

AUDIT AUTHORITY AS A MAIN ELEMENT OF THE EUROPEAN UNION FUNDS PROJECTS CONTROL SYSTEM

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Abstract. As one of prerequisites to ensure successful and efficient management of European Union funds projects, is establishing of management and control system that is able to react and prevent or minimize in a timely manner the risks that endanger implementation of European Union funds, as one of the European Commission's requirements are adequate European Union funds project controls. The Audit Authorities are a main element 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, as a consequence, reasonable assurance that the underlying transactions are legal and regular.

Keywords: audit authority, European Union funds, project, control, error, audit.

Jel classification: H83.

1. Introduction

Article's aim 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.

Based on the current situation the Audit Authority's as a main element of the European Union's funds management and control system current role is identified. Changes in European Union's funds management and control system in planning period 2007 to 2013 are analyzed, including the Audit Authority's role, main functions and tasks. In addition the evaluation is performed on whether the changes in the management and control system were necessary and what is their impact on the entire system.

The remaining issue is whether the Audit Authority of three European Union's funds - European Regional Development Fund, European Social Fund and Cohesion Fund can provide reasonable assurance to European Commission and on eligibility of allocated funds.

Strictly segregating the Audit Authority's role, the necessary measures for strengthening the Audit Authority's role in European Union funds 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 as consequence reasonable assurance that the underlying transactions are legal and regular.

2. European Union's funds management and control system

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, European Social Fund and Cohesion Fund. [Council Regulation (EC) No. 1083/2006, 11.07.2006]

EU funds management in Latvian legislation is regulated by the EU Structural Funds and Cohesion Fund Management Law [The Parliament of the Republic of Latvia. 06.06.2002.], 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 Cabinet's 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. [Draft National Strategic Reference Framework 2007-2013, 2007]

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.

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).



Fig. 1. Division of EU funding by operational programmes from total EU funding EUR 4.53 bill. (Source: Ministry's of Finance (Republic of Latvia) data)

Overview - the total EU funding in Latvia for the 2007 to 2013 planning period is 4.5 billion EUR or 3.18 billion LVL, which is the third part of the Latvia's budget. Table 1 in the transport sector, then follows environment sector with 17%. In education sector it is planned to allocate Top of Form 10 % of funding and for Science 6 % of funding or 188 million lats, but in health 5 % of funding.

Table 1. Division of EU total funding of EUR 4.5 billion (LVL 3.18 bln.) (Source: Ministry's of Finance (Republic of Latvia) data)

Support field	Funding LVL	Funding EUR**	%
Transport/ICT***	957 477 128	1 362 367 215	30%
Environment	545 528 682	776 217 384	17%
Entrepreneurship and Innovations	347 650 239	494 661 724	11%
Education	312 078 259	444 047 357	10%
Employment and Social Inclusion	204 433 669	290 882 904	6%
Urban Environment	192 923 989	274 506 106	6%
Science	188 199 785	267 784 169	6%
Health	159 446 956	226 872 579	5%
Energy	140 796 916	200 335 963	4%
Assistance for the EU Funds Management (Technical Assistance)	78 064 529	111 075 818	2,5%
Culture	23 335 214	33 203 018	1%
Administrative Capacity Building	18 619 661	26 493 391	1%
Tourism	15 461 688	22 000 000	0,5%
Total	3 184 016 714	4 530 447 628	100%

The Latvian institutional framework of the EU funds management can be seen on the following figure (Fig. 2).

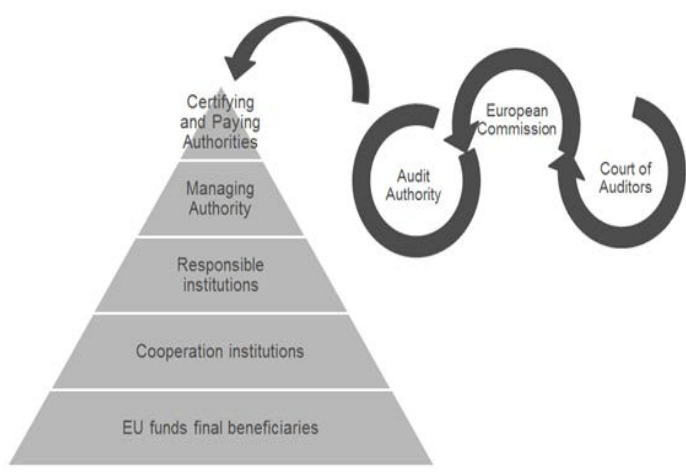


Fig. 2. Latvian institutional framework of the EU funds management
(Source: Ministry's of Finance (Republic of Latvia) data)

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 financings.

