self-control/supervision and direct central government control may be biased and direct central government control over the LGS might turn out to be dominant. The autonomy and sovereignty of the LGS is crucial for the sake of a democratic society, because an unreasoned implementation of and biased ACS activities over the LGS may put democracy at real risk. Therefore, proportional balance between relations of state and LGS has to be reached. This is supported by Michal Illner (1998: 29), who argues that the levels of centralization and decentralization have to be weighed against the functional and contextual factors so that the optimum between them can be determined. State-level controllers and supervisors, particularly in small states, may be under the control of a few particular interest groups, because different networks centre on personal relations. In such cases, the idea offered by the author may put particular LGUs or the entire LGS under risk of violence of democratic values, corruption and the misuse of public resources. Yet, on the other hand, an approach such as the one presented in this paper allows for the possibility of avoiding this particular threat if the international or federal subjects of ACS are involved in a proper manner and extent. Fortunately, complete centralized control is impossible in any complex system (Mathews, 1996: 41). According to Barry Quirk (2005: 616), system-wide approaches to improving public sector efficiency have previously relied on top-down regimes and models. The approach presented by the author is a synthesis of the top-down and bottom-up models.

In real life there are a number of subjects who exercise external control and supervision tasks over LGUs in Estonia, but the large number of subjects of an ACS organization



make the management of a coordination task considerably challenging. One cannot presume that the result of this is that some LGUs might be under unnecessarily excessive 'oversight' or are completely out of 'sight' for longer periods of time. On the other hand, the inhabitants of a particular LGU should not have to suffer because of the low administrative capacity of local governance institutions or because of the improper and corrupt action of local politicians or civil servants. They should have access to public services as do the inhabitants of other LGUs of the same country and they should be of the same level of quality as the 'normal'<sup>15</sup> inhabitants of other LGUs have. According to Lucy de Groot (2005: 677), in a move towards centralised inspection and control in the UK, it helped to raise the quality of services, improved the effectiveness of corporate governance and increased public transparency in decision making and resource allocation, but the industry of inspection and regulation became so complex that it has spiralled out of control. Estonia is a very small state in comparison with the UK. Thus, the threat of an 'over-complication' of control and supervision activities is of a lesser degree. However, the different subjects of ACS objectively and subjectively have different, sometimes even controversial, goals, objectives and interests in the longer or shorter periods of time. Besides, in multi-level systems an important challenge is related to the distribution of authority and the power between levels (Birrell, 2007: 668; Fimreite and Aars, 2007: 677). Political reluctance, the threat of 'over-complication' and possible tensions in the distribution of powers between the different levels of controllers and supervisors can be reasons for a lack of or little support for the ideas of the author by practicing politicians and public managers in Estonia.

## **CONCLUSION**

World-wide long-lasting practical experience from the public, non-governmental and private sectors significantly shows that ACS activities have generally failed. There are many different theoretical and practical reasons for that, but the most principal factor is the incorrect paradigm of treatment of this particular object of research. The author presents a philosophical platform that stands on 7 pillars and some ideas for the operation of an integral ACSS of the LGS, particularly focusing on small LGUs. Although the new paradigm of treating the matter of ACS of LGUs has a fundamental difference and advantages in comparison with the present paradigm, the author points out that his approach has obvious limits as well. This approach only works on the precondition that there is the possibility of deeming a set of different international, governmental, regional and local organizations to actually be acting and belonging to one particular virtual organization. The successful introduction of an integral ACSS into the context of actual governance and local self-governance is a serious challenge for politicians and civil servants, because this requires a high level of coordination of ACS activities between the different bodies responsible for watching over the performance of a particular LGU. However, the approach presented in this paper is evidently a step further along in the theoretical and practical treating of the issues of audit, control and supervision in the local self-government sector. Further research has to be done to determine more particular pros and cons challenging the introduction and application of the holistic approach of the ACSS of the LGS in different types and sizes of countries.

## NOTES

---

<sup>1</sup> The numbers presented in this table should be treated with a certain reservation and cannot be taken as use-proven solid academic facts. The methodology of the data provided was not guaranteed to be understood and followed by each county government with equal accuracy and data presented by county governments to the Ministry of the Interior was of inconsistent quality. Collecting and processing the data presented in this particular table was not a regular standardized activity of county governments, but an *ad hoc* task initiated by the Ministry of the Interior. However, the data presented in the table is useful and expressive information describing the actual state at large of the supervision activities done by the county governments over LGUs in Estonia.

<sup>2</sup> There were 742 family doctors under the supervision of county governors in Estonia in 2003.

<sup>3</sup> There were 255 social care facilities under the supervision of county governors in Estonia in 2003.

<sup>4</sup> The total number of proceedings (409) of supervision over educational and child raising activities includes proceedings performed in children's facilities, vocational education facilities and in secondary schools and gymnasiums.

<sup>5</sup> There were 1133 educational facilities under the supervision of county governors in Estonia in 2003.

<sup>6</sup> There were 278 contracts for the use of funds allocated for youth work from the state budget under the supervision of county governors in Estonia in 2003.

<sup>7</sup> There were 94 carrier licences, 28 line licences, 722 public transport lines, 108 public service contracts and 13 administrative contracts under the supervision of county governors in Estonia in 2003.

<sup>8</sup> This is supervision over sports issues.

<sup>9</sup> The author is of the opinion that Sterck, Scheers and Bouckaert gave an overview of the audit pyramid not the control pyramid in their research, because the cases intermediated in their report are nearly cases of design, performance and maintenance of relations between internal and external audit activities, which stand on the base of the internal control systems of an entity under audit. (Sterck, Scheers and Bouckaert, 2005: 131). Nevertheless, the author recognizes that sometimes bodies authorized for external audit over public sector entities also have a mandate for external control or supervision as well. For example, in the United Kingdom the NAO is the office of the Comptroller and Auditor General. The Comptroller's function involves controlling the release of money from the Exchequer to government departments.

<sup>10</sup> Herewith, one has to bear in mind that the Dominant Principal is the resident of the LGU. According to Lawrence B. Solum (1989: 73), *'The fundamental conception of the self-government theory is that in a democracy the people are sovereign; the people are the rulers, not the ruled'*. The state and the LGU should always be understood to be servants of the inhabitants of the LGU or citizens of the state.

