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THE ROLE OF AUDIT AUTHORITY IN EUROPEAN UNION FUNDS MANAGEMENT AND CONTROL SYSTEM

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Abstract

The aim of this paper is to define the Audit Authority's of European Union funds current role and model in European Union's funds management and control system, as well as to evaluate possible improvements to the Audit Authority's actions. Strictly segregating the Audit Authority's role, the necessary measures for strengthening the Audit Authority's role in European Union funds management and control system are defined in the conclusion of the paper. It is concluded that one of the prerequisites for funding is the creation of Audit Authorities as part of European Union funds management and control systems, which would provide assurance to the European Commission that the management and control systems are effective in providing reasonable assurance that the expenditure presented to the European Commission are correct, and a consequence reasonable assurance that the underlying transactions are legal and regular.

Key words: *Audit Authority, European Union funds, management and control system*

1. INTRODUCTION

EU funds in 2007 to 2013 planning period are regulated by a number of EU laws and regulations, the most important of which is the Council Regulation No.1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund (ERDF), European Social Fund (ESF) and Cohesion Fund (CF).[9]

EU funds management in Latvian legislation is regulated by the EU Structural Funds and Cohesion Fund Management Law, under which the following is stated:

- rights and obligations of the institutions involved in the EU funds management as well as rights and obligations of the EU funds beneficiaries
- the decision making and appeal procedures of the institutions involved in the EU funds management
- the Cabinets of Ministers responsibility

The planning process of EU funds is also done at both EU and national level – according to EU level strategy (*Community Strategic Guidelines*), national strategy (*National Strategic Reference Framework*) and national *Operational programmes*.[10]

[9] European Commission, Council Regulation (EC) No 1083/2006 of 11 July 2006 laying down general provisions on the European Regional Development Fund, the European Social Fund and the Cohesion Fund and repealing Regulation (EC) No 1260/1999, 31.07.2006, 25 p.

[10] The Investment and Development Agency's of Latvia homepage <http://www.liaa.gov.lv/uploaded_files/00JAUNIE00/Sfondi/KAN/Mainamie/APA2/Programma_11_01_11.pdf>

According to the decision of the Council of the EU on long-term financial framework for 2007 - 2013, Latvia has received EUR 4.53 billion (EUR 4'530'447'634) for achievement of Cohesion Policy goals through acquisition of the EU funds (ERDF, ESF and CF).

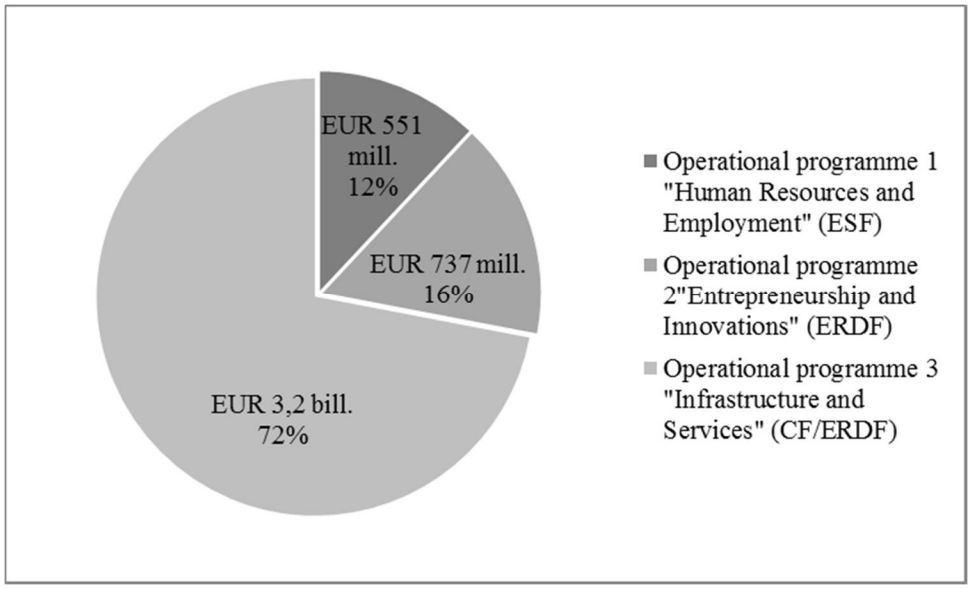


Fig.1. Division of EU funding by operational programmes from total EU funding EUR 4.53 bill.