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 and State Chancellery. Responsible institutions participate in the development of the planning documents, develop EU funds project evaluation criteria, ensure project implementation monitoring, analyze 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 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 [Annual Control Report, 23.12.2011.].

The State Treasury performs functions of the paying authority and the certify 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.

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 (Voroncova 2009).

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. (Janberga 2012).

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 re-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).

Summarizing 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 data stored at the Audit Authority's database and Annual Control Report (Annual Control Report, 23.12.2011.) concerning the management and control system audits carried out by the Audit Authority's during 2011 and first half of 2012 in the institutions involved in the management of the EU funds 2007-2013 planning period – managing authority, certifying and paying authority, 9 responsible authorities and 6 cooperation authorities. In total results of 22 management and control system audits were analysed. Peripheral research was carried out on audits of operation at the final beneficiaries. In total results of 201 EU funds projects' audits were analysed. The aim of the research was to find areas improved due to the work of the Audit Authority and as a consequence to conclude on whether the Audit Authority plays a major role in EU funds management and control system or a new structure would be more effective.

The methods used for this research were integrated by the author from various methods of other researchers of Latvian State administration and audit, as well as classical management theory (Hargie, Tourish 2009; Baltiņa 2010; Bergmane 2010; Blanchard 2009; Didenko 2007; Franck 2007; Frederick 2008; Görgens-Albino 2009; Gregory 2012; Handy 2009; Linnas 2010; Magone 2010; Ponomarjovs 2011; Ponomarjovs, Molčanova 2010; Praude, Belcikov 2001; Pulmanis 2012; Robbin, DeCenzo 2008; Štrausa 2004).

The work by the Audit Authority was done keeping in mind that Member State must ensure that an adequate control system is in place to prevent irregularities occurring.

It is concluded, that all the Audit Authority's performed controls were carried out on the original documents available at the final beneficiary and where controls were carried out on the copies of the documents (for example payment claims checks) the intermediate bodies were asked by the Audit Authority to obtain assurance that the originals are maintained at the final beneficiaries level (for example by carrying out on-the-spot checks). The information on all carried out controls which was used for this research is available in the database managed by the managing authority – the Management Information System, ensuring that all the institutions involved in the management of EU funds have the access to this information and can use it in order to optimise it's controls.

The results of the research show that measures to prevent errors usually are provided as the result of controls performed by the Audit Authority. In all analysed Audit Authority's audits it was stated, that if irregularities were identified the procedure was started by the Audit Authority to:

1. Notify the competent authorities of the event in order to determine proprietary, administrative, civil or penal responsibility.
2. Recover any EU funds that were unduly used, ensure the restitution to the central administration on the part of the State, and to the European Commission on the part of the Community.

Moreover the managing authority in those situations adopted the measures necessary to end the irregular situations.

As for the Audit Authority's performed controls, first of all they performed tests to make sure that the project meets the selection criteria. Thus, the mature selection criteria developed by the responsible institutions will be, the less risk of negative impact on the state budget will be, but taking into account that controls performed by the intermediate bodies should also be very strong.

Next step the Audit Authority performed was analysing controls performed by the intermediate bodies – controls on the expenditures. There are found 2 ways to make expenditure real:

1. Real Costs. In the case of real costs typical documents that are subject to checks by EU funds project controllers are: invoices, ledgers (proofs of payment), pro-rata basis if needed.
2. Simplified Costs:
 - indirect costs declared on a flat-rate basis, up to 20% of the direct costs of a project;
 - flat-rate costs calculated by application of standard scales of unit cost as defined by the Member State;
 - lump sums to cover all or part of the costs of a project.

The controls carried out on the expenditures directly depend on the way the expenditures are made real.

In the case of simplified costs:

1. There are no supporting documents about costs at the beneficiaries' level.
2. Documentation is available only at programme level – the flat-rates, unit costs or lump sums are stated in the Cabinet of Ministers regulations on the implementation of certain activity.
3. Specific attention during the controls should be paid to the outputs and / or results of a project.

Besides, the research showed that Audit Authority's independent checks of the expenditures were also carried out in order to verify if the products/services/construction is actually delivered/made in accordance with the project agreement. In analysed projects checked by the Audit Authority particular attention during these controls was paid to:

1. Project budget not overrun.
2. Budget line respected (and correctly registered).
3. Financial plan respected.
4. Timetable respected.
5. Indicators achieved.

