

THE IMPACT OF EXTERNAL PUBLIC AUDIT ON PUBLIC ADMINISTRATION EFFICIENCY

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Abstract:

The control of governmental expenditure is one of the main traits of democratic systems. Similarly, the supreme state audit has been around for centuries, in most European states, which have established mechanisms to ensure accountability for the management of public expenditure, as well as to guarantee their transparency and supervision. Public audit focuses on the formation and use of public funds, being an integral part of good governance. It has a wide range of manifestation, covering all areas of the public sector, each of them being analyzed from at least two perspectives: the financial effort of the public sector to carry out the activities and the impact of these activities that are useful to society. The study of the norms elaborated at international level and the experience of advanced European states offers a comprehensive perspective on public audit from a conceptual point of view within the current European context and helps us highlight the role of audit in restoring public confidence in the quality of the financial reporting system. Moreover, public audit plays a decisive role in increasing efficiency and transparency in the management of public resources and in reducing corruption. The impact of the external public audit activity of the Romanian Court of Accounts on the correct and effective management of public financial resources can be highlighted as a whole, using the data from the audit reports published by the institution.

Key words: *audit, external public audit, supreme audit institutions, public finances*

JELClassification: E60, H83

1. Introduction

The control over public finances has been delegated to the supreme audit institutions (SAI), created as public organisms independent from national administrations. Moreover, the practice has proved over time that the most reliable financial reporting accomplished in the public sector was conducted by the Supreme Audit Institutions due to the fact that their independence was guaranteed by their own organization and functioning laws or by the constitutional provisions that lie at the basis of their establishment.

At the level of the European Union, institutional independence from state power is guaranteed by the national constitutions of the Member States and it is a requirement for joining EU. A closer institutional relationship is achieved between SAIs and the legislative authorities, who are the main beneficiaries of the audit reports.

The efficient operation of supreme audit institutions can have a long-term influence on the efficiency of public administration, due to their oversight of public expenditure, and also of the perceived level of corruption, as increased efficiency of government activity contributes to reducing the perceived level of corruption [1]. In this regard, several studies have been published that analyze

the relationship between public external audit and corruption (Olken, 2007, Blume and Voigt, 2011), how external public audit contributes to its reduction (Liu, J., Lin, B., 2012) and how it contributes to increasing transparency of public spending (Schelker și Eichenberger, 2010). SAIs can detect deviations and violations from public revenues and expenditures and by default they can detect the corruption facts that may occur and make appropriate decisions to fix these problems.[2]

2. Theoretical and conceptual aspects of external public audit, at international level

The term “audit” is originally derived from the latin verb ”audio, audiere” and means ”to hear, to listen to”, being subsequently taken over in English in the form ”to audit” , with the meaning ” to verify, to inspect, to review accounts”. At present, the term „*audit*” has been assimilated into Romanian with the same meaning, to which other concepts such as *rigor, modernism, qualification*[3] are associated, depending on the context. It is most often used to express a field of its own, with its own objectives, specific techniques and methods, which are in a continuous change conditioned by the transformations of the existing environment.

The American Accounting Association formulated in 1973, a definition of the audit frequently used in the specialized literature: “*Auditing is a systematic process of objectively obtaining and evaluating evidence regarding assertions about economic actions and events to ascertain the degree of correspondence between those assertions and established criteria and communicating the results to interested users.*”[4]

In the economy dictionary published in Romania, auditing is defined as “*professional verification of an information / situation in order to express a competent, reasoned and independent opinion on the basis of a (standard) quality criterion*”.[5]

The first supreme audit institutions appeared in the 19th century (Austria - 1805, France - 1807, Bavaria - 1812, Prussia - 1824, Holland - 1840, Spain - 1851), having duties in the fiscal field, of verifying compliance with the financial law and obtaining maximum efficiency in the economic field.

