

ASSESSMENT OF THE EUROPEAN UNION STRUCTURAL ASSISTANCE AUDIT MODEL

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Abstract. *The paper covers an analysis and critical assessment of the procedure of selecting the audit model for the European Union structural assistance and elaborates on applicable models. It reviews the authorities of the EU Member States tasked with the performance of the auditing function. The article provides an assessment of the status of the supreme audit institution which acts as a body auditing structural assistance. The conclusion is drawn that in cases when the provisions of different auditing standards differ, regulations of the European Union should specify the particular requirements applicable to the audit.*

Key words: *the European Union, structural assistance, audit authority*

Introduction

One of the key priorities of the European Union (EU) is reduction of differences among the EU Member States and separate regions. Reduction of differences accelerates the development of the EU countries. The average income per capita in the Member States that joined the EU in 2004, calculated in purchasing power parities, was by 76 per cent lower than in the EU-15, but in terms of development the new Member States considerably outpace the old ones: in 2003, the average growth rate of 10 accessing countries was 3.6 per cent and of the 15 MS 0.4 per cent. This phenomenon has a great positive effect on the overall EU development dynamics (Opinion..., 2005).

More than one third of the EU budget is allocated for reducing the existing disparities, improving regional competitiveness and employment, promoting the interregional and European cooperation (Kas yra..., 2008). The EU assistance in 2010 State Budget of the Republic of Lithuania comprises about eight billion litas, i.e. 37 per cent of the total planned budget revenues (2010 State Budget, 2009), and the amount committed for 2007–2013 for Lithuania equals to LTL 23 billion.

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The EU structural assistance is allocated from three funds – the European Social Fund, the European Regional Development Fund and the Cohesion Fund. A proper use of the proceeds of these funds can be ensured only by a well-functioning management and control system. One of the main elements of this system is an audit authority. The EU authorities establish the main requirements to be observed by the Member States in establishing the national procedure of administrating and supervising the assistance. In observance of these criteria, each country develops the management and control system and the audit model thereof. For this reason, the audit models of the EU structural assistance funds in different countries vary.

Scientific literature provides only a fragmented analysis of the subject of audit of the EU structural assistance; therefore, it is not clear whether all operating models are equally effective.

The purpose of the study was to analyse and assess the EU structural assistance audit model when the supreme audit institution is tasked with conducting the audit (as this is one of the possible types of EU structural fund audit models, but it differs from the others most as the supreme audit institution is not under state government). The *hypothesis* was that this model would provide more independence in conducting the EU assistance audit.

Tasks:

- to analyse the circumstances to be taken into consideration in developing an effective audit model of structural assistance funds;
- to review audit models of structural assistance funds applicable in different EU Member States;
- to analyse and critically assess the status of the supreme audit authority in auditing the EU structural funds.

The study object was the activities of authorities auditing the EU structural assistance funds management and control system.

The study model: theoretical qualitative (unstructured) communication research; content analysis based on a comparative research of regulatory acts of the EU and the Republic of Lithuania; analysis and critical assessment of the functions of authorities administrating and controlling the EU proceeds; summary.

1. Analysis of the EU requirements for the management and control of structural assistance

Requirements for the commitment and administration of structural funds are set forth in the European Council Regulation (EC) No 1083/2006 of 11 July 2006. Article 59 of the Regulation establishes that the system of management and control shall be guaranteed by the following authorities:

- managing authority – national, regional or local public authority or a public or private body designated by the Member State to manage the operational programme.

The managing authority shall be responsible for managing and implementing the operational programme in accordance with the principle of sound financial management;

- certifying authority – national, regional or local public authority or body designated by the Member State to certify the statement of expenditure and applications for payment before sending them to the Commission. The certifying authority of an operational programme shall be responsible for drawing up and submitting to the Commission certified statements of expenditure and applications for payment;
- audit authority – national, regional or local public authority or body, functionally independent of both the managing and the certifying authorities. It shall be responsible for ensuring that audits are carried out to verify an effective functioning of the management and control system of the operational programme and that audits are carried out on operations on the basis of an appropriate sample to verify the expenditure declared.

Requirements for the audit authority and audit are set in the Council Regulations (EC) No 1083/2006 and No 1828/2006. Analysis of these requirements reveals certain ambiguities and inconsistencies with the existing audit practices. Audit, as a rule, is perceived as an examination of financial statements with the purpose to enable the auditor to express his opinion whether financial statements in all material respects have been prepared in agreement with the established financial reporting requirements (International..., 2005). However, Article 62(a) of the Regulation (EC) No 1083/2006 requires to conduct the audit of the management and control system and 62(b) to verify the declared expenditure. Regulation No 1828/2006 requires issuing an opinion as to whether the management and control system functions effectively and the declaration of expenditure is correct. It can be concluded that the audit of the use of the EU structural assistance could be considered as financial audit only to a certain extent. Such ambiguity would not give rise to any bigger problems, all the more, given the variety of audit types existing at the global level (*Gupta, 2005*), if not for certain requirements established in the Regulation (EC) No 1828/2006 and its Annex that might contribute to such ambiguity. Pursuant to Article 17 of the Regulation No 1828/2006, the method used to select the sample of expenditure shall take an account of internationally accepted audit standards and must be documented, while the annex to this Regulation requires to issue an opinion as to whether the management and control system functions effectively, so as to provide a reasonable assurance that the statements of expenditure presented to the Commission are correct and, as a consequence, a reasonable assurance that the underlying transactions are legal and regular can be obtained.

