

Audit Bases of Soundness in EU Budgetary Governance

Volume III



**Financial and Compliance Audit & Performance Audit
within the system of EU Budgetary Governance**

Prof. Dr. Dimitrios V. Skiadas, LLB, MJur, PhD

Dept. of International & European Studies, Univ. of Macedonia
Jean Monnet Chair on EU Budgetary Governance and Audit



**JEAN MONNET CHAIR
ON BUDGETARY GOVERNANCE
AND AUDIT**

Cooperation with
European Commission
& European Court of Auditors



**ΕΚΔΟΣΕΙΣ
ΕΛΛΗΝΙΣΤΙΚΗΣ
ΜΑΚΕΔΟΝΙΑΣ**

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Preface

The Jean Monnet Chair on EU Budgetary Governance and Audit is hosted at the Department of International and European Studies of the University of Macedonia in Thessaloniki, Greece. The Chair was awarded by the European Commission and the Education, Audiovisual, and Culture Executive Agency (EACEA), under the Jean Monnet Scheme within the Erasmus+ Programme of the European Union, which supports university initiatives aimed at creating teaching activities in European integration.

The purpose of the Chair is to enhance the limited, so far, academic work, in terms of teaching and research, with regard to EU Budgetary Governance and Audit, by increasing the interest and deepening the knowledge in the field of studies related to EU (legal, economic, political), as well as, to address the University's outward orientation by providing the general public and the specialised groups of stakeholders in the public and private sector, information and (when requested) specialised knowledge on issues regarding EU Budgetary Governance, as a means of interpreting the developments in the EU. Understanding at least the fundamentals of EU Budgetary Governance allows for a new look on the benefits of European integration, a look based on academically verified evidence that will enhance the dialogue and the cooperation between the academia and the civil society.

One of the tasks of the Chair is the production of materials regarding its academic topics. These materials entail a variety of texts such as Notebooks, Papers and Books.

This book aims to provide a point of reference on some very technical and specialised issues pertaining EU Budgetary Governance and Audit. It will entail a focused analysis of the

institutional and legal framework of the audit function, within the overall system of EU Budgetary Governance. The 1999 developments and the subsequent political and institutional options on EU governance, as well as the Lisbon Treaty have established several schemes pertaining the management of EU funds and the corresponding audits. Furthermore, the EU's response to the financial crisis lead to new schemes of providing financial support to Member States, establishing new lending mechanisms and using the EU budget as collateral. These new arrangements set significant challenges for the EU's control and audit system at all levels. The book will seek to establish that all these activities and the relevant transactions are being audited in an appropriate and efficient manner, and to examine whether these audit schemes are actually in a position to provide a substantive assurance on the soundness of the EU Budgetary Governance. The entire analysis will seek to establish the legitimacy of EU Budgetary Governance in the weberian perspective (traditional, charismatic and rational-legal legitimacy).

Given the extent of the EU's control and audit schemes, the book will comprise three volumes.

The first volume will examine the schemes of internal and external control and audit within the system of EU Budgetary Governance, their advantages and disadvantages, especially vis-a-vis each other, and their potential to establish the EU Budgetary Governance's soundness. These schemes are examined as an integrated system of control and audit.

The second volume will examine the political element of the audit schemes included in EU Budgetary Governance. The increased role of the European Parliament, as well as the involvement of national parliaments, on issues relevant to the management of EU funds, have pointed out, quite emphatically, that it is necessary for all budgetary activity to be explained and justified as the parliamentary institutions are becoming

more and more demanding with regard to being well informed on such issues before approving or discharging the executive's actions with regard to the EU budget's implementation at EU and national levels.

The third volume will focus on the comparison between the classic/traditional types of audit (financial and compliance audit), as these types have been maintained in certain EU member states as the sole audit method, and the performance (value for money) audit, used by the European Court of Auditors and other national audit institutions as additional audit method. This comparison will help identifying the more suitable type of audit (including the possibility of combining their elements) taking into account the nature of the transactions and policies to be audited.