Subsequent political and economic changes have generated significant changes in the institutional organization, regarding the responsibilities and within the scope of SAI in Europe. The changes the organization and functioning laws of SAI have undergone during the recent years of the 20th century have also had positive influence on the way these institutions are organized and on their area of action.

The area of competence of the national SAIs has been expanded by providing a statutory basis for performance audit, starting with 1993 in Ireland, 1994 in Italy, or 1998 in Belgium. Denmark has also adopted significant changes to the legislation, emphasizing the independence and the access right of the General Auditor, and in Finland, the responsibility and independence of the National Audit Office has been increased.

The duties and organization of SAIs in the European Union depend on the particularities of the component states:

✓ *The size of the population and the geographical area of the states*, Malta having the smallest geographical area and population, and France having the largest geographical area or Germany having the largest population;

✓ *Various administrative organization*, from unitary states such as Greece, Portugal, Romania to the federal states such as Germany;

✓ *Different parliamentary structure*, such as unicameral parliament in Denmark, Estonia, Sweden, or bicameral, in Austria, Belgium, France, Germany and Romania.

✓ *The level of economic development*, from heavily industrialized states like Germany, Great Britain or France to countries with a high developed service sector such as the Netherlands and Ireland or a strong agricultural sector in Grece or Portugal.

Presently, the international audit activity is regulated by the standards issued by the

International Organization of Supreme Audit Institutions (INTOSAI) and International Federation of Accountants (IFAC). According to its constitutive act, INTOSAI is a permanent, autonomous, independent and non-political organization promoting the exchange of ideas and experience between the supreme audit institutions in the field of government auditing. [6]

In the 9th INTOSAI Congress held in Lima (Peru), one of the most valuable auditing documents was approved, entitled the Lima Declaration of Guidelines on Auditing, declaration structured on 7 chapters, each of them being further developed into 25 sections. Elaborated more than three centuries ago, this declaration that clearly stipulates the place and role of government auditing in controlling the use of public money, has not lost its topicality, being considered „*Magna Charta*” of government auditing. The collaboration between INTOSAI, The International Auditing and Assurance Standards Board (IAASB) and the International Federation of Accountants (IFAC) was validated, in 2001, by publishing, the first updated version of the INTOSAI Audit Standards, in the Seoul Congress.

The Declaration defines the purpose of auditing, to report the deviations from the accepted standards and the violation of the principles of legality, efficiency, effectiveness and economy of the financial management, in order to take corrective measures. The Lima Declaration highlights the need for an economic auditing, regarding the efficiency and effectiveness of public administration, complementary to the auditing concerning legality and regularity: „The traditional task of the Supreme Audit Institutions is to audit the legality and regularity of financial management and of accounting. In addition to this type of audit, which retains its significance, there is another equally important type of audit - performance audit - which is oriented towards examining the performance, economy, efficiency and effectiveness of public administration. Performance audit covers not only specific financial operations but the full range of government activity, including both organisational and administrative systems.”[7]

3. Features of the external public audit of public finances

The audit objectives, procedures and techniques have evolved over time, as the complexity of the activities and of the areas subject to the audit has increased. After the years 1850, due to the fact that the world economy has experienced a strong growth in the light of the great discoveries of the 19th century, in addition to fraud detection, a new objective was to ensure the reliability of financial statements. For the first time, public audit began to be regulated by special laws, the pioneer in the field was the United Kingdom, by adopting the National Audit Law of 1866, a law amended and subsequently supplemented only in 1921 and 1983. The motto of the Finance and Audit Department was maintained by the present National Audit Office of UK: „To help the nation spend wisely”[8]

The world crisis of 1929-1933 is another important milestone in the evolution of the audit activity, due to the fact that the state, shareholders and banks demanded a thorough examination of the financial statements issued by various companies, certifying their financial situation and their profits. It is estimated that the crisis was not only economic, but also a crisis of the quality of the information provided by accounting [9]. To increase the credibility of the accounting information, the companies were subsequently forced to audit and publish their financial statements.