<sup>11</sup> 64 inhabitants as of 01.01.2007.

<sup>12</sup> 94 inhabitants as of 01.01.2008.

<sup>13</sup> The figures from 0 to 5 in Table 3 indicate the theoretical functional/operational capacity and quality of the ACSS subsystems and elements. A 0 means that one or another part of the ACSS does not exist at all. A 5 shows that one or another part of the ACSS has an excellent function/operational capacity and quality. These figures have only an explanatory meaning.

<sup>14</sup> The number of hierarchies in coordination organisation is too big even in Estonia. Fortunately, the multiplicity of coordination hierarchies and the existence of copious coordinators leave some room for self-organisation processes, but may generate a counter influence as a result of the non-coordinated action by various coordinators.

<sup>15</sup> The term 'normal' is understood to be that the inhabitants of an LGU have access to public services with a level of quality as high as the inhabitants of an LGU with a sufficient, but not extraordinarily high level of income and with an administrative capacity matching in terms of contemporary self-governance good practice. What is important is that no LGU should have a very low level of welfare and administrative capacity in comparison with other LGUs of the same state.

**TGHGTGPEGU''**

**Dqqmu'èpf'Ej crvgtu'kp'Dqqmu''**

Bertalanffy von, Ludwig, 1968, *General System Theory: Foundations, Development, Applications* (New York: George Braziller Inc.). Bosanquet, Bernard, 2001; *The Philosophical Theory of the State* (Ontario: Batoche Books/ Kitchener).

Olle, Vallo, 2002, *Kohalik rahvaalgatus ja rahvahäätetus* (Tartu: Tartu Ülikooli Kirjastus).

Prigogine, Ilya, Stengers, Isabelle, 1984, *Order out of chaos: Man's new dialogue with nature* (New York: Bantam).

Schumpeter, Joseph A., 1939. *Business cycles. A Theoretical, Historical and Statistical Analysis of the Capitalist Process*. Abridged, with an introduction by Rendigs Fels (New York Toronto London: McGraw-Hill Book Company).

Wallerstein, Immanuel, 1974, *The Modern World-system: Capitalist Agriculture and the Origins of the European World Economy in the Sixteenth Century* (New York: Academic Press).

### **Magazines and regular publications**

Aarrevaara, Timo, 2003, 'Municipalities and Europeanized Networks', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 298 - 306.

Birrell, Derek, 2007, 'The role of local government in the review of public administration in Northern Ireland: The challenges of enhancement, devolution and modernisation', *Local Government Studies*, 33/5, 657 - 675.

Boland, Leo, Coleman, Emer, 2008, 'New Development: What Lies Beyond Service Delivery? Leadership Behaviours for Place Shaping in Local Government', *Public Money and Management*, 28/5, 313 - 318.

De Groot, Lucy, 2005, 'Generating Improvement from Within: The Role of the Improvement and Development Agency for Local Government', *Local Government Studies*, 31/5, 677 - 682.

Fender, John; Watt Peter A., 2002, 'Should central government seek to control the level of local authority expenditures?', *Fiscal Studies*, 23/2, 265-285.

Fimreite, Anne Lise, Aars, Jacob, 2007, 'Tensions and cooperation in a multi-level system: Integrating district councils in city government in Bergen', *Local Government Studies*, 33/5, 677 - 698.

Gunaratne, Shelton A., 2005, 'Public Diplomacy, Global Communication and World Order: An Analysis Based on the Theory of Living Systems', *Current Sociology*, 53/5, 749-772.

Gunaratne, Shelton A., 2003, 'Thank you Newton, welcome Prigogine: 'Unthinking' old paradigms and embracing new directions. Part 1: Theoretical distinctions', *Communications*, 28, 435-455.

Hanberger, Anders, 2009, 'Democratic accountability in decentralised governance', *Scandinavian Political Studies*, 32/1, 1 - 22.

Haveri, Arto, 2003, 'Inter-municipal Cooperation as a Part of Local Governance', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 316 - 325.

Helander, Voitto, 2003, 'Public Sector Reforms and the Third Sector', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 290 - 297.

Heuru, Kauko, 2003, 'Development of Municipal Administration in Finland', *Finnish*

- 
- Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 257 - 262.
- Howard, Joanna, Sweeting, David, 2007, Addressing the legitimacy of the council-manager executive in local government, *Local Government Studies*, 33/5, 633 - 656.
- Kettunen, Pekka, 2003, 'How Democratic are the Finnish Local Governments?', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 271 - 278.
- Kettunen, Pekka, Kungla, Tarvo, 2005, 'Europeanization of Sub-national Governance in Unitary States: Estonia and Finland', *Regional and Federal Studies*, 15/ 3, 353 – 378.
- Laakso, Seppo, 2003, 'The Europeanization of the Administrative Law in Finland', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 307 - 315.
- Linnas, Raivo, 2009, Legal Framework and Present State of External Control and Supervision over Local Self-Government Units in Estonia, *Kunnallistieteellinen Aikakauskirja*, 2, 141 - 162.
- Linnas, Raivo, 2008, 'Audit in Small Local Government Units: The Case of Estonia', *Kunnallistieteellinen Aikakauskirja*, 1, 65 - 82.
- Linnas, Raivo, 2007, 'Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments (Based on the Case of Estonia)', *Kunnallistieteellinen Aikakauskirja*, 3, 282 - 294.
- Matei, Lucica, Matei, Ani I., 2008, 'Globalization and Europeanization – A Projection on a European Model of Public Administration', *Theoretical and Applied Economics*, 4/ 4, 33 - 52.
- Mathews, J., 1996, 'Holonic organisational architectures', *Human Systems Management*, 15/27 - 54.
- Näpinen, Leo, 2004, 'Understanding of the World and the Scientific Paradigm of Self-Organization', *Studia Philosophica IV, Special Issue: Proceedings of the 7th Summer Symposium of the International Society for the Philosophy of Chemistry (Tartu, 16-20 August, 2003)*, 40, 157 – 177.
- Näpinen, Leo, 1994, 'Iseorganiseerumismõtlemine, selle omandamise vajadus Eesti ühiskonnas', *Teaduslugu ja Nüüdisaeg IX: Teadusfilosoofia ja teadusmetodoloogia Eestis: Olukord ja perspektiivid*, 158 - 180.
- Oulasvirta, Lasse, 2003, 'Local Government Finance and Grants in Finland', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 340 - 348.
- Pihlajaniemi, Toivo, 2003, 'The Changing Roles of the State and Municipalities', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 263 - 270.
- Prigogine, Ilya, 2000, The networked society, *Journal of World-Systems Research*, 6, 892 - 898.
- Ryynänen, Aimo, 2003, 'Modification of Finnish Local Government - Between Continuity and Change', *Finnish Local Government Studies/Kunnallistieteellinen Aikakauskirja*, 4, 255 - 262.
- Schmidt, Günter, 2004, 'Some preliminary thoughts on how legislation can provide rules to enhance the culture of public administration and what organizations can do to implement standards', *Halduskultuur 2003*, 14-22.
- Solum, Lawrence B., 1989, 'Illinois Public Law Research Paper No 08-06', *Northwestern University Law Review*, 83/1, 2, 9, 54-135.

