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## *New methods for the audit of the utilisation of EU funds*

After the establishment of the European Union and the continuous enlargement thereof, as well as in line with the globalisation trends, a “new” player appeared in the international political and economic arena that wants to play a major role in shaping the processes due to its size and economic weight. According to its objective, it wants to be one of the most rapidly developing regions of the world, and to this end it spends enormous sums on the implementation of its strategic objectives.

In its 2005 budget the European Union supported the individual Member States and the approved projects with a total of EUR 105,684 million. In line with the community regulation, this sum equals the amount of revenues, since the budget of the EU is required to be balanced and to “break even” each year.

Such a huge sum implies great opportunities, but also great responsibilities. Although it was not negligible in the beginning either, the audit of the utilisation of common funds has been given more and more emphasis both in terms of regularity and lawfulness. The competent organisations, first of all the European Court of Auditors (ECA) have been forced to face the fact that the existing methods and the established procedures are not appropriate for tracking the processes in a comprehensive manner, wherefore a change is necessary.

### SINGLE AUDIT SYSTEM

Pursuant to Section 1 of Article 248 of the Treaty of Rome, the European Court of Auditors audits the report on the implementation of the EU budget each year based on the international standards and its own audit policies. During this process, it audits the lawfulness and regularity of all revenues and expenditures of the EU and organisations established by the European Union. Since 1994, the audit has been concluded with an evaluation of budget implementation, and the ECA has issued a statement of assurance (Déclaration d'assurance, DAS) on a yearly basis.

“The aim of the work on the reliability of the accounts of the European Communities is to obtain sufficient evidence to conclude on the extent to which revenue, expenditure, assets and liabilities have been properly registered and that the annual accounts faithfully reflect the financial position at the end of the year.”<sup>1</sup> In other words, the European Court of Auditors states whether the report on the implementation of the budget has been compiled in accordance with the accounting principles and rules, and whether it properly and reliably informs about the financial status of the European Union, as well as about the financial transactions conducted during the year.

In relation to the Statement of Assurance issued for the 11<sup>th</sup> time in 2004, *Hubert Weber*, president of the European Court of Auditors said the following before the European Parliament in Strasbourg on 15 November 2005:

“When considering the financial year 2004, the Court came to the conclusion that the consolidated financial statements gave a faithful picture of the income and expenditure for the year and of the financial position at its end, with the exception of the entry for 'sundry debtors'. As was the case in the past, the accounting system used to draw up the annual accounts for 2004 is not equal to the task of listing all the assets and liabilities in the balance sheet, although it has to be said that the Commission made distinct progress in introducing accrual accounting in time for the financial year 2005. At the time of the audit, though, it did appear to the Court that further progress would be needed, as the figures needed to draw up the opening balances for 2005 had not yet been validated by the Commission's authorising officers. If appropriate action is not taken by the end of this year, the reliability of the accounts for 2005 may well be compromised by the defects highlighted by the Court.”

According to the European Court of Auditors, there were endemic errors in expenditure under the common agricultural policy, and deficiencies were also found during the structural measures. As a result, the ECA could state with adequate certainty only about nearly 35% of the budgetary expenditures that they were lawful and regular. Therefore, similarly to the former years, the ECA was unable to issue a positive DAS about the financial management of the European Union in 2004. Having realised the unfavourable process and with a view to find a solution, the ECA has again advocated the introduction of the Single Audit Model, through which the standardised audit of the Member States would allow for the more

efficient control of the regularity and effectiveness of the utilisation of funds.

In its opinion submitted to the European Parliament – pursuant to the latter's request posted in April 2002 – before the audit of the implementation of the 2004 budget<sup>2</sup> (in which the European Court of Auditors states with some irony that there is no single recognised definition of the 'single audit' it proposes to introduce), the ECA accepted that there had recently been significant progress in improving internal control systems, however it expressed strong criticism in several aspects.

It criticised the lack of a clearly established control strategy that would precisely specify the objectives. It found problems in the field of coordination of the checks, which partly leads to parallel checks, and partly results in uncontrolled areas. The lack of coordination is also indicated by the fact that the individual audit organisations do not take into account audits conducted by others, however, the knowledge of such audits – provided they were carried out in line with the international standards – would enhance the audit activity both at national and EU level. Further improvement could be achieved through the harmonisation of the fields of audit, the applied procedures and timing.