The twentieth century brought a development of audit objectives, which also comprise, besides verifying the accuracy of the financial statements, the physical existence of the declared assets. Also, exhaustive verification is increasingly complemented by the survey technique. From the second half of the 20th century, audit objectives were extended to ensure compliance with the regulations in force, with accounting and auditing principles and rules.

The mandate of the Supreme Audit Institutions in the European Union is customized according to the particularity of each Member State, as follows:

- The Supreme Audit Institutions can carry out ex ante or ex post checks, in order to assess the legality and regularity of revenue and expenditure, as well as the economy, efficiency and

effectiveness of policies, programs and measures or the functioning of public administration;

- Some supreme audit institutions have a special status as jurisdictional courts, allowing them to initiate legal proceedings against public fund managers (Belgium, France, Greece, Italy, Portugal, Spain);
- Certain SAIs are part of the parliamentary control structure, although they are independent (Austria, Denmark, Finland, Ireland, Lithuania, Malta, United Kingdom, Poland, Spain, Sweden, Hungary);
- Some SAIs are also entitled to give opinions on draft laws within their remit;
- The volume of SAI's human and financial resources vary between Member States, according to the particular characteristics of the national administrations, by the internal organization or the missions assigned to them (larger budgets in Italy, Germany, France, Austria, Luxembourg, Finland and reduced in Bulgaria, Lithuania, Croatia, Latvia or Romania).

Taking into consideration the documentary analysis on International Auditing Standards and the incidental legislation adopted at the national level, several types of audits have been identified, which can be grouped according to the following criteria:

- a) organisation: external public audit and internal public audit
- b) the nature of the legal relationship between the parties: legal audit and contractual audit
- c) the time of execution: ex- ante audit and ex- post audit
- d) the purpose of the audit: compliance audit, financial audit, performance audit and system audit
- e) the area audited: organisational audit, social audit and environment audit.

The main types of audit activities performed by the Supreme Audit Institutions in the EU are as follows:

✓ **financial audit**, which examines documents, reports, internal control systems, accounting and financial procedures and other records, in order to verify that the financial statements present a correct and accurate picture of the financial status and whether the results of the financial activities are in accordance with the accepted accounting standards and principles;

The purpose of the financial audit is to provide assurances that the financial statements examined are complete and accurately prepared, and the economic operations were carried out in accordance with the applicable legal regulations.

It is impossible to meet the objectives of the financial audit under conditions of absolute certainty, and this activity usually requires a lot of expenses, whereas auditing is performed by employing tests, providing reasonable but not absolute assurance that the financial statements do not contain significant deviations and have been accurately prepared, in accordance with the applicable legal regulations. Auditors are not responsible for detecting fraud and corruption, even if they can prevent mistakes, this responsibility rests with the management of the audited entity.

However, even under these circumstances, auditors must maintain professional skepticism and be alert when they find errors, economic operations or unusual results, indicating the existence of fraud, weaknesses of internal control, inconsistencies in financial accounting records, lack of probity or corruption.

✓ **compliance audit**, which verifies whether the economic and financial management of the audited entity, activity or program complies with the applicable legal provisions and norms.

The compliance audit, also called the legality audit, monitors whether the entity complies with the legal rules and policies.

Its main purpose is to evaluate how the entity's financial-accounting function is fulfilled and consists of:

- a) certifying the financial responsibility of the government administration as a whole;

b) system and financial transactions auditing, including assessment of compliance with the statutes and regulations in force;

c) audit of internal control and its functions;

d) audit of honesty and suitability regarding the administrative decisions taken within the audited entity.[10]

✓ **performance audit**, examines the programs, the operations, the management systems and the procedures employed by the entities and the institutions managing the resources, in order to evaluate the economy, efficient and effective use of the respective resources. Performance audit is an audit of results. According to the terminology issued by the Supreme Audit Institution of the United Kingdom (NAO), performance audit is equivalent to the phrase "value for money", and Supreme Audit Institution of Canada defines it as „management auditing”.