---

Steyvers, Kristof, Bergström, Tomas, Bäck, Henry, Boogers, Marcel, De La Fuente, José Manuel Ruano, Schaap, Linze, 2008, 'From Princeps to President? Comparing Local Political Leadership Transformation', *Local Government Studies*, 34/2, 131 - 146.

Straussfogel, Debra, 1997, 'A system perspective on world-systems theory', *Journal of Geography*, 96, 119-126.

Van de Walle, Steven, Van Roosbroek, Steven, Bouckaert, Geert, 2008, 'Trust in the Public Sector: Is There Any Evidence for a Long-Term Decline?', *International Review of Administrative Sciences*, 74/ 1, 45-62.

Wallerstein, Immanuel, 1999, 'The Heritage of Sociology. The Promise of Social Science', *Current Sociology*, 47/1, 1-37.

### **Other sources**

Arabyan, Knarik, 2007, 'Audit in the Local Self-Government System of the Republic of Armenia: Legislative frameworks and practices', Chapter 9 in *Local Governments in Eastern Europe, in the Caucasus and in Central Asia*.

Bektemirov, Kuvatbay, Rahimov, Eduard, 2001, 'Local Government in Uzbekistan'.

Chong-Min, Park, 2006, 'Local Governance and Community Power in Korea'.

Coleman, Michael, Colantuono, Michael G., 2003, 'The Origin and Devolution of Local Revenue Authority'.

Constitution of the Republic of Estonia, The (CRE), (RT I 2007, 33, 210).

Davis, Howard, Downe, James, Martin, Steve, 2001, 'External inspection of local government. Driving improvement or drowning in detail?'

Illner, Michal, 1998, 'Chapter 1. Territorial Decentralization: An Obstacle to Democratic Reform in Central and Eastern Europe?', In *the Transfer of Power: Decentralization in Central and Eastern Europe*, Edited by Jonathan D. Kimball, The Local Government and Public Service Reform Initiative, Hungary.

IMF, 2001, 'Report on the Observance of Standards and Codes (ROSC)', Latvia, 29 March, 2001.

Jõks, Allar, 2008, 'Kellele kuulub Eesti riik?', *Postimees* 56/5235), 07 March 2008.

Prosecutor's Office Act (POA), (RT I 2006, 21, 160).

Sellers, Jefferey M., Lidström, Anders, 2007, 'Local Government and the Welfare State'.

Sepp, Veiko, Noorkõiv, Rivo, Haljaste, Karin-Liis, 2006, 'Kohaliku omavalitsuse üksuste haldussuutlikkuse hindamise meetoodika.'

State Audit Office (SAO), 2006, 'Ülevaade riigi vara kasutamise ja säilimise kohta 2005. aastal'.

Sterck, Miekatrien, Scheers, Bram, Bouckaert, Geert, 2005, 'The Modernization of the Public Control Pyramid: International Trends', Report D/2005/10106/018. Bestuurlijke Organisatie Vlaanderen, 164.

Swiderska, Krystyna, Roe, Dilys, Siegele, Linda, Grieg-Gran, Maryanne, 2008, 'The Governance of Nature and the Nature of Governance: Policy that works for biodiversity and livelihoods'.

Teder, Indrek, 2008, Riigikogu 23.09.2008 stenogramm.

Ter-Minassian, Teresa, Craig, Jon, 1997, 'Control of Sub-national Government

---

Borrowing', In Teresa Ter-Minassian, ed, *Fiscal Federalism in Theory and Practice: A Collection of Essays*, International National Monetary Fund.

The Office of the Chancellor of Justice (OCJ), 2007, Annual Report 2006 of the Chancellor of Justice, Tallinn.

Woolas, Phil, 2005, 'Inspection of Local Services: Launch of Inspection Consultation Document', Speech, 28 November 2005.

Work, Robertson, 1998, 'Factors to Consider in Designing Decentralised Governance Policies and Programmes to Achieve Sustainable People-Centred Development', Management Development and Governance Division, United Nations Development Programme, New York, February 1998.

### **WWW documents**

Aas, Krista, 2007, 'Kohaliku omavalitsuse üksuste investeeringud. Riigikontrolli aruanne Riigikogule'. Tallinn, 30. August 2007. Available at [WWW]<http://www.riigikontroll.ee/>, 12 January 2008.

Friedberg, Asher, 1999, 'Evaluating the Effectiveness of Public and Internal Audit in Local Government - The Case of Israel'. Available at [WWW][http://www.asosai.org/journal/1999/evaluating\\_the\\_effectiveness.htm](http://www.asosai.org/journal/1999/evaluating_the_effectiveness.htm), 30 November 2006.

Mikli, Airi, 2007, 'Rae valla majandustegevus 2006. Aastal. Riigikontrolli aruanne Riigikogule.' Tallinn, 13. November 2007. Available at [WWW]<http://www.riigikontroll.ee/>, 12 January 2008.

Ministry of the Interior (MI), 2005, 'Local Government in Estonia'. Available at [WWW][http://www.siseministeerium.ee/public/LGinEstonia2005\\_20070322090339.pdf](http://www.siseministeerium.ee/public/LGinEstonia2005_20070322090339.pdf), 30 December 2007.

Ministry of the Interior (MI), 2007, 'Kohalik omavalitsus haldussüsteemis'. Available at [WWW]<http://www.siseministeerium.ee/5945>, 15 August 2007.