At present, at the global level, there exist three groups of the generally accepted auditing standards:

- international standards on Auditing (2005);

- international standards for Supreme Audit Institutions (2010);
- international standards for the Professional Practice of Internal Auditing (2009).

Analysing the International Standards on Auditing, J. Mackevičius notes that they represent the entirety of the principles, regulations and procedures of reviewing and assessing financial reports. They establish the principles, regulations and procedures that are found by auditors in all stages of the audit (Mackevičius, 2009).

The INTOSAI standards are aimed at the supreme-level audit authorities. They are of recommendation nature and provide only the general principles to be followed by the supreme audit authorities and auditors. These standards almost do not contain any particular guidance as to the performance of audits.

The goals of the International Standards for the Professional Practice of Internal Auditing are to:

1. Set forth the main principles of audit activities.
3. Provide a scheme for conducting and developing a comprehensive and useful internal audit.
4. Establish the basis for assessing the internal audit activity.
5. Facilitate the improvement of the development and operation of the organisation.

All the above standards are similar in their essence and are intended for the performance of the auditors' work; however, each of these standards contain certain specific provisions that are not characteristic of other standards. The preparation of an audit report might serve as a good example here. The International Standards on Auditing do not devote attention to the drafting of this document, because, in observance of these standards, such document is not mandatory, and they require issuing only the auditor's opinion. Differently from the International Standards on Auditing, INTOSAI standards do not mention any particular reporting form. According to the Regulation No 1083/2006, in addition to issuing an opinion, the audit authority is required to prepare the annual report; therefore, authorities of various countries, working according to different standards, might have an entirely different understanding and even legal basis concerning the form of such document.

Requirements established in the aforementioned Regulations to observe the internationally recognised audit standards show that the aim of the EU and its authorities is to get closer to the international auditing practices. However, audit of the use of the EU structural assistance should be attributed to atypical audits, and therefore its regulation should be clarified and provided in more detail. The forms of audit should also be defined more clearly in the Regulations. The literature, as a rule, distinguishes and elaborates on three forms of audit (Lakis, 2007; Santiso, 2009). They include financial, compliance and performance audits. Each of these audits has its own specifics. Their procedure and documentation of results also differ.

2. Assessment of alternative models of audit of the EU structural assistance

Discussions concerning the most appropriate model of assistance administration have been under way for a long time, but no consensus on this matter has been reached yet. New Member States were proposed two main models of payment and management of the structural assistance funds (Allen, Tommasi, 2001):

1. Management by operating authorities (application of this model was proposed in the countries that have an effectively functioning system of management and supervision of the national budgets).
2. Setting up an organisation (agency) of the national fund functioning as a separate subdivision of the Ministry of Finance.

The status of an audit authority should be selected according to the chosen management model. In the cases when the management of the EU funds is assigned to existing authorities, the functions of an audit authority might be delegated to a newly established body which is more independent of the bodies of the operating system, and vice versa – when a new authority is being set up for the management of the EU proceeds, its audit might be entrusted to an already functioning and experienced audit authority.

Independence is understood as freedom enjoyed by an audit authority and its auditors within the limits of mandated powers to act freely without any influence or pressure from the outside. It means that an audit authority should also have the right to decide on the organisations to be audited, when they should be audited and their auditors should have the possibility to obtain all information necessary for carrying out the audit and select freely the audit procedures.

Experience is understood as competence, professionalism and ability to apply them in practice. These features are of particular relevance in the EU audits that are characterised by large numbers of mistakes and even fraud. Professional competence and practical skills of the auditor are one of the main elements conducive to identifying fraud and unauthorised use of assistance (Mackevičius, Kazlauskienė, 2009). These features should apply both to each individual auditor and the entire group of auditors acting jointly.

In organisational terms, the management and control model may be different, varying between the model in which the performance of the functions of managing, certifying and audit authorities is assigned to different subdivisions of the same organisation and the model according to which the functions of all such authorities are carried out by different organisations. There are also other intermediate alternatives of combining any two authorities inside one organisation. All alternatives have their pros and cons.