Analyzing the experience of developed countries in Europe, the role of this type of audit is conditioned by the reform of public finances and especially by budget programming. Therefore, two approaches have been outlined:

✓ British approach, requiring as mandatory elements of the budgetary architecture the existence of measurable objectives, cost indicators and performance standards. Such budgetary programming allows the SAI to assess the economy, efficiency and effectiveness of public funds.

✓ The German approach focuses on implementing cost indicators of processes rather than formulating performance standards, and SAIs carry out performance auditing activities focused on well-defined economic topics.

The results of the audit activities carried out are summarized in the audit reports, which present the auditors' findings and observations, deficiencies are reported, audit conclusions are expressed and recommendations are made to remedy the deficiencies found. Audit reports are used by the management of public institutions at all levels of state administration, to improve the efficiency, effectiveness and economy of public spending, to prevent errors, deficiencies and frauds and to ensure the compliance of their actions with the legal norms in force.

4. The evolution of the external public audit in Romania and its role in increasing public administration efficiency

In Romania, external public auditing activity fosters awareness of the way the financial resources and public materials are managed and the economic-financial performance of public institutions within the national and local administration is achieved.

„External audit is the audit carried out by an entity that is not under the control of the audited entity and which, in theory, may not relate, in terms of its assessment, to the objectives of the audited entity. External audit is performed outside the audited entity. The external audit examines whether the revenues were collected, the expenses were made legally and regularly and whether the financial management was adequate. It reports on any irregularities found.”[11]

The Supreme Audit Institution of Romania is represented by the Romanian Court of Accounts, founded by the Law of January 24, 1864, published in the Official Bulletin no. 18 of January 24, 1864, under the title the "High Court of Accounts", mandated "to examine and rule on the accounts under the category of treasury revenues, county general cashier offices, autonomous administrations and indirect contributions administrations, as well as to discharge the companies managing expenses made by all accountants".[12] The Romanian Constitution of 1866 provides reference for the role of this institution within the state architecture: „The final settlement of accounts is to be submitted to the Assembly within two years at most as of the conclusion of each exercise”. The institution operated continuously until the instauration of the communist regime in Romania, being abolished by Decree no. 352 of December 1, 1948.

The institution was re-founded and integrated within the national administrative system by the Romanian Constitution of 1991, and by the Law no. 94/1992, the role of this institution within the Romanian state was re-established, the Court of Accounts being „the suprem institution of financial control and jurisdiction within the financial sector”. The amendments to the law on the organization and operation of the Court of Accounts, through Law no. 217/2008, divided the activity of the Romanian Court of Accounts into three levels: control, financial audit and performance audit. The institution exercises control over the formation, administration and use of financial resources of the state and of the public sector. The control function is performed through external public auditing procedures provided in its own audit standards, developed in accordance with generally accepted international auditing standards.[13]

The Law on the organization and functioning of the Romanian Court of Accounts defines external public auditing as an external verification of the public entity with the role of certifying the accounts, tasked with the following mission [13]:

- the manner of collecting, managing and the administration of financial and public sector resources;
- the administration of the public and private patrimony of the state and of the administrative-territorial units;
- the quality of financial management from the point of view of efficiency, effectiveness and economy and compliance with the law in the management of material and financial assets.

The public institutions subject to external auditing by the Court of Accounts, are as follows: the state and the administrative-territorial units, the National Bank, autonomous regies, state-owned enterprises, autonomous social security entities or others, authorities with responsibility in the field of privatization and any other natural or juridical persons receiving financial support from the state, subsidies or administering assets in the public or private domain of the state.

The external public audit on the non-reimbursable community funds is exercised by the Romanian Court of Accounts, through the Audit Authority, the only national authority proficient in performing this form of audit, in accordance with the community and national legislation.