In the programming period 2007-2013 the EU fund assistance is mainly directed to public education, technological distinction and flexibility of enterprises, as well as development of science and research to facilitate knowledge-based national economy and strengthen other pre-conditions for sustainable economic development and living conditions in Latvia in general (to achieve average development indicators in the EU Latvia through acquisition of the EU funds has to implement national development strategy prescribed in the National Development Plan. Priority of the national development strategy is educated, creative and enterprising man, but the key goal is national economy based on education, science and competitive enterprises).

Overview - the total EU funding in Latvia for the 2007 to 2013 planning period is 4.5 billion EUR, which is the third part of the Latvia's budget. According the Table 1 major part is in the transport sector, than follows environment sector with 17 %. In education sector it is planned to allocate 10 % of funding and for Science 6 % of funding, but in health 5 % of funding.

Table 1. Allocation of EU total funding of EUR 4.5 billion

Support field	Funding EUR	%
Transport	1 362 367 215	30%
Environment	776 217 384	17%
Entrepreneurship and Innovations	494 661 724	11%
Education	444 047 357	10%
Employment and Social Inclusion	290 882 904	6%

Table 1. Allocation of EU total funding of EUR 4.5 billion (cont.)

Support field	Funding EUR	%
Urban Environment	274 506 106	6%
Science	267 784 169	6%
Health	226 872 579	5%
Energy	200 335 963	4%
Assistance for the EU Funds Management (Technical Assistance)	111 075 818	2,5%
Culture	33 203 018	1%
Administrative Capacity Building	26 493 391	1%
Tourism	22 000 000	0,5%
Total	**4 530 447 628**	**100%**

According to the information provided in the figure 2 the management system of the EU funds in Latvia consists of multiple levels of authorities – starting from the EU funds final beneficiaries who receive the financing.

The next level is cooperation institutions. The cooperation institutions are six state agencies. They ensure selection and evaluation of the EU funds project applications and ensure project implementation monitoring and control, carry out on-the-spot verifications of individual projects at the premises of beneficiary and carry out administrative verifications in respect of each payment claim received from the beneficiary at the premises of the cooperation institutions.

The next level is responsible institutions. The responsible institutions are eight line Ministries. Responsible institutions have the following functions: participate in the development of the planning documents including Operational programmes, develop EU funds project evaluation criteria, ensure project implementation monitoring, analyse the problems of the EU funds and project implementation and submit to the managing authority proposals for the improvement of the implementation of EU funds activities and projects.

The next level of the EU funds management is the managing authority, functions of which are performed by the Ministry of Finance, and it is responsible for ensuring EU funds management and implementation. The managing authority, in cooperation with the responsible institutions and in consultation with the social, non-governmental and regional partners, developed national planning

2. THEORETICAL BACKGROUND

The Latvian institutional framework of the EU funds management can be seen on the following figure.