Professor Dimitrios Skiadas

Jean Monnet Chair
on EU Budgetary Governance and Audit

Introduction

One of the most recent and interesting findings with regard to public auditing is its under-theorization in academic and professional literatures, and the fact that any relevant theoretical approach relies heavily on institutional descriptions (i.e. analysis of existing public audit institutions) rather than theoretical foundations, and in the rare cases of a theoretical basis for public audit, this is largely self-justificatory or drawn from the private audit theoretical analysis and tradition. This finding is further highlighted if seen in the context of factors which are quite crucial for the function of audit such as: a) the importance of public audit on determining the positive or negative outcome of the functioning of states, particularly but not exclusively in relation to the disbursement and use of “public money”, b) the commitment and use of significant monetary, human and other resources to public audit schemes and operations, in periods of sustained austerity, thus necessitating a relevant value-for-money explanation, c) the creation or maintenance of audit institutional arrangements in various countries or similar entities, usually as a result of their historical experience, aiming to enhance their democratic nature and succeeding in appearance but not in essence, and d) the public audit institutional framework has not been adjusted to the conditions created by the new public management concept with regard to the public goods and services provider, i.e. the state or the private sector and the adoption of relevant management practices (see Heald, 2018, pp. 317-318).

This finding provides with a very interesting cause on examining not only the institutional and political framework of public audit, but also its substance, especially with regard to an entity such as the European Union, whose *sui generis* nature

creates correspondingly particular conditions and circumstances for an operation such as public audit, within its budgetary governance.

It is common ground that the primary concern of all governments is to establish a scheme through which they can achieve the planning of the various public policies and the control of collecting revenue and incurring expenditure in order to implement these policies. This scheme entails usually three basic elements: a) Budgeting, which allows for the planning, management and coordination of various activities, b) Auditing, which provides the tools for ensuring the financial control and the accountability of the collection and use of the resources and c) Evaluation, which promotes the soundness of the use of resources, based on economy, efficiency and effectiveness. These elements are regarded as central both to the proper operation of the functions of the political system, as well as the sustaining of economic growth (see Gray, Jenkins & Segsworth, 1993, p. 3)

Subsequently, the element of audit is a core feature in the operation of a state or a similar entity. Auditing is a cornerstone of good public sector governance. By providing unbiased, objective assessments of whether public resources are being collected and managed responsibly and effectively to achieve intended results, the auditing mechanism helps public sector organizations to achieve accountability and integrity, improve operations, and create confidence among citizens and stakeholders (see Institute of Internal Auditors, 2012, p. 5).

The context in which the public audit operates is public budgetary governance. This governance aims at providing public goods to the state's population, and the relevant expenditure is to be financed by public revenue, which, in turn, derives, directly or indirectly, from the taxes paid by the population. Taxation is thus perceived as a form of "sacrifice" suffered by each member of the population in order for the state to ob-

tain the financial means for the production and provision of public goods and services (see Skiadas, 2011, p. 30). Thus both public revenue and public expenditure constitute elements the development of which is imperative to be audited, in order to achieve results within the budgetary governance scheme. The main reason of this audit lays with a danger that threatens both revenue and expenditure, the free-riding i.e. the burden on a shared resource that is created by its use or overuse by people who aren't paying their fair share for it or aren't paying anything at all. It has been found that establishing and using audit schemes, with an increased degree of frequency, focusing on the compliance of the members of society to their legally prescribed obligations, will lead eventually to a learning outcome i.e. the members of society will learn to meet their obligations for their own benefit (the educative effect of audit as established by Dai, Hogarth & Villeval, 2015). Making the people realise that the true significance of the audit schemes is not just a mere imposition of sanctions for non-compliance as an exogenous effect, but also an integrated function, with an endogenous dimension as, in essence, it makes them part of the budgetary governance system though their participation in financial as well as political terms, helps them understand the negative results of evading their obligations (e.g. taxation) and encourages them to behave honestly and accept the (financial and political) cost of maintain the audit schemes, or even demanding them (see Hsu, 2013).