6. If there are clear linkages to the project (deliverables).
7. If the changes made in the project agreement meets the project selection criteria.

The next step was for the Audit Authority to gain assurance whether the project had been implemented in accordance with EU and national laws which includes:

1. The eligibility rules. The eligibility rules at Latvian level are stated in the Cabinet of Ministers regulations on the implementation of certain activity. And particular attention during controls of eligibility was paid on:
 - Time – are there activities outside eligibility dates? Is there a need for pro-rata basis? Is there a need for depreciation costs?
 - Location – are benefits for the eligible regions respected? Is there specification for travel and accommodations? Is there a need for pro-rata basis?
 - Action - Expenditure related to the project? Is there a need for pro-rata basis?
2. Durability and Revenue:
 - In case of projects with the investments in infrastructure and operational investments it was controlled if the maintenance of an investment or jobs created was ensured within five years (three for SME) from the completion of the project.
 - In case of profit generating projects it was controlled if the revenue generated within five years of the completion of a project was deducted from the expenditure declared to the European Commission.
3. Information and Publicity Rules. Particular attention during the controls of information and publicity was paid to whether the publicity and information measures ensure following:
 - Increase transparency and awareness of EU funds.
 - Let the public know that EU money is being well spent.
 - Ensure maximum benefit by multiplying the effects of EU funding
 - Helping others to benefit from specific activities, good practices and results achieved.
 - Creating awareness of project activities and results.

The next step done by the Audit Authority was to gain assurance whether the project was being implemented in accordance with the EU treaty rules which include:

1. State aid. When verifying if state aid rules relates to a project the following cumulative criteria was assessed and all criteria were met to constitute state aid:
 - Granted by a Member State or through State resources.
 - Advantage “favouring” certain undertakings or the production of certain goods.

- Distortion or risk of distortion of competition.
 - Effect on trade between Member States.
2. Public procurement – whether the project is implemented in accordance with the Public Procurement Law and is not contrary to the European Commission Directives on public contracts. Here, the role of the Procurement Monitoring Bureau here must be stressed out. Accordingly the procurement ex-post checks carried by the intermediate bodies still should be very strong.
 3. Gender Equality – controllers verified if the equal treatment between women and men were respected during project implementation.
 4. EU environmental policies and rules were also checked not only in compliance with EU and national legislation but also against provisions of the project agreement, if specific contributions were foreseen.

When performing the study of the errors found by the Audit Authority typical errors made by the EU funds beneficiaries were identified:

1. Incorrectly calculated resources necessary for the project implementation - financial, time limits, people.
2. Delayed project deadlines.
3. The commercial extensions are not coordinated.
4. Lack of carefully selected partners.
5. Poorly planned cash flow.
6. The agreement is not read and beneficiary has not complied with the agreement conditions.
7. Expenditure estimates is not provided.
8. Project accounting procedures are not described in the accounting methodology, which does not contribute to the audit trail.
9. Accounting does not comply with Latvian laws and regulations - the principles of accounting, document processing, transaction legality.
10. The data on the preparation of payment claims is not kept.
11. The data that do not meet the accounting is included in the payment claims.
12. The contract / project number is not indicated in the project-related documentation, thus creating the risk of double-financing.
13. There is no evidence that the project manager controls the progress of the project and finances.
14. Documents are not stored in accordance with statutory requirements and contractual terms (term used in the nomenclature, storage location records).
15. The nomenclature does not set the document retention period.

Mostly all of the above mentioned errors are timely preventable by use of preventive measures, as well as by complying with the above mentioned requirements, upon receipt of EU funding.

4. Conclusions

The research on the EU funds controls provides the following conclusions:

1. The established EU funds project control mechanism is structurally complex.
2. All the institutions involved in the EU funds management perform EU funds project controls, but Managing Authority could be single institution which would have the overall vision of results from performed controls and thus the overall compliance of projects with EU and Latvian regulations.
3. It is necessary to focus on the EU funds project ex-ante checks, eliminating the errors in the project initiation stage, thereby avoiding financial corrections.
4. By identifying typical errors made during EU funds projects implementation, the beneficiaries should focus on the preventive measures in order to timely prevent errors.
5. When applying for the EU funding the beneficiaries should get acquainted with the set requirements and should follow them in good faith.
6. Audit Authority plays a major role in protecting European Commission's budget by finding and reporting irregular expenditure and preventing the final beneficiaries from similar mistakes in future. Thus a new structure in EU funds' management and control system is not necessary.
7. In future the Audit Authority should spend more resources for proactive activities, thus preventing irregularities.

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