Mäeltsemees, Sulev, 1994, Estonia 1994. Available: [WWW]<http://unpan1.un.org/intradoc/groups/public/documents/UNTC/UNPAN003969.htm>, 15. 10. 2006.

Oviir, Mihkel, 2006, Presentation at the Riigikogu on the overview of the use and preservation of state assets in 2005. Shorthand report from the 8th session (8.11.2006) of the 10th composition of the Riigikogu. Available at [WWW]<http://web.riigikogu.ee/ems/stenograms/2006/11/m06110807.html>, 30 December 2007.

Prigogine, Ilya, 1983, '*Ilya Prigogine: Wizard of Time*'. Interviewed May 1983 by Robert B. Tucker. Available at [WWW][http://www.edu365.cat/aulanet/comsoc/visions/documentos/interview\\_prigogine\\_1983.htm](http://www.edu365.cat/aulanet/comsoc/visions/documentos/interview_prigogine_1983.htm), 07 August 2009.

Walker, David M, 2005, 'The Government Accountability Office Report GAO-05-325SP: 21st Century Challenges: Re-examining the Base of the Federal Government'. Available at [WWW]<http://www.gao.gov/new.items/d05325sp.pdf>, 30 December 2007.

## Appendixes

### *Appendix 1*

#### Curriculum Vitae

##### 1. Personal data

Name: Raivo Linnas

Date and place of birth: 26.10.1961, Tallinn.

##### 2. Contact information

Address: Akadeemia tee 3, Tallinn 80035, Republic of Estonia.

Phone: +372 5122224

E-mail: Raivo.Linnas@mail.ee

##### 3. Education

Educational institution	Graduation year	Education (field of study/degree)
Tallinn University of Technology	2010	PhD Candidate
Tallinn University of Technology	Not completed.	Courses of Master of Sciences in Economics (7343906).
Tallinn Polytechnical Institute (Tallinn University of Technology)	1985	Qualification equivalent to a master's level degree in technical engineering.

##### 4. Language competence/skills (fluent; average, basic skills)

Language	Level
Estonian	Fluent
English	IELTS: Academic 6,0; Listening 6,0; Reading 6,0; Writing 6,0; Speaking 6,0.
Russian	Average

## 5. Special Courses

Assessing the Impact of Financial Regulation: Experiences and Challenges, Bank of Italy, November 2009, Rome.

Seventh European Academic Conference on Internal Audit and Corporate Governance, Cass Business School, Catholique University of Louvain, Erasmus University, Business University Nyenrode, University of Pisa, April 2009, London.

International Accounting and Auditing for Financial Institutions, FSI-BIS, February 2009, Basel.

Seventh European Academic Conference on Internal Audit and Corporate Governance, Cass Business School, Catholique University of Louvain, Erasmus University, Business University Nyenrode, University of Pisa, April 2009, London.

Reputational Risk and Global Internal Control Training, Banco de Espana, September 2008, Madrid.

Auditing Integrity and Compliance, De Nederlandsche Bank, July 2008, Amsterdam.

First Global Academic Conference on Internal Audit and Corporate Governance, ECIIA/University of Pisa/Cass Business School/Erasmus University, April 2008, Rotterdam.

Interpersonal Skills, Audentes-Ariko, 2007, Tallinn.

Introduction Supervision on Pension Funds, De Nederlandsche Bank, June 2007, Amsterdam.

Fifth European Academic Conference on Internal Audit and Corporate Governance, University of Pisa/Cass Business School, April 2007, Pisa.

Impact Assessment, Deutsche Bundesbank/Bundesanstalt für Finanzdienstleistungsaufsicht, October 2007, Eltville.

Foresight, PHOENIX project, November 2006, Tallinn.

Seminar on Solvency 2, Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS), October 2006, Budapest.

Impact Assessment of Legal Acts, Tallinn University of Technology, October 2005, Tallinn.

Nordic Good Governance, Tallinn University of Technology /University of Tartu, September 2005, Laulasmaa.

1st Insurance Supervision Seminar, Financial Stability Institute (FSI), August 2005, Beatenberg.

Banking Supervision Under the Basel II Accord, Deutsche Bundesbank, September 2004, Frankfurt-am-Main.

Seminar for International Regulators, Financial Services Authority (FSA), December 2003, London.

Enforcement and Market Oversight, US SEC/SMAS/FSVC, November 2003, Ljubljana.



Kõrgemad Riigikaitse Kursused, Kaitseministeerium (Ministry of Defense), September 2003.

Art of Motivation, Tallinna Konverentsid, September 2003, Tallinn.

Internal Audit and Internal Control in Financial Supervision Authorities, EAST-WEST Management Institute/USAID, February 2003, Washington DC.

Operations of Modern Controller's Department, De Nederlandsche Bank, December 2002, Amsterdam.

Management Accounting, Bank of Finland, March 2002, Helsinki.

Internal Audit, Risk Management and Quality Management in Financial Supervision Sphere, Financial Services Authority (FSA), March 2002, London.

Advanced Management, Management for Development Foundation (MDF), 2001, Tallinn.

Training and Pilot Project of Quality Assessors, Estonian Export Agency/Ministry of Economic Affairs/Estonian Association for Quality, 2000/2001, Tallinn.

Performance Audit, Algemene Rekenkamer (Netherlands Court of Audit), December 2000, Tallinn.

A Role and Functions of State Audit Institutions in the EU, OECD/SIGMA, 2000, Tallinn.

Writing Reports That Count, PriceWaterhouseCoopers, 2000, Tallinn.

Process Management, Management for Development Foundation (MDF), 2000, Tallinn.

Financial Audit and Value-for-Money Audit (1 month), National Audit Office (NAO) UK, 2000, London.

Project Management, Helvetia Balti Partnerid (HBP), 2000, Tallinn.

Civil Law, State Law, Public Management, Public Sector Financial Management, Public Sector Accounting (3 months), Public Service Academy of Estonia, 1999, Tallinn.

Rational Organization of Managerial Work, Merlecons OÜ, 1999, Tallinn.

Claim Handling of MTPL and Hull Insurance, Conseil des Bureaux, 1997, Paris.

Internal Control and Auditing of Insurance Companies, ABI-FSA-TAIEX, 1997, London.

Marketing, 1996, Tallinn.

New Technology in Insurance, ITC, 1996, Vienna.