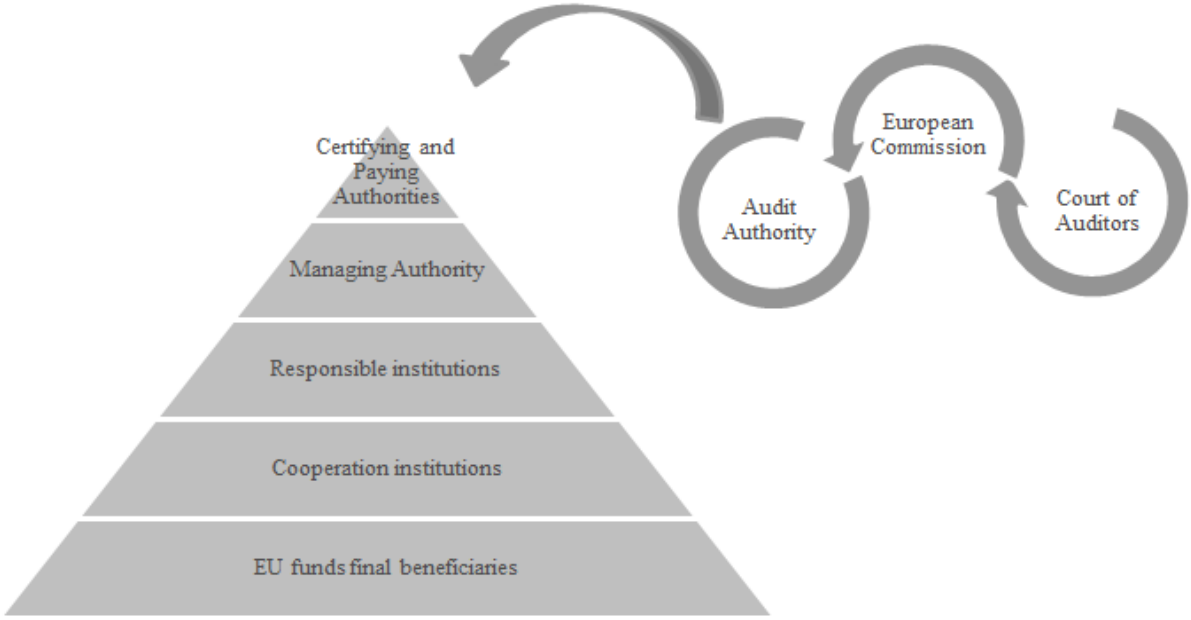


Fig.2. Latvian institutional framework of the EU funds management

documents including Operational programmes for the period from 2007 to 2013, thus ensuring the partnership principle in the preparation of the planning documents, as well as ensuring coordination between structural and cohesion funds sectors. Moreover, the managing authority ensures development of computer-based EU funds management information system and evaluation of the EU funds and communication management.[11]

The State Treasury performs functions of the paying authority and the certifying authority. The State Treasury is responsible for making payments concerning EU funds projects and for financial accounting of payments made. The State Treasury prepares and submits to the European Commission certified expenditure declarations and payment claims, thus confirming that the expenditure declarations are correct and results from the reliable accounting systems and are based on the verifiable supporting documents, as well as the expenditure declared complies with the applicable Community and Latvian law and are made in respect of operations selected for funding under the programme, the applicable criteria and complying with Community and Latvian legislation.

In order to prepare and submit to the European Commission certified expenditure declarations and payment claims, certifying authority must take a series of controls to make sure the incurred costs are real. The certifying authority shall carry out checks of the data included in the interim expenditure declarations, in the final expenditure declarations and sample checks of the payment

[11] Audit Authority of the Republic of Latvia, Annual Control Report for the period from 01.07.2010. to 30.06.2011. (Approved 23.12.2011.).

claims supporting documentation. Moreover for obtaining assurance, certifying authority has the right to propose and carry out on-the-spot verifications of individual projects on a sample basis.

Audit authority is the last element of the EU funds management system, functions of which are ensured by the Ministry of Finance. Audit authority's functions are strictly separated from the managing authority's functions. The purpose of the Audit authority is to provide independent and objective statement to the European Commission, regarding the efficiency of the functioning of the management and control system of the EU funds and the legality and accuracy of the declared expenditure. Audit authority is independent in the planning of the functioning thereof, the carrying out of audits, the preparation of reports and the provision of an opinion, and it operates in compliance with the International Standards on Auditing and the Code of Ethics. In order to achieve its target the Audit authority performs:

- audits of the management and control system in the institutions involved in the management of the EU funds and follow up the progress of implementation of the recommendations expressed as a result of audits
- audits of operations in the institutions involved in the management of the EU funds, as well as at the final beneficiaries and follow up the progress of implementation of the recommendations expressed as a result of audits

The Latvian management and control system of EU funds is a part of the overall European EU funds management system and accordingly European institutions reserved rights to perform controls at a national level as well.[12] The first controlling authority at a European level is the European Commission, which, chooses either to rely on the work carried out by the national audit authority or otherwise – makes are-examination of the work carried out by the Audit authority or carries out independent controls.