It has been argued that auditing is a somehow fuzzy concept that is difficult to define as there are several relevant overlapping concepts (e.g. investigation, assessment, verification, review, etc) which interact and when used in order to produce a definition of audit, they provide a normative and idealized projection of the hopes invested in the results of the auditing activity instead of providing a description of actual operational capability. The core definition refers to financial audit as an

independent examination of, and expression of opinion on, the financial statements of an entity. Thus, the main conceptual elements are identified: independence from the matter being audited, technical work in the form of evidence gathering and the examination of documentation, the object of financial audit being the financial statements. These elements have been supplemented by the element of accountability as one party (agent) gives an account to another (principal) and this process should be free of “moral hazards” and “information asymmetries” as the agents should not act against the principals’ interests, taking advantage of their superior substantive knowledge, thus leading to a risk deduction for the principals. The notion of audit contains programmatic/normative elements relating to the ideas and objectives that shape the mission of audit in the context in which it is undertaken, and technological/operational elements relating to the actual tasks and actions that are included in practicing audit (see Power, 1997, p. 4-6).

In this context, the traditional approach of audit had originally focused on the attestation and compliance functions, as these functions are considered to be reasonably objective and therefore legitimate. Highlighting objectivity as the most significant quality of an auditing scheme, especially with regard to public audit, was challenged by another approach of a more normative nature, focusing on the relationship of “what is against what ought to be”, thus extending the scope of audit from financial and compliance audits to value-for-money/performance audits, and including thus in the auditing objectives the verification of efficiency and effectiveness of the government’s activities (see Gray, Jenkins & Segsworth, 1993, p. 7). This extension has increased the role of the public audit institutions as mechanisms of contributing to the budgetary governance’s in terms of (see Institute of Internal Auditors, 2012, p. 5):

- Oversight which focuses on the public sector entities complying with their obligations and identifies illegal and irregular activities
- Insight which focuses on the provision of an independent assessment of public sector programs, policies, operations, and results in order to assist the competent decision-makers
- Foresight which focuses on the identification of trends and emerging challenges.

The tools employed by the public audit institutions in performing these tasks entail financial and compliance audits, performance audits, investigations, and advisory services.

In order to bring this analysis into the EU budgetary governance context, one should examine the provisions of EU primary law relating to the types of audit employed by the competent institution, the European Court of Auditors (ECA). These are the provisions of Art. 287 (2) TFEU according to which

2. The Court of Auditors shall examine whether all revenue has been received and all expenditure incurred in a lawful and regular manner and whether the financial management has been sound. In doing so, it shall report in particular on any cases of irregularity.

The audit of revenue shall be carried out on the basis both of the amounts established as due and the amounts actually paid to the Union.

The audit of expenditure shall be carried out on the basis both of commitments undertaken and payments made.

These audits may be carried out before the closure of accounts for the financial year in question.

The terms used therein provide the concepts that form the variety of the types of audit to be employed by the ECA in carrying out its tasks.

The receipt of the Union's revenue as well as the incurrence of the Union's expenditure "in a lawful and regular manner" refer to the ECA establishing the legality and the regularity of the relevant transactions. The ECA's examination as to legality and regularity is based on checking whether individual acts of assessment and payment of revenue and, in parallel with these, individual commitments and payment operations, have been carried out in compliance with the relevant legal provisions such as sectoral regulations, conventions, mandates, agreements and contracts. The legality audit goes a little further by including a review of the management as a whole, focusing mainly on its compatibility with the Treaties and the secondary legislation namely the Financial Regulation (Regulation 2018/1046 on the financial rules applicable to the general budget of the Union, [2018] OJ, L 193/1 – hereafter the current Financial Regulation) as well as any internal management rules (See European Court of Auditors, 1996, p. 18-19). These auditing activities constitute the financial and compliance audit.

The ECA's financial and compliance audit has a further legal basis in EU primary law. According to the provisions of Art. 287 (1) TFEU

1. The Court of Auditors shall examine the accounts of all revenue and expenditure of the Union.

It shall also examine the accounts of all revenue and expenditure of all bodies, offices or agencies set up by the Union in so far as the relevant constituent instrument does not preclude such examination.

The Court of Auditors shall provide the European Parliament and the Council with a statement of assurance as to the reliability of the accounts and the legality and regularity of the underlying transactions which shall be published in the Official Journal of the European Union. This statement may be supplemented by specific assessments for each major area of Union activity.

The examination of the accounts is the core of the financial auditing process. And based on this examination the ECA has to provide its Statement of Assurance. This Statement represents the ECA's findings on the compliance of the transactions with the legal standards and procedures provided for by the relevant EU rules. This compliance is based also on the reliability of the audited accounts, something that is to be verified by the ECA.