With a view to achieve a positive DAS, the European Court of Auditors practically laid down basic principles in its proposal.

► Common control principles and standards should be applied for a coherent and comprehensive control framework. These principles and standards should be used in all Member States, at all levels of administration and in all institutions.

► The internal control system is not required to determine the lawfulness and regularity of each transaction with absolute certainty. It is sufficient to achieve reasonable certainty.

► To this end, the costs of controls should be in proportion to the overall benefits they bring in both monetary and/or political terms.

▶ The system should have, at its basis, a chain of control procedures, in which controls should be applied, documented and reported on the basis of uniform standards. This will make the system transparent and reliable for all parties (auditor, auditee, citizens, authorities, etc.) concerned to ascertain their reliability.

At the end of its report the European Court of Auditors points out that the development and application of an efficient control system require commitment and active involvement from all Member States and competent institutions of the European Union.

Pursuant the report of the ECA, the European Parliament and the Council called the Commission to take the necessary measures. In its Communication issued in June 2005 on the roadmap to an internal control framework, the ECA specified the measures required to be taken by the Commission and the Member States to achieve these objectives. After that, the Communication<sup>3</sup> on the Commission Action Plan towards an Integrated Internal Control Framework, which was issued in January 2006, contained 16 concrete proposals for action in the 2006-07 period in four themes of action.

▶ *Simplification and common control principles*

Elimination of overly bureaucratic, onerously complicated or hardly understandable regulation. Development of the common principles and strategy of internal controls, definition of the “tolerable risk of error”.

▶ *Management declarations and audit assurance*

Declarations by management should improve the level of assurance. Increasing the audit and reporting scope of the national audit institutions. Application of the best practice.

▶ *Single audit approach: sharing results and prioritising cost-benefit*

Large-scale sharing of audit findings among the Commission, the Member States and third countries. The methodology of preliminary cost estimation and evaluation of the benefits of controls shall be worked out.

▶ *Sector-specific gaps*

All services of the Commission shall prepare plans of action to develop the control framework and to enable the compilation of action reports in a more standard and unambiguous manner. Revision and further development of the control system of the Structural Funds. Promotion of the “Contracts of Confidence” initiative.

All these measures entitle us to hope that in the foreseeable, albeit not too near future the European Union will be able to develop and implement a single audit model.

## SINGLE REPORTING SYSTEM

Already in its proposal tabled in June 2005 – which set the issuance of a positive DAS by the European Court of Auditors as a strategic objective as a result of the improvement of the control system – the European Commission attributed an important role to the national audit institutions in the process of reviewing the control systems, in the ex-post audits of the Member States' disclosure statements and statements of assurance, as well as in reporting to the national parliaments.

As it can be concluded from the above, elaboration and application of the Single Audit Model is a precondition for the European Court of Auditors to issue a completely positive DAS on the budget of the European Union. In the absence of such a model, the achievement of a positive DAS remains a theoretical possibility, since the differences between the national procedures, practices and methods do not make it possible to compare the figures and audit findings, which considerably reduces their usability. At the same time, these differences represent one of the greatest obstacles to the introduction of the Single Audit Model, since the development, adoption and problem-free application of new, standard methods in all

the 25 (27 from 2007) Member States of the European Union requires a long time and great efforts.

One of the last stages of the proposed audit process is reporting. It would be a significant step towards the transparency of the utilisation of EU funds if the national audit institutions reported on their related audits and experiences in the same structure, already before the introduction of the Single Audit Model. Naturally, data produced with different methods can only be compared after very thorough professional analysis, but at least the benefit of the existence of the reports would be unquestionable.

The Contact Committee consisting of the heads of the European Court of Auditors and the audit offices (supreme audit institutions) of the EU Member States approved the guidelines for cooperation among the audit institutions of the European Union already at its Prague meeting held in 2003. An important element of this cooperation is that the independent national audit institutions must conduct audits and report on the utilisation of EU funds and the development of the related financial management in the subject year. This can contribute to a more efficient and transparent utilisation of the EU budget both directly and indirectly. The document pointed out that the development of the control of the EU funds is in the individual interest of the national parliaments and is also the collective interest of the Member States.