The highest authority at a European level is the European Court of Auditors, which examines the effectiveness of the European Commission's work, as well as performs DAS test (checks individual project applications on a sample basis).

Summarising all before mentioned and as described in Figure 2, in the management and control system in the EU funds programming period from 2007 to 2013 in Latvia consists of multistep structure – starting from the EU funds final beneficiaries, above which are cooperation institutions and responsible institutions, followed by the managing authority, then certifying authority and Audit authority as well as on the EU level by the European Commission and the European Court of Auditors. Each of the mentioned institutions takes place a system to ensure that EU funds are spent properly.

3. RESEARCH

EU funds control research was based on the management and control system audits carried out by the Audit Authority's during 2011 in the institutions involved in the management of the EU funds in 2007-2013 planning period – managing authority, certifying and paying authority, responsible authorities (8 line ministries and State Chancellery) and cooperation authorities (6 agencies). In total results of 15 management and control system audits were analysed. Peripheral research was carried out on audits of operation at the final beneficiaries. In total results of 127 EU funds projects' audits were analysed.

[12] Janberga O., 2012, EU Funds Project Controls, Project Management Development – Practise and Perspectives, Conference Proceedings, pp.82-91.

In addition, results from audit mission of European Commission DG REGIO and DG EMPLOY in 2010 and 2011 were taken into account. Information on 27 European Union member states' European Union's management and control systems and Audit authorities' structure was also analyzed.

The Audit Authority is essential element for EU funds and foreign aid financial management and control system.One of the prerequisites for funding is the creation of Audit Authorities as part of European Union funds management and control systems, which would provide assurance to the European Commission that the management and control systems are effective in providing reasonable assurance that the expenditure presented to the European Commission are correct, and a consequence reasonable assurance that the underlying transactions are legal and regular.

Until middle 2011, Latvian Audit Authority functions were decentralized. Part of Audit Authority functions – performance of system audits – was delegated to institutions involved in EU funds management and control system – cooperation institutions, responsible institutions, certifying authority internal audit unit, 15 institutions in total. This kind of decentralization for many institutions created risk and legitimate concerns about Audit Authority's delegated functions improper implementation, as well as complicated and expensive control and monitoring procedure for delegated functions.

Overall supervision of delegated functions performed Ministry's of Finance Internal Audit Department, which was responsible for all functions of Audit Authority. Audit Authority provided functions in accordance with International internal auditing standards.

During the rest of European Commission's internal control system design, it was concluded, that almost 50% of EU Member States Audit Authorities' functions were provided by Internal Audit units.

As a result of numerous European Commission's General Directorate's audit missions to Latvian Audit Authority in 2010 and 2011, fundamental changes in EU funds management and control system were performed. As a motivating measure for changes suspension of financing has been used.

Starting with 2011, internal audit union functions of all 17 institutions involved in 2007-2013 planning period's European Union funds' management and control system were concentrated at the Audit Authority at the Ministry of Finance. In carrying out its functions the Audit Authority transferred from the International internal auditing standards to the International Standards on Auditing issued by the International Federation of Accountants. According to the standards mentioned above significant changes in methodology for carrying out system audit and audits of certified expenditure were made.

In addition as result of its mission European Commission has identified a significant risk to Audit Authority's independence.

Condition imposed - to concentrate all Audit Authority's functions in the Ministry of Finance, reduced to minimum the risk of audit independence, which could have occurred, primary because each internal audit division of institutions involved in European Union funds' management is directly subordinate to that institution's management, thus not creating confidence, that audit results, findings, possible errors or irregularities and discrepancies will be reported to Audit Authority. As a result, starting with June 2011 all Audit authority's functions was concentrated at Ministry of Finance.