The soundness of the financial management is verified through the examination of three inter-related aspects of management, called the three "Es": Economy, Efficiency and Effectiveness. The "Economy" relates planned input of resources to the actual input meaning the examination of whether the least expensive means of achieving a given target have been used or not, i.e. it is an examination of alternatives. The "Efficiency" is reflected by the relationship between actual input (resources) and actual output (results achieved) meaning the examination of whether the means adopted were employed in the most appropriate manner, it is an examination of performance. The "Effectiveness" which is measured by the comparison of actual output with planned output meaning the examination of whether the purpose has been achieved or not i.e. it is an examination of the success rate. These examinations constitute the performance or "value for money" audit (see James, 1984, p. 475, Strasser, 1992, p. 279).

The structure of the analysis entails a presentation of the financial and compliance audit functions, as undertaken by the ECA, a presentation of the performance audit as undertaken by the ECA and a comparison between these two schemes, aiming at highlighting their complementarity. The main source for the materials regarding the proceedings of the audit functions included in those two schemes will be the corresponding manuals prepared by the ECA. At the end of the analysis there is an annex with graphs presenting the main stages of the au-

ding process: planning, examining and reporting.

Before entering the analysis however, it is important to remember the method of audit employed by the ECA, as this will provide a global picture of the audit operations undertaken by this institution. This method, known as the “systems-based approach” entails the following (see European Court of Auditors, 1981, p. 8-9):

“...the auditor seeks to rely, as far as possible, on the way in which the information he is to audit is produced. It is based on the idea that the internal administration, by its organisation and mode of operation, should be self controlling; this constitutes the concept of internal control. In applying this approach the Court examines all the elements of the institution’s internal management which makes up the processes of authorising, recording and verifying financial transactions e.g. the organisation plan and the allocation of responsibilities for actions and decisions having financial and accounting implications. If the systems and procedures appear to be sound, the Court carries out tests of cases and transactions and such analytical checks as it deems necessary to confirm that the systems are operating as described and producing satisfactory results. If systems’ weaknesses are identified, cases and transactions are examined to establish the practical consequences of weaknesses... It is in the interests of the Communities in general that any deficiencies in management procedures should be identified and remedied.”

This method necessitates the following actions on behalf of the ECA auditors (see James, 1984, p. 477):

- “a) to ascertain and document the whole system of control within the organisation,*
- b) to check that the prescribed system is actually followed,*
- c) to evaluate the system and identify weak areas,*

- d) to carry out compliance tests over the whole year (these tests are to provide each year a reasonable degree of assurance that the prescribed accounting system and controls actually exist and are being complied with, including the questions: i) were the necessary procedures performed, ii) were they performed by the appropriate person, iii) how well they were performed),*
- e) to prepare audit plans and programmes of the substantive tests indicated to be needed (these tests are to obtain evidence as to the validity and the propriety of the treatment of accounting transactions or, conversely, of errors or irregularities therein, unintentional or intentional, which have a material monetary effect on the accounts being audited,*
- f) to carry out these programmes,*
- g) to carry out such other tests (e.g. analytical, comparative) as considered necessary,*
- h) to record and report the results,*
- i) to determine and carry out substantive tests on the final accounts.”*

It is therefore imperative for the ECA at first to examine, analyse and document the system of internal control of the auditee and then to test the compliance of the system's actual function in practice with the theoretical model made by the ECA after the first examination (see Kok, 1989, p. 354). If the results of this test show that the system is valid, then the ECA's auditor proceeds with the examination of essential figures of financial transactions using though a limited number of samples and carries out substantive and comparative tests (European Court of Auditors, 1996, p. 21). This method is compatible with operations in financial and compliance audits as well as with operations in performance audits.



Financial and Compliance Audit in the EU Budgetary Governance

I.I. General Remarks

It is well known that the need for accounting and auditing has very deep historical routes. Their timeless presence is linked to the development of economic transactions at all levels, including the financial markets and the states' implementation of public policies. Thus accounting has become the fundamental language of the financial communication presenting an image of the financial situation of an entity and auditing has become the instrument that provides accounting with the necessary credibility for such a presentation (see Obert & Mairesse, 2009, p. 1-2).