When all functions are conducted by the same organisation, sharing information about the specifics of administration of the EU assistance is easier, but an audit authority might find difficulty in selecting adequate audit methods. In the second case, the functions of using the EU assistance might be delegated to the existing audit authority which, while

being experienced in the field of audit, will be able to select proper audit methods but might be exposed to difficulty in understanding the specifics of the EU assistance administration procedure. Consequently, the procedure for exchanging information among the managing, certifying and audit authorities as well as the possibility, where appropriate, of corroboration between related audit authorities should be in place.

3. Review of authorities auditing the use of the EU structural assistance

Pursuant to the European Council Regulation (EC) No 1083/2006, an audit authority may be a national, regional or local public authority or body, functionally independent of the managing and certifying authorities. This means that the Regulation leaves room for the Member States to decide by themselves on the status of the audit authority and requires only the guarantee of independence. Using the offered possibility of choice, the Member States have assigned the functions of conducting the audit to different authorities. The list of audit authorities is provided in Table 1.

TABLE 1. Structural assistance audit authorities in the EU, 2007–2013

Member State	Audit authority	Member State	Audit authority
Germany	Ministry of Finance	Austria	Departments under Governments or ministries
Luxemburg	Ministry of Finance	Malta	Departments under Governments or ministries
France	Departments under Governments or ministries	Slovenia	Departments under Governments or ministries
Belgium	Departments under Governments or ministries	Cyprus	Departments under Governments or ministries
Netherlands	Departments under Governments or ministries	Czech Republic	Ministry of Finance
Italy	Self-government bodies	Slovakia	Ministry of Finance
United Kingdom	Self-government bodies	Poland	Ministry of Finance
Denmark	Departments under Governments or ministries	Latvia	Ministry of Finance
Ireland	Departments under Governments or ministries	Estonia	Ministry of Finance
Portugal	Departments under Governments or ministries	Lithuania	Supreme audit institution
Finland	Ministry of Finance	Bulgaria	Ministry of Finance
Sweden	Departments under Governments or ministries	Romania	Supreme audit institution
Greece	Departments under Governments or ministries	Hungary	Ministry of Finance
Spain	Ministry of Finance	-	-

Source: Dulkys, 2010.

As we can see from Table 1, the use of the EU structural assistance in the Member States, as a rule, is audited by the departments under governments or ministries (12 Member States). In eleven Member States, these functions are performed by the ministries of finance, in two Member States by self-government bodies and in the remaining two countries by the supreme audit authorities.

All the above listed audit models are consistent with the procedure established in the EU; however, bearing in mind the fact that the management and audit of the EU structural assistance differs from analogous typical activities, in the opinion of the authors of this article, more attention should be devoted to the analysis of the audit model in which the functions of an audit authority are delegated to the supreme audit authorities.

4. Assessment of compatibility of the status and functions of the supreme audit institution in auditing the EU structural assistance

Only in two EU Member States – Lithuania and Romania – the functions of audit of the EU structural assistance are delegated to the supreme audit institutions. Both of them are functioning in observance of the principles formulated in the Lima Declaration of Guidelines on Auditing Precepts (1977) and the Mexico Declaration on Independence (2007) and therefore have a similar legal status and functions. Due to these circumstances, the assessment of the status and functions is based only on the experience of the National Audit Office.

In Lithuania, the functions of the authority for managing and certifying the use of the EU structural assistance are carried out by the departments of the Ministry of Finance. The Ministry of Finance is acting in observance of Resolution No 1139 of the Government of the Republic of Lithuania of 17 October 2007 on the distribution of functions and responsibilities among institutions in implementing the Lithuanian Strategy for the use of the European Union Structural Assistance for 2007–2013 and of Operational Programmes. By virtue of this Resolution, one more additional body has been set up within the Ministry of Finance – a coordinating authority not described in any regulation of the EU. This authority is responsible for the establishment of the system of coordination and control over planning, management and use of the EU structural assistance, supervision and improvement of performance.

The Parliament of the Republic of Lithuania assigned to National Audit Office of Lithuania the fulfilment of functions of the audit authority for the use of the EU structural assistance (On assignment..., 2003, 2007). The Explanatory Letter of the Parliament of the Republic of Lithuania concerning the delegation of the functions of auditing, the use of the EU financial assistance to the National Audit Office of Lithuania (Resolution..., 2007) specifies that, pursuant to the Council Regulation (EC) No 1083/2006, a Member State shall establish the relationships between the managing, certifying and audit authority in observance of institutional, legal and financial systems of the given Member State. The status of the National Audit Office of Lithuania and its relationship with the Ministry of Finance are shown in Fig. 1.