Financial Management of Insurance Business, PHARE-KPMG, 1996, Tallinn.

Fundamentals of Insurance Management and New Markets, Association of British Insurers (ABI), 1995, London.

TPML and Hull Insurance, Kölnische Rück, 1995, Riga.

Business English, Canterbury LTC, 1995, Canterbury.

International Trade Finance, Fairplace (UK), 1994, Tallinn.

Dynamic Management, Management Centrum NCW (Netherlands), 1994, Tallinn.

From Planned Economy to Dynamic Management, Management Centrum NCW (Netherlands), 1994, Tallinn.

Bank Financial Management, Fairplace (UK), 1993, Tallinn.

Fundamentals of Bank Management, Belgian Bankers Association, 1993, Tallinn.

## 6. Professional Employment

Finantsinspektsioon (Financial Supervision Authority), from 07.01.2002 to today, Head of Internal Audit.

Riigikontroll (State Audit Office), from 10/1998 to 01/2002, the Head of Performance Audit Department, the Deputy Auditor General, an Adviser to Auditor General.

Salva Kindlustuse AS (A Non-life Insurance Company), from 04/1996 to 07/1998, a Member of Executive Management Board, the Claim Handling Director, the Development Director.

Eesti Kõrgem Kommertskool (The Estonian Business School), from 09/1996 to 06/1998, a Lecturer on Fundamentals of Business Management.

Eesti Transpordikindlustuse AS (A Non-life Insurance Company), from 08/1994 to 02/1996, the General Director, the Chairman of the Management Board, an Establisher.

Eesti Sotsiaalpank (An Universal Bank), from 09/1993 to 05/1994, a Member of the Management Board, a Vice Chairman of the Management Board, an Adviser to the Chairman.

State Joint Stock Company Balti ES (Formerly SJSC Baltiyets, Metal and Electronics Industry), from 07/1993 to 01/1994, the Chairman of the Management Board.

State Joint Stock Company Baltiyets, from 12/92 to 01/94, the Chairman of the Management Board.

Ministry of Finance, Eesti Majanduse Stabiliseerimise Fond, from 09/1992 to 12/1992, the Executive Director.

## 7. Scientific work

### Publications

Linnas, Raivo. (2010) Comparison of Internal Audit in Estonia and the Nordic Countries. *Managerial Auditing Journal*, 1–19, (Forthcoming, ETIS 1.1).

Linnas, Raivo. (2010) Integral Model of Audit, Control and Supervision of Local Self-Government. *Local Government Studies*, 1–30, (Forthcoming, ETIS 1.1).

Linnas, Raivo. (2009) Siseaudit Eestis ja mujal Euroopas. *Riigikogu Toimetised*, 20, 140–149.

Linnas, Raivo. (2009) Legal Framework and Present State of External Control and Supervision of Local Self-Government Units in Estonia. *Kunnallistieteellinen Aikakauskirja*, 141–162.

Linnas, Raivo. (2009) Siseaudit Eestis on Euroopa keskmisel tasemel. *Eesti Majanduse Teataja*, 27–37.

Linnas, Raivo. (2008) Audit in Small Local Government Units: The Case of Estonia. *Kunnallistieteellinen Aikakauskirja*, 65–82.

- Linnas, P. (2008) Теоретические и практические аспекты планирования инновационной политики (на примере Эстонии). ВЕСТНИК ВГУ, СЕРИЯ: ЭКОНОМИКА И УПРАВЛЕНИЕ, 10–24.
- Linnas, Raivo (2008) Kohaliku omavalitsuse auditi, järelevalve ja kontrolli probleeme Eestis. Riigikogu Toimetised, 176–184.
- Linnas, Raivo. (2008) An Assessment and Evaluation of Innovation Policy: The Case of Estonia. Eesti majanduspoliitilised väitlused = Estnische Gespräche über Wirtschaftspolitik = Discussions on Estonian economic policy XVI. (98–118). Berliner Wissenschafts-Verlag, Mattimar.
- Linnas, Raivo. (2008) Audit in Small Local Government Units: The Case of Estonia. First Global Academic Conference on Internal Audit & Corporate Governance, Rotterdam, 20.-22.04.2008. Plenary session, 21.04.2008.
- Linnas, Raivo. (2008) Siseaudiitorid vajavad oma seadust. Ärielu, 62–64.
- Linnas, Raivo (2007) General Theoretical Approach and Practical Aspects of Innovation Policy Planning: Based on the Example of Estonia. Acta Universitatis Latviensis, 718 (239–259). Riga, Latvia University.
- Linnas, Raivo. (2007) Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments. (Based on the Case of the Estonia). Kunnallistieteellinen Aikakauskirja, 282 - 294.
- Linnas, Raivo. (2007) Innovatsioonipoliitika koordineerimine Eestis. Riigikogu Toimetised, 79–87.
- Linnas, Raivo. (2007) General Theoretical Aspects of Policy Making and Management. Eesti majanduspoliitilised väitlused = Estnische Gespräche über Wirtschaftspolitik = Discussions on Estonian economic policy (124–141). Berlin-Tallinn: Berliner Wissenschafts-Verlag, Mattimar.
- Linnas, Raivo. (2007) Innovatsioonipoliitika kavandamisest Eestis. Riigikogu Toimetised, 65–72.
- Linnas, Raivo. (2006) Entrepreneurship as a Tool of an Economic Policy: Background, Factors and Possibilities. XIV majanduspoliitika teaduskonverents: XIV teadus- ja koolituskonverentsi ettekanded-artiklid = Die XIV wirtschaftspolitische Konferenz: Beiträge der XIV wissenschaftlichen und ausbildenden Konferenz = 14th scientific conference on economic policy: reports-papers of the XIV scientific and educational conference (497–519). Berliner Wissenschafts-Verlag, Mattimar.
- Linnas, Raivo. (2006) Koostöö kohaliku omavalitsusega. Liinak, E. (Eds.). Abiks kiriku kaastöölistele (61–73). Tallinn.: SA EELK Misjonikeskus.
- Linnas, Raivo. (2005) Mis on siseaudit? Verbis aut Re 2005, lk. 2.
- Linnas, Raivo. (1998) Ühiskond ja korrupsioon. Ratsionaalsus ja demokraatlik riik. Ühiskond ja korrupsioon : valik artikleid ja ettekandeid (9–19). Tallinn: Jaan Tõnissoni Instituut.
- Linnas, Raivo. (1997) Ärijuhtimise alused: loengumapp. Tallinn: EBS Print.
- Gineitiene, Z. Linnas, R. (1990). Naujos ūkininkavimo formas pereinant prie rinkos santykiu. Laudies Ukis, Teorios ir praktikos žurnalas, 6–7.