At the same meeting the Contact Committee set up a Working Group with a view to coordinate the annual reports of the national audit institutions about the utilisation of EU funds at Member State level. (“Working Group on the National SAI reports on EU financial management”). The other aim of establishing the Working Group was to strengthen cooperation among the national audit institutions of the Member States in the field of controlling the utilisation of EU funds, as well as to draw attention to the importance

of reliable information on the utilisation of the various monetary funds by the Member States in the subject year, and the importance of audits aimed at investigating the utilisation of such funds, both for the Member State and the EU institutions. The Working Group provides assistance in the practical implementation of audits by the national audit institutions, as well as in the preparation of the reports of the audit institutions and the comparison of the audit results at Member State level by developing general guidelines and instructions.

The Contact Committee considered it as an important task to require all national audit institutions to publish their experiences about the audit of the utilisation of EU funds in annual reports, in the first step. At its meeting held in Stockholm in 2005, the audit institution of the Netherlands proposed, highlighting the importance of annual reports, the preparation of annual reports by each national audit institution. Due to objections lodged by the representative of the French audit institution – with regard to the fact that the Contact Committee can adopt resolutions only univocally – the adopted proposal turned out to be much “softer”, since it only called for the production of reports at regular intervals.

This is also a good indication of the fact that due to the harmonisation of the national interests and traditions, it is expected to take a long time before the European Union succeeds in having a single system adopted and introduced. Instead of raising the concept of a single reporting system, at this point it was only proposed that each national audit institution should prepare a report on the annual utilisation of funds in any form. Since the national laws mandate the audit institution of France to prepare such a report only once in every three years, the French did not undertake the extra task of reporting annually.

The most important feature and advantage of the annual (trend) reports is that they pro-

vide a multi-directional flow of information, since the uniformly structured national reports compiled on the basis of standard aspects:

- point out, summarise and structure EU related information for the national general public, and draw attention to subjects of national interest. They provide assistance in disseminating knowledge about the various forms of subsidies and tendering systems across the EU, they bring EU administration closer to the citizens and make it more understandable;
- serve as an important instrument for the national parliaments to hold the national governments accountable, and to control financial processes. The standardly structured reports provide a basis for comparison, through which the required analyses can be performed in an international comparison;
- provide valuable information for the other member states and European institutions about the financial and economic processes and management of the Member States. This makes it possible to learn about and adopt positive examples;
- reports compiled according to the same standards facilitate the audit of financial processes by the European Court of Auditors, and thus contribute to the issuance of a positive DAS.

For the time being four countries (the Netherlands, the United Kingdom, Denmark and Italy) issue trend reports about the utilisation of EU funds. After the Stockholm decision more countries are expected to join this group.

## THE HUNGARIAN REPORTING SYSTEM

The control of the utilisation of grants arriving from the European Union was given more and more emphasis as the European integration process unfolded. In parallel with this – as the

accession process progressed and was later successfully completed – the number of audits of subsidies flowing to Hungary increased proportionately to the growth in the available funds.

The strategy of the State Audit Office of Hungary – the external audit institute of public finances – pays utmost attention to the audits of the planning, use and utilisation of EU funds and resources from domestic co-financing. Using the possibilities inherent in international cooperation, the SAO consciously prepared for the fulfilment of new tasks arising from EU membership. The SAO relied on the best practice of EU Member States, as well as on the theoretical and practical assistance of the European Court of Auditors during the professional development of SAO audits, too. It pursued its activities in compliance with the international standards during the audit of the utilisation of EU funds, too, using methods meeting the EU requirements. In the framework of systems audits it examined the regulatory environment, the institutional framework, the monitoring system and the selected programmes applying the methods of regularity and performance audits.

Section 4 of Parliamentary Resolution No. 43/2005 (V. 26.) on the acceptance of the Report of the SAO on its activities in 2004<sup>4</sup> stipulates that: “...the State Audit Office of Hungary shall give an overview on the practice of the complete utilisation of EU funds, within this framework it shall review the work of national institutions performing the audit of financial flows related to EU funds and present the audit findings”.

After the accession, a significant share of the EU funds was made available to Hungary, too. In 2005, as much as HUF 204 billion arrived in Hungary as budgetary grants, and HUF 307 billion as out-of-budget financing, which totalled 2.3% of the annual GDP. The State Audit Office of Hungary is trying to foster the

“EU-conform” utilisation of these and future funds by compiling annual reports, too.

Since due to the causes outlined above there is no accepted, standard form for the preparation of the annual report (Summary in Hungarian usage), a decision had to be reached in several methodological issues for the first time. During this, we had to take into account the Hungarian endowments, but it was also an important aspect that – as far as possible – the Hungarian Summary should follow the logic of annual reports prepared by other countries so far, and thus facilitate the subsequent process of standardisation.