Until the end of 2008, the activity of the Court of Accounts was mainly focused on financial control. Subsequently, following the amendments brought by Law no. 217/2008, the control activity has decreased, being gradually replaced by the auditing activity. An overview of the auditing activity performed by the Romanian Court of Accounts during the last 7 years, in the period 2013 – 2019 respectively, classified by audit purposes, is presented in table no. 1:

Year	Total audit activities performed by RCA:	Conformity Audit	Financial Audit	Performance Audit	Additional income (mil. eur)	Damages (mil eur)
2013	2601	676	1638	287	519,70	363,80
2014	2674	681	1647	346	612,50	534,30
2015	2751	831	1800	120	812,94	395,76
2016	2577	768	1699	110	339,04	410,52
2017	2509	656	1619	234	214,50	150,80
2018	2346	572	1670	104	200,33	75,12
2019	2379	525	1620	234	152,08	56,46

Table no. 1 The auditing activity performed by the Romanian Court of Accounts during the period 2013 – 2019 and their results

Source: Personally designed according to the data published in the Annual Reports of the Court of Accounts

Meanwhile, we centralized the main results recorded in the audit reports, quantifying the irregularities by which additional budgetary revenues were registered and the damages reported in the spending of public funds and in the administration of the public and private assets of the state.

Analysing this information, extracted from the Annual Public Reports published on the institution's website [14], the following aspects, graphically represented in figures no. 1 and 2, were revealed :

- the Court of Accounts conducted during this period, mainly, financial audit activities, due to the commitment to auditing annually the accounts of the central administration entities and over 30% of the accounts of entities managing the local budgets of administrative-territorial units;
- Compliance audit activities still hold a significant share in the workload of the Court of Accounts, more than 20%, even if in recent years there has been a slightly decreasing trend;
- Performance audits conducted by the Court of Accounts took a small share, below 10 percent;
- The financial impact of the audit activities carried out by the Court of Accounts has been decreasing, publicly highlighting the fact that the activity of the entities has improved from one financial year to another;
- However, the volume of budget revenues not monitored and not collected and of the damages reported in the execution of the public expenses remains significant;
- This shows a lack of other forms of control at the level of the public entities in Romania and may be an explanation for the fact that the number of performance audit activities conducted by the Court of Accounts is still low, compared to other types of audit activities.

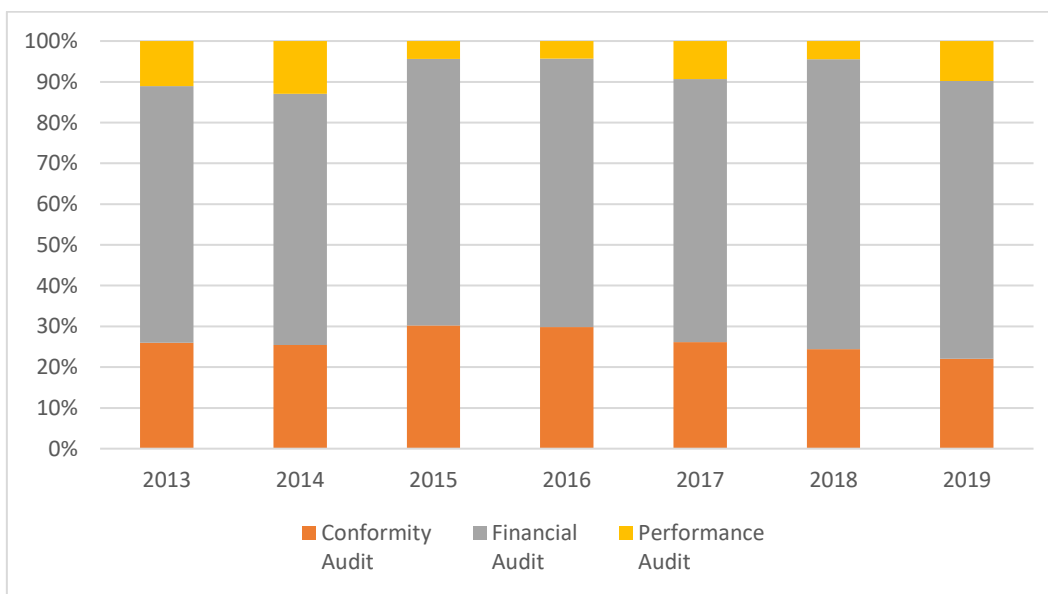


Figure no. 1 Types of audit activities conducted by RCA in the period 2013 - 2019