To implement European Commission's requirement for Audit Authority's independence, changes in Audit Authority's functional subordination were made. As a result Audit Authority's functional subordination to the Minister of Finance has been established. But administrative subordination to the State Secretary of the Ministry of Finance was maintained.

In addition to that, changes to Law on Management of European Union Structural Funds and the Cohesion Fund were made. It was determined that the Audit Authority shall inform the Cabinet of

Ministers of the current year audit's results by March 1 of current year, using as intermediate the Minister of Finance. If the Audit Authority is aware that the EU funds are likely to be significantly affected, Audit Authority shall inform the Cabinet of Ministers immediately.

In addition to that, head's of Audit Authority right to sign the documents was authorized; as a result Audit Authority's documents don't need additional ordination.

Any document signed by the head of Audit Authority will reach the destination without additional agreement from higher-ranking institutions.

As another important aspect of ensuring independence for Audit Authority, starting with second half of 2011 Audit Authority was granted right to report to European Anti Fraud Office in cases of suspected or detected fraud.

Each year up to December 31, Audit Authority has to submit the Annual control report and opinion on management and control systems to European Commission. In the Annual control report there is a description of the results of evaluation of established system and opinion on their compliance with provisions of Regulation on management and control systems. In these documents Audit Authority has defined included information's, evaluation's and opinion's legitimacy, since they are among the principal elements which European Commission relies upon in context with divided management of Community's budget.

Directly on these documents assurance is based on whether Member States are using financial support in accordance with applicable rules and principles necessary to protect Community financial interests.

To ensure a proper scope and effectiveness of the audit as well as audit's performance in accordance to the same standards in all Member States, to prepare an Annual control report and an opinion on the management and control systems and eligibility and the legality of certified expenditure the Audit Authority shall carry out:

- management and control system audits
- audits of operations.

Given that currently there are active preparations for the formation of EU funds management and control system for the next 2014-2020 planning period, an important issue is the role of Audit Authority in new planning period. As until 2011 the Audit Authority's functions were performed by Internal audit the question remains, whether in the next period this function will be assigned to Internal audit or an existing structure, or an independent body, or perhaps the highest control body in the state - State Audit Office.

During the analysis of current period's EU funds management systems analysis in other EU countries, it was found that in some of them Audit Authority's functions are performed by the highest national control authority – State Audit Office, but in some of them, particularly in new EU Member States, - by Internal Audit.

During analysis, identifying positive and negative aspects of Audit Authority placement in the next programming period, it was found that Audit Authority's role in the next programming period of 2014-2020 is possible, first of all, within the Ministry of Finance as an independent body, identical to current planning period. Second, State Audit Office may carry out functions of Audit Authority.

Third, the Audit Authority's functions may ensure the new independent authority. As the fourth least possible option is that the Audit Authority functions would provide Internal Audit.

Each of the variants has advantages and disadvantages. The question of the location of Audit Authority in new 2014-2020 EU funds' planning period is the issue for further research.

4. CONCLUSION

The research on the role of Audit Authority in EU funds management and controls system provides following conclusions:

- if the EU funds management and control system does not include Audit Authority in compliance with European Commission's requirements, it creates a risk that EU funds' financing will be stopped
- Audit Authority established in 2011 for EU funds 2007-2013 planning period in the Ministry of Finance is an independent body
- independence was ensured from the second half of 2011, stating that the Audit Authority is:
  - ✓ directly subordinate to Minister of Finance
  - ✓ independent from other institutions involved in EU funds' administration, with the obligation to report directly to Government - the Cabinet of Ministers
  - ✓ performance of its functions - to provide an opinion to the European Commission - is separated from the Internal audit, accordingly changing the use of International Internal Audit Standards to International Standards on Auditing
- the transition from a decentralized to centralized Audit Authority's functions performance has been made by concentrating all functions in one institution, rather than in 15 institutions mentioned above
- the problem has been identified concerning the place and role of Audit Authority for the new programming period (2014.-2020.).

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