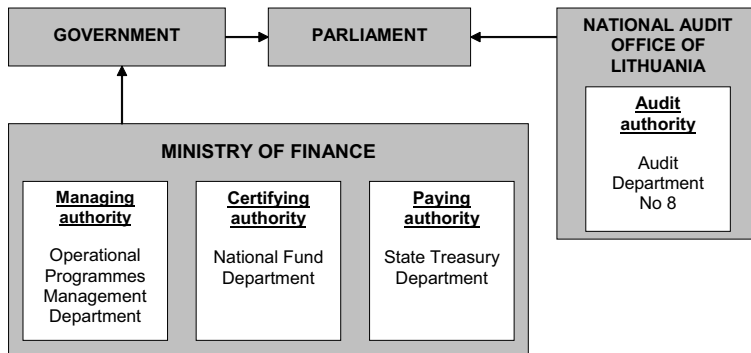


FIG. 1. Financial independence of audit authority from managing and certifying authorities

Sources: Audit Strategy, 2008.

The Supreme Audit Institution tasked with the performance of functions of the controlling authority became part of the EU structural assistance management and the control system managed and supervised by the ES Ministry of Finance (as a coordinating authority). At the same time, a certain legal collision has occurred regarding the status of the National Audit Office of Lithuania. The main function of the National Audit Office of Lithuania is supervision of the legality and efficiency of the management and use of state finances and other assets and implementation of the State Budget. The National Audit Office of Lithuania is directly subordinate to the Parliament of the Republic of Lithuania. It is not subordinate to the Government of the Republic of Lithuania, which is also formed by the Parliament, or to the ministries reporting to the Government.

This contradiction might influence the implementation of the Lima Declaration (1977). Section 5 of the Lima Declaration stipulates that Supreme Audit Institutions can accomplish their tasks in an objective and effective manner only when they are independent of the audited entity and are protected against external influence.

It can be concluded that the audit authority of the EU structural assistance was approved disregarding the provisions of the Lima Declaration. Doubts as to whether the Supreme Audit Institution is suitable for acting in the capacity of the controlling authority have already existed in Europe and Lithuania. The European Court of Auditors is of the opinion that the Supreme Audit Institution according to its designation, status and principles of the Lima Declaration, carries out the external audit which is not part of the EU structural assistance management and control system (Bernicot, 2006). Lithuanian auditors support this opinion and argue that the EU financial assistance received by Lithuania should be audited by the National Audit Office of Lithuania as an independent supreme audit body of the public sector, i.e. it should not carry out the mandatory audit functions established in the EU regulations, because responsibility for them should rest upon the executive power – the Government. In such a way, the National Audit Office of Lithuania would still audit the State Budget, part of which comprises the EU funds (Mackevičius, Pranckevičiūtė, 2007).

Conclusions

The EU structural assistance is used for reducing the disparities among separate Member States and regions, promoting interregional and European cooperation, enhancing competitiveness and employment.

The management and control of funds must be guaranteed by the beneficiaries of the assistance. These countries may choose the management and control model on their own discretion, however, without violating the principles set forth in the EU regulations. However, audit requirements laid down in the regulations differ from the traditional perception of audit. Traditional audit is perceived as audit of financial statements. The regulations require conducting the audit of the system of management and control of funds and certifying the declared expenditure. It means that the audit of the EU structural assistances is financial only to a certain extent and that the existing audit institutions are not fully prepared for this work.

According to the requirements of the regulations, the audit must be carried out in observance of the internationally accepted auditing standards. However, at present, there are three groups of the generally accepted auditing standards: the International Standards on Auditing, the INTOSAI auditing standards and the International Standards for the Professional Practice of Internal Auditing. Furthermore, certain matters the clarification whereof is required by the regulations are not covered by the standards; therefore, it would be expedient to define precisely in the EU regulations the elements that are not defined in the standards or the definitions of which vary among the standards.

As the management and control of funds are related to each other, selection of the audit model should depend upon management. In organisational terms, the management and control model may be different, varying between the model in which performance of the functions of managing, certifying and audit authorities is assigned to different subdivisions of the same organisation and the model according to which the functions of all such authorities are carried out by different organisations.

In the EU Member States, the work of an audit body, in most instances, is carried out by departments under the government or by the ministries of finance. There are only two countries in which audit functions are carried out by the supreme bodies. In Lithuania, the functions of the authority managing and certifying structural assistance are carried out by the Ministry of Finance, and the audit authority is a supreme audit institution – the National Audit Office of Lithuania. This model is appropriate and might be consistent with all legal acts, but there is an additional – coordinating – function established in the Ministry of Finance which is responsible for the development and improvement of the system of management and control. This means that decisions of the Ministry of Finance can be binding to the National Audit Office of Lithuania which, as an audit authority, constitutes part of the management and control system. Such procedure contradicts the provisions of the Lima Declaration and implies that when a supreme audit institution

(which is not under state government) performs the EU structural assistance audit functions (the model was defined as different from others mostly by the independence level of audit authority), it tends to be less independent than when performing its day-to-day duties.

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