Linna, R. Gineitiene, Z. (1990). Vidine imones ūkiskaita: principai, problemos ir realizavimas. Estijos patirtis. *Laudies Ukis, Teorios ir praktikos žurnalas*, 5–7.

#### 8. Defended supervised thesis

Kai Kallas, Master's Degree, 2008, (sup) Raivo Linna, Kaasamise olulusis kvaliteetse avaliku teenuse väljatöötamisel – Keskkonnaministeeriumi avalike teenuste standardite näitel. (The importance of involvement in developing high-quality public services, based on the example of the Ministry of the Environment's public service standards.), Tallinn University of Technology, Faculty of Social Sciences, Department of Public Administration.

#### 9. Main areas of scientific work/Current research topics

Culture and Society, Social Sciences (Audit, Control and Supervision; Economic Policy; Policy Management; Public Management, Innovation and New Technologies).

## Elulookirjeldus

### 1. Isikuandmed

Ees- ja perekonnanimi: Raivo Linnas  
 Sünniaeg ja -koht: 26.10.1961, Tallinn  
 Kodakondsus: Eesti Vabariik

### 2. Kontaktandmed

Address: Akadeemia tee 3, Tallinn 80035, Eesti Vabariik  
 Telefon: +3725122224  
 E-posti aadress: Raivo.Linnas@mail.ee

### 3. Hariduskäik

Õppeasutus (nimetus lõpetamise ajal)	Lõpetamise aeg	Haridus (eriala/kraad)
Tallinna Tehnikaülikool	2010	Haldusjuhtimise doktorant
Tallinna Tehnikaülikool	lõpetamata	magistriõpe majandusteaduskonnas ärikorralduse õppesuunal (7343906)
Tallinna Polütehniline Instituut	1985	Tehnikateaduste magistri kraadi tasemele vastav haridus.

### 4. Keelteoskus (alg-, kesk- või kõrgtase)

Keel	Tase
Eesti keel	kõrgtase
Inglise keel	IELTS Academic 6,0 Listening 6,0, Reading 6,0, Writing 6,0, Speaking 6,0
Vene keel	kesktase

### 5. Täiendusõpe

Assessing the Impact of Financial Regulation: Experiences and Challenges, Bank of Italy, november 2009, Rooma.

Seventh European Academic Conference on Internal Audit and Corporate Governance, Cass Business School, Catholique University of Louvain, Erasmus

University, Business University Nyenrode, University of Pisa, aprill 2009, London.

International Accounting and Auditing for Financial Institutions, FSI-BIS, veebruar 2009, Basel.

Reputational Risk and Global Internal Control Training, Banco de Espana, september 2008, Madrid.

Auditing Integrity and Compliance, De Nederlandsche Bank, juuni 2008, Amsterdam.

First Global Academic Conference on Internal Audit and Corporate Governance, University of Pisa/Cass Business School/Erasmus University, aprill 2008, Rotterdam.

Introduction Supervision on Pension Funds, juuni 2007, De Nederlandsche Bank, juuni 2007, Amsterdam.

Reputational Risk and Global Internal Control Training, Banco de Espana, september 2008, Madrid.

Auditing Integrity and Compliance, De Nederlandsche Bank, juuni 2008, Amsterdam.

Suhtlemisuskused, Audentes-Ariko, 2007, Tallinn.

Impact Assessment, Deutsche Bundesbank/Bundesanstalt für Finanzdienstleistungsaufsicht, oktoober 2007, Eltville.

Introduction Supervision on Pension Funds, De Nederlandsche Bank, juuni 2007, Amsterdam.

Fifth European Academic Conference on Internal Audit and Corporate Governance, University of Pisa/Cass Business School, aprill 2007, Pisa.

Seminar on Solvency 2, Comitee of European Insurance and Occupational Pensions Supervisors (CEIOPS), oktoober 2006, Budapest.

Õigusaktide mõju analüüs, Tallinna Tehnikaülikool, oktoober 2005, Tallinn.

Nordic Good Governance, Tallinna Tehnikaülikool /Tartu Ülikool, september 2005, Laulasmaa.

1st Insurance Supervision Seminar, Financial Stability Institute (FSI), august 2005, Beatenberg.

Banking Supervision Under the Basel II Accord, Deutsche Bundesbank, september 2004, Frankfurt-am-Main.

Seminar for International Regulators, Financial Services Authority (FSA), detsember 2003, London.

Enforcement and Market Oversight, US SEC/SMAS/FSVC, november 2003, Ljubljana.

Korgemad Riigikaitse Kursused, Kaitseministeerium, september 2003, Lapanina.

Motiveerimise kunst, Tallinna Konverentsid, september 2003, Tallinn.

Internal Audit and Internal Control in Financial Supervision Authorities, EAST-WEST Management Institute/USAID, veebruar 2003, Washington DC.

Operations of Modern Controller's Department, De Nederlandsche Bank, detsember 2002, Amsterdam.

Management Accounting, Bank of Finland, märts 2002, Helsingi.

Internal Audit, Risk Management and Quality Management in Financial Supervision Sphere, Financial Services Authority (FSA), märts 2002, London.

Advanced Management, Management for Development Foundation (MDF, Netherlands), 2001, Tallinn.

Kvaliteedijuhtimise Assessorite Koolitus ja Pilootprojekt, Eesti Ekspordiagentuur/Majandusministeerium/Eesti Kvaliteediühing, 2000/2001, Tallinn.

Performance Audit, Algemene Rekenkamer (Hollandi Riigikontroll), detsember 2000, Tallinn.

A Role and Functions of State Audit Institutions in the EU, OECD/SIGMA, 2000, Tallinn.

Writing Reports That Count, PriceWaterhouseCoopers, 2000, Tallinn.

Process Management, Management for Development Foundation (MDF, Netherlands), 2000, Tallinn.

Financial Audit and Value-for-Money Audit (1 kuu), National Audit Office (NAO) UK, 2000, London.