Source: designed by the author, on basis of the data extracted from the Annual Reports of the Court of Accounts

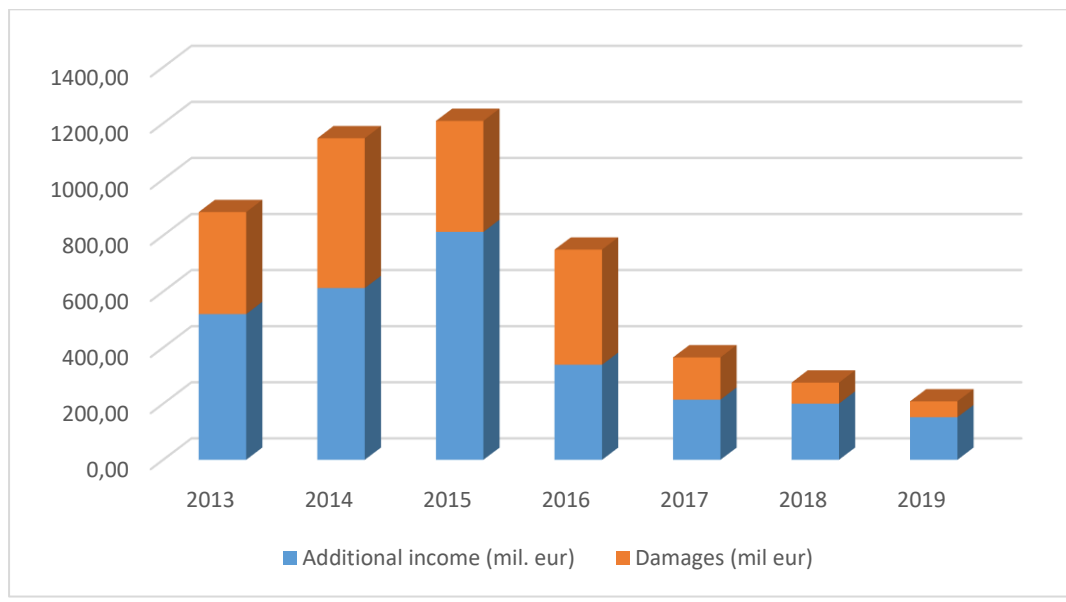


Figure no. 2 Evolution of the additional revenues and damages reported during the audit activities performed by RCA, in the period 2013 - 2019

Source: designed by the author, on basis of the data extracted from the Annual Reports of the Court of Accounts

5. Conclusions

Public audit mainly monitors the manner the public and private assets of the state are formed and used, the quality of financial management in terms of efficiency, effectiveness and economy and the manner of respecting legality in the management of public material and financial resources. It is the attribute of Supreme Audit Institutions, entities whose independence and autonomy from the national government is guaranteed by their establishing laws and constitutional provisions. Currently, due to the changes and reforms that are increasingly occurring within the states' social, administrative and economic systems, the reform of the public finance audit has become a topical concern, in order to shape an effective system able to meet society's expectations for ensuring high quality services. Drawing on the experience of developed states, increasing the share of performance audit activities enables audit institutions to contribute more to improving the economy, efficiency and effectiveness of public sector entities, the British approach being more common in European states.

The Romanian Supreme Audit Institution has successfully adapted to the transformations in the field of public audit that occurred internationally, achieving increased quality of the auditing activities and successful implementation of international standards issued by the international institutions the Court of Accounts is a member of. To successfully increase the share of performance auditing the Court of Accounts needs to diminish its control role, enforcing legality and conformity, by strengthening the internal control of public institutions.

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