Countries pioneering in the preparation of annual reports use both their national and the EU figures in their reports. Consequently, they can prepare their reports only with a one year lag, due to the time consuming nature of the compilation of the official EU statistics. However, in the Hungarian practice it would be uncustomary and presumably unacceptable if in 2006 the State Audit Office would report on processes that took place in 2004 instead of those of 2005, wherefore the Summary exclusively relies on domestic figures.

Each annual report published so far gives a shorter or longer presentation of the EU processes, too in addition to analysing the domestic processes. This is especially true for the Dutch example, which is understandable, since the country leading in terms of per capita payments concentrates more on the utilisation of its contribution than on incoming subsidies the amount of which is negligible compared to the GDP. However, Hungary is a net EU fund receiver, and due to the not yet fully formed system in charge of the reception of funds and control of utilisation we found it more reasonable to “sweep before our own door”. If the process of standardisation continues to go in this direction, the State Audit Office of Hungary will, of course, also be ready and able to examine the processes in an international aspect.

Naturally, we utilised the results of audits performed by domestic and international organisations in the subject year while compiling the Summary, and incorporated the findings in the material. During this process we took into account the recommendations of the European Court of Auditors, and strove for reasonable and not absolute assurance. A “double-check” by the State Audit Office would have contradicted the principle according to which the costs of the controls shall not exceed the overall benefits they bring in both monetary and/or political terms.

Since this was the first Summary on the utilisation of EU funds and the experiences of the operation of the control system, there was “great temptation” that the first report should provide a comprehensive overview about the entire period that has passed since Hungary's EU accession, and not only about 2005. However, this would have contradicted the established international practice, according to which the reports cover the results of one year in every case. Significant funds were channelled to Hungary even before the accession, wherefore we try to ensure comprehensiveness by attaching an overview in the form of an annex. The Summary itself deals with 2005 only.

The Summary prepared in compliance with the basic principles outlined above presents the Hungarian institutional framework that operated in 2005 for the control of financial assistance from the European Union. It contains the Hungarian and international legal regulations in effect in 2005 that determined the operations and audit activities of such organisations. The document provides a comprehensive picture about the tasks and powers of the different organisations and the roles they played during the audits.

Naturally, the Summary on 2005 cannot be comprehensive in the sense that it can only rely on audits performed to date. The audits carried

out in the subject year targeted the development of the management and audit systems of the institutions in line with the requirements, as well as the regularity of tendering activities launched during 2004. The low rate of payments effected did not make it possible for the audit organisations to audit the effectiveness and efficiency of the utilisation of funds. In line with this, the 2005 Summary can provide a realistic picture about the utilisation of funds and Hungary's absorption ability only to a limited extent. However, the Summary – planned to be issued annually from this year onwards – will soon cover the entire scope of the utilisation of EU funds, and will be suitable for identifying trends and changes.

The benefits from the Summary on the experiences about the utilisation of EU funds and on the evaluation of the control system can only be reaped if it is made widely known.

Therefore, we forwarded the Summary to all parliamentary deputies, the Government, public dignities and the Hungarian members of the European Parliament. We forwarded the abbreviated English version to the presidents of the national supreme audit institutions of the Member States of the European Union, the commissioners and directors-general of the European Commission, as well as to the members of the European Court of Auditors.

With the Summary so prepared the State Audit Office of Hungary was one of the first national audit institutions to meet the requirements of the Commission, the European Court of Auditors and the Contact Committee of the Heads of the supreme audit institutions of the European Union, according to which each national audit institution should give account of the utilisation of EU funds in the form of yearly reports.

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## NOTES

<sup>1</sup> Annual Report on the Implementation of the Budget (2005/C 301/01) Section 1.2.

<sup>2</sup> Opinion No. 2/2004 of the Court of Auditors of the European Communities on the “single audit” model (and a proposal for a Community internal control framework)

<sup>3</sup> Communication from the Commission to the

Council, the European Parliament and the European Court of Auditors on the Commission Action Plan towards an Integrated Internal Control Framework COM (2006) 9

<sup>4</sup> Pursuant to Section 17 (4) of Act XXXVIII of 1989 on the State Audit Office, the SAO conducts occasional audits upon the instructions of the National Assembly.