Projektijuhtimine, Helvetia Balti Partnerid (HBP), 2000, Tallinn.

Tsiviilõigus-, riigiõigus, avalik haldus, avaliku sektori finantsjuhtimine ja avaliku sektori majandusarvestus (3 kuud), Sisekaitseakadeemia, 1999, Tallinn.

Juhitöö ratsionaalne korraldamine, Merlecons OÜ, 1999, Tallinn.

Sõiduki- ja liikluskindlustuse kahjukäsitlus, Conseil des Bureaux, 1997, Pariis.

Internal Control and Auditing of Insurance Companies, ABI-FSA-TAIEX, 1997, London.

Marketing, 1996, Tallinn.

New Technology in Insurance, ITC, 1996, Viin.

Kindlustusseltsi finantsjuhtimine, PHARE-KPMG, 1996, Tallinn.

Fundamentals of Insurance Management and New Markets, Briti Kindlustusandjate Assotsiatsioon (ABI), 1995, London.

Kasko- ja liikluskindlustus, Kölnische Rück, 1995, Riia.

Business English, Canterbury LTC, 1995, Canterbury.

Rahvusvahelise kaubanduse finantseerimine, Fairplace (UK), 1994, Tallinn.

Dynamic Management, Management Centrum NCW (Holland), 1994, Tallinn.

From Planned Economy to Dynamic Management, Management Centrum NCW (Holland), 1994, Tallinn.

Panga finantsjuhtimine, Fairplace (UK), 1993, Tallinn.

Panga juhtimise alused, Belgia Pangaliit, 1993, Tallinn.

## 6. Teenistuskäik

Finantsinspektsioon, siseaudiitor, 07.01.2002 kuni tänaseni.

Riigikontroll, 10/1998 kuni 01/2002, riigikontrolöri alaline asendaja, tulemusauditi osakonna peakontrolör (juhataja), III ja VI kontrolliosakonna peakontrolör, riigikontrolöri nõunik.

Salva Kindlustuse AS, 04/1996 kuni 07/1998, juhatuse liige, kahjukäsitusdirektor, arendusdirektor.

Eesti Transpordikindlustuse AS 08/1994 – 02/1996, juhatuse esimees, peadirektor.

Eesti Sotsiaalpank, 09/1993 kuni 05/1994, juhatuse esimehe asetäitja, juhatuse liige, juhatuse esimehe nõunik.

RAS Balti ES (endine RAS Baltijets), 07/1993 kuni 01/1994, juhatuse esimees.

RAS Baltijets, 12/92 kuni 09/93, juhatuse esimees, juhatuse liige, likvideerimiskomisjoni esimees.

Rahandusministeerium, Eesti Majanduse Stabiliseerimise Fond, 09/1992 kuni 12/1992, tegevdirektor.

AS Hansa Press, 12/1990 kuni 09/1992, nõunik.

VF "IVA", 05/1990 kuni 12/1990, peaspetsialist.

JSTKB "MAINOR", 10/1988 kuni 05/1990, IME-osakond, sektorijuhataja.

Teraviljasaaduste Ministeerium, 06/1986 kuni 10/1988, peamehaanik.

Tallinna Parfümeeria- ja Toidurasvade Kombinaat, 08/1985 kuni 06/1986, tsehhijuhataja, peaenergeetik-peamehaanik.

## 7. Teadustegevus

### Publikatsioonid

Linnas, Raivo. (2010) Comparison of Internal Audit in Estonia and the Nordic Countries. *Managerial Auditing Journal*, 1–19, (Forthcoming, ETIS 1.1).

Linnas, Raivo. (2010) Integral Model of Audit, Control and Supervision of Local Self-Government. *Local Government Studies*, 1–30, (Forthcoming, ETIS 1.1).

Linnas, Raivo. (2009) Siseaudit Eestis ja mujal Euroopas. *Riigikogu Toimetised*, 20, 140–149.

Linnas, Raivo. (2009) Legal Framework and Present State of External Control and Supervision of Local Self-Government Units in Estonia. *Kunnallistieteellinen Aikakauskirja*, 141–162.

Linnas, Raivo. (2009) Siseaudit Eestis on Euroopa keskmisel tasemel. *Eesti Majanduse Teataja*, 27–37.

Linnas, Raivo. (2008) Audit in Small Local Government Units: The Case of Estonia. *Kunnallistieteellinen Aikakauskirja*, 65–82.

Линнас, Р. (2008) Теоретические и практические аспекты планирования инновационной политики (на примере Эстонии). *ВЕСТНИК ВГУ, СЕРИЯ: ЭКОНОМИКА И УПРАВЛЕНИЕ*, 10–24.

Linnas, Raivo (2008) Kohaliku omavalitsuse auditi, järelevalve ja kontrolli probleeme Eestis. *Riigikogu Toimetised*, 176–184.

Linnas, Raivo. (2008) An Assessment and Evaluation of Innovation Policy: The Case of Estonia. *Eesti majanduspoliitilised väitlused = Estnische Gespräche über Wirtschaftspolitik = Discussions on Estonian economic policy XVI*. (98–118). *Berliner Wissenschafts-Verlag, Mattimar*.