In the EU context, the audit consists, at first, in providing assurance i.e. expressing conclusions and, where required, opinions on a given subject, either on the reliability of the consolidated annual accounts or on the compliance with applicable laws and regulations. These are the “assurance engagements” of the ECA, as they are designed to enhance the degree of confidence of the intended users in the subject concerned, by applying objective criteria thereto. An assurance engagement may be (see European Court of Auditors, 2017a, p. 8):

- a reasonable assurance engagement which entails actions aiming to reduce risk to an acceptably low level so as to obtain reasonable assurance as the basis for a positive form of expression of the conclusion(s) and, where required, an opinion reached on the basis of audit procedures performed (e.g. “the accounts present/do not present fairly...”);
- a limited assurance engagement which entails the employment of limited procedures leading to a limited or moderate assurance as the basis for a negative form of expression of conclusion (e.g. “nothing has come to our attention to indicate that...”).

Such assurances derive from financial and compliance audits enabling the ECA to form a conclusion on the particular audit objectives and, where required, to issue an audit opinion. The ECA’s financial and compliance audits typically encompass audits of (see European Court of Auditors, 2017a, pp. 10-11): a) reliability of accounts which comprise the financial statements and the report(s) on implementation of the budget, aiming to establish whether the consolidated annual accounts present fairly, in all material respects, the financial position and the results of operations and cash flows in accordance with the applicable financial reporting framework, b) the legality and regularity of transactions underlying the accounts aiming to establish whether the transactions comply, in all material respects, with the applicable laws and regulations (i.e. the TFEU, the Financial Regulation, Implementing Rules, specific regulations, financing decisions and contractual provisions). The financial and compliance audits entail testing the effectiveness of internal control systems, including those concerned with the reliability of the consolidated annual accounts or preventing or detecting and correcting illegal and irregular revenue and expenditure. An overview of the main elements of the ECA’s financial and compliance audits is the following:

Overview of financial and compliance audits

	Financial Audits	Compliance Audits
Subject	Reliability of the annual accounts	Legality and regularity of underlying transactions
	Effectiveness of internal control systems	
	Recurrent tasks: audit programme for these audits remains generally unchanged from year to year	Selected task: audit programme depends on the specific objective of the audit
	Recurrent or selected task	
Task substance	Examine accounts, determine if they give a true and fair view	Review procedures and financial records to determine whether laws, regulations, rules and procedures set out by legislation are being followed; test the reality and legality of underlying transactions.
	Test systems to determine if they are effective for purpose (reliability or compliance)	
Assertions	Occurrence; completeness; accuracy; cut-off; classification; legality and regularity; existence; rights and obligations; valuation and allocation. Distinguish between events for the period, those at period end, and presentation	Occurrence; completeness; accuracy; cut-off; existence; rights and obligations; valuation; and eligibility.
	Proper design, maintenance and continuous effective operation of systems	

Source: European Court of Auditors, 2017a, p. 13

Both financial and compliance audits entail procedures of gathering, updating and analysing information from different sources, in order ultimately to make decisions, draw conclusions and, where required, issue an audit opinion, based on sound professional judgement. They entail three phases: planning, examination and reporting. The planning phase entails the assessment of material risks through understanding the audit environment, the collection and analysis of information and the design of audit procedures. The examination phase entails the actual performance of audit procedures such as tests of control, analytical and other substantive procedures, the evaluation of results in light of the expectations and the revision of the audit approach if deemed necessary. Finally the reporting phase entails the formation of the audit conclusion and/or opinion and the drafting of the relevant report. Throughout these phases, the relevant documentation of the audit process and findings should be organized in a timely manner, be always updated and provide sufficient detail in order to support the clear understanding of the work performed, evidence obtained and conclusions reached (see European Court of Auditors, 2017a, p. 14-15).