- Linnas, Raivo. (2008) Audit in Small Local Government Units: The Case of Estonia. First Global Academic Conference on Internal Audit & Corporate Governance, Rotterdam, 20.-22.04.2008. Plenary session, 21.04.2008.
- Linnas, Raivo. (2008) Siseaudiitorid vajavad oma seadust. *Ärielu*, 62–64.
- Linnas, Raivo (2007) General Theoretical Approach and Practical Aspects of Innovation Policy Planning: Based on the Example of Estonia. *Acta Universitatis Latviensis*, 718 (239–259). Riga, Latvia University.
- Linnas, Raivo. (2007) Theoretical and Practical Problems Related to the Audit, Control and Supervision System of Local Governments. (Based on the Case of the Estonia). *Kunnallistieteellinen Aikakauskirja*, 282–294.
- Linnas, Raivo. (2007) Innovatsioonipoliitika koordineerimine Eestis. *Riigikogu Toimetised*, 79–87.
- Linnas, Raivo. (2007) General Theoretical Aspects of Policy Making and Management. *Eesti majanduspoliitilised väitlused = Estnische Gespräche über Wirtschaftspolitik = Discussions on Estonian economic policy* (124–141). Berlin-Tallinn: Berliner Wissenschafts-Verlag, Mattimar.
- Linnas, Raivo. (2007) Innovatsioonipoliitika kavandamisest Eestis. *Riigikogu Toimetised*, 65–72.
- Linnas, Raivo. (2006) Entrepreneurship as a Tool of an Economic Policy: Background, Factors and Possibilities. XIV majanduspoliitika teaduskonverents: XIV teadus- ja koolituskonverentsi ettekanded-artiklid = Die XIV wirtschaftspolitische Konferenz: Beiträge der XIV wissenschaftlichen und ausbildenden Konferenz = 14th scientific conference on economic policy: reports-papers of the XIV scientific and educational conference (497–519). Berliner Wissenschafts-Verlag, Mattimar.
- Linnas, Raivo. (2006) Koostöö kohaliku omavalitsusega. Liinak, E. (Eds.). *Abiks kiriku kaastöölistele* (61–73). Tallinn.: SA EELK Misjonikeskus.
- Linnas, Raivo. (2005) Mis on siseaudit? *Verbis aut Re* 2005, lk. 2.
- Linnas, Raivo. (1998) Ühiskond ja korruptsioon. Ratsionaalsus ja demokraatlik riik. *Ühiskond ja korruptsioon : valik artikleid ja ettekandeid* (9–19). Tallinn: Jaan Tõnissoni Instituut.
- Linnas, Raivo. (1997) *Ärijuhtimise alused: loengumapp*. Tallinn: EBS Print.
- Gineitiene, Z. Linnas, R. (1990). *Naujos ūkininkavimo formos pereinant prie rinkos santykiu. Laudies Ukis, Teorios ir praktikos žurnalas*, 6–7.
- Linnas, R. Gineitiene, Z. (1990). *Vidine imones ūkiskaita: principai, problemos ir realizavimas. Estijos patirtis. Laudies Ukis, Teorios ir praktikos žurnalas*, 5–7.

## 8. Kaitstud lõputööd

Kai Kallas, magistrikraad, 2008, (juh) Raivo Linnas, Kaasamise olulisus kvaliteetse avaliku teenuse väljatöötamisel - Keskkonnaministeeriumi avalike teenuste standardite näitel. (Kaasamise olulisus kvaliteetse avaliku teenuse väljatöötamisel - Keskkonnaministeeriumi avalike teenuste standardite näitel), Tallinna Tehnikaülikool, Sotsiaalteaduskond, Avaliku halduse instituut.

## 9. Teadustöö põhisuunad

Ühiskonnateadused ja kultuur, Sotsiaalteadused (audit, kontroll ja järelvalve; avalik haldus; majanduspoliitika, tegevuspoliitika juhtimine, innovatsioon ja uued tehnoloogiad).

## 10. Muu teadus- ja arendustegevus

Akadeemilise seminari “Internal Audit and Supervision Models and Internal Control Systems in Public Sector” kaas-peakorraldaja, 25.-26.08.2006, Tallinn.

Sisekaitseakadeemia siseaudiitori eriala rakenduskõrghariduse õppekava koostamine. Töörühma arvatud Sisekaitseakadeemia rektori 03.11.2004 kk nr 1.1-5/114. Õppekava kooskõlastused: HTM 02.06.2005, nr. 7.1-3/4528; RM 09.05.2005, nr 10-2/4242 (2004 – 2005).

Transparency International ekspert (Country Study “National Integrity System Indicators”), 2000.

INTOSAI sisekontrolli II konverentsi delegaat, 2000, mai, Budapest.

Vabariigi Valitsuse valitsusasutuste finants- ja sisekontrolli süsteemi loomise kava väljatöötamise asjatundjate komisjoni liige, 1999.

Eesti Kõrgem Kommertsikool (Estonian Business School), 09/1996 kuni 06/1998, ärijuhtimise aluste lektor. Vastutusallas ärijuhtimise õppekava, ainekaartide ja loengumapi väljatöötamine ning ärijuhtimise kaugõppe üliõpilastele loengute ja seminaride pidamine ning eksamite vastu võtmine (kokku 2x75 üliõpilast).

Kirjutanud loengumapi “Ärijuhtimise alused”. Tln, 1997, EBS Kirjastus.

Euroopa Liidu poolt korraldatud rahvusvahelise energeetikaseminari EEEE-2000 kaasorganisaator, Stockholm.

Vabariigi Valitsuse Ida-Virumaa komisjoni ekspert majanduse, tööstuse ja panganduse alal, 1993 – 1994.

Vabariigi Valitsuse seadusloome komisjoni allkomisjoni liige, 1990.

Vilniuse Riikliku Ülikooli ettevõtluse külalislektor, 1990.

Regionaalse Isemajandamise ja Enesefinantseerimise Rahvusvahelise konverentsi kaaspeaettekandja, 1989, Tbilisi.

Kirjutanud retsensiooni ühele doktoritööle, 3 magistritööle ja 2 diplomitööle. Juhendanud magistri- ja bakalaureuseõppe üliõpilasi.

Osalenud mitmetel eri konverentsidel ja seminaridel, sh ettekannetega ning kirjutanud teadus- ja teisi artikleid.

**Tallinn University of Technology Doctoral Theses Series I: Social Sciences**

6. Ülle Madise. Elections, Political Parties, and Legislative Performance in Estonia: Institutional Choices from the Return to Independence to the Rise of e-democracy. 2007.
7. Tarvo Kungla. Patterns of Multi-Level Governance in Europe: The Challenge of the EU's Enlargement. 2007.
8. Mikk Lõhmus. Avaliku halduse detsentraliseerimine Eestis. 2008.
9. Tarmo Kalvet. Innovation Policy and Development in the ICT Paradigm: Regional and Theoretical Perspectives. 2009.
10. Thomas Duve. Die Verschuldung Deutscher Gemeinden: Präventionsansätze im Spannungsverhältnis von Kommunalen Selbstverwaltung und Staatlicher Gesamtverantwortung. 2009.
11. Veiko Lember. Contracting-Out Public Services and Public Procurement for Innovation: Revisiting Contracting Limits in Estonia and Beyond. 2009.
12. Raivo Linnas. An Integrated Model of Audit, Control and Supervision of the Local Government Sector: The Case of Estonia. 2010.