More specifically the planning phase involves collecting and assessing information and making decisions as to the audit scope, approach, timing and resources. The aim is to perform audit work that reduces, to an acceptably low level, the risk of reaching a wrong conclusion or, where required, an opinion on the audit objectives. The relevant outputs are a) an Audit Planning Memorandum (APM), which commits the resources and sets out the overall strategy for the audit, and b) Audit Programmes, which contain the instructions for the nature, timing and extent of audit work to be performed. The nature and extent of planning activities vary according to the size and complexity of the audited subject and the auditor's previous experience with the auditee. It must be noted that audit plan-

ning is not static but rather a continual and interactive process which continues throughout the audit, responding to new circumstances such as unforeseen changes in the auditee's operations or systems, or unexpected results coming to light during the examination phase of the audit. In order for the plan to be complete, the following is required: a) the determination of materiality (i.e. setting the level of deviation considered to be likely to influence users of the financial information) both from a quantitative and qualitative perspective, b) the identification and assessment of material risks (risks that are deemed tolerable coming to a wrong conclusion – for the ECA this is 5%) through understanding the entity and its environment, including its internal control, c) the design of audit procedures regarding the nature, timing and extent of the audit work to be performed in response to the risks identified and d) the drawing up of the Audit Planning Memorandum (APM) and the Audit Programme. It should be noted that a financial or compliance audit is not a mere series of mechanical steps to be completed. During the planning of such audit tasks, professional judgement and skepticism should be exercised, and the knowledge obtained from relevant performance audits in the field in question should be taken into account (see European Court of Auditors, 2017a, p. 19-60 for more details).

The examination phase involves a series of activities as means to carry out the audit procedures as planned, to modify it as deemed necessary during its course, and to evaluate the results thereof. These activities are the following: At first it is necessary to design the audit in order to determine the nature, timing and extent of test of controls and substantive procedures. This includes a selection of specific items for testing, sampling, defining errors, and determining population and samples. The key element is to collect evidence using the audit tools available. The tests of controls are to be preceded by an evaluation of the internal controls concerned. The methods

of gathering relevant and reliable evidence entail inspections, observations, enquiries, confirmations, recalculations, re-performances, information from other sources such as written representations or the work of others, and analytical procedures i.e. procedures used to help conduct a more economic, efficient and effective audit, that consist of studying plausible relationships between both financial and non-financial data, whether within the same period and entity and/or from different periods and entities. These audits will provide details as well as values based on the relationship between the data collected, but the quality of data collected has to be assured. The evidence collected will be analysed in order to determine the causes and effects of the errors found. Such errors should be accurately recorded, especially when testing a statistical sample, so that the audit results can be projected or extrapolated. It is necessary to understand the nature and cause of the errors found, and thus the errors should be classified as quantifiable or non-quantifiable, as material by value, nature or context, as an isolated anomaly or a systematic occurrence. The monetary errors are projected on the relevant audited items in order to consider their impact while in cases of non-statistical samples, it is necessary to judge on the likely nature of misstatements on non-compliances. The scale of errors found is compared to the tolerable error threshold set by the ECA. The outcome of this process is to be a professional judgement evaluating the quantitative and qualitative aspects of the errors and providing a conclusion on the status of the audited items. This conclusion is to be communicated to the auditee, along with its factual basis, so that this basis is cleared and be used without any further disputes in the audit's report (see European Court of Auditors, 2017a, p. 61-89 for more details)

The reporting phase consists of the production of the ECA's various reports. Their purpose is to communicate the results of ECA's work to the discharge authority, the auditee and the

general public. The key to a good report is effective communication, as the report must clearly and objectively set out the main findings and conclusions on the audit objectives, allowing the reader to understand what was done, why and how, and providing practical recommendations. The reporting phase begins with the drafting of the preliminary observations and ends with the publication of the report. It includes drafting, approval of the preliminary observations by the Chamber and the ECA, the adversarial procedure with the auditee, the adoption of the final report by the ECA, its translation, presentation to the discharge authority and its publication. The ECA produces three types of financial and compliance audit reports, the Annual Report, the Specific Annual Reports and the Special Reports (these may entail the results of performance audits as well), as follows:

Types of reports published by ECA

	Annual Reports	Specific Annual Reports	Special Reports
<i>Subject</i>	Final Consolidated annual accounts of the European Union and the underlying transactions Annual accounts of the European Development Fund and the underlying transactions	Annual accounts of other EU bodies, offices and agencies and the underlying transactions, as provided by EU Law	Specific management topic or budgetary area
<i>Basis</i>	Obligation of the ECA stated in the TFEU	Obligation of the ECA stated in the TFEU or regulations of the bodies, offices and agencies	Right of the ECA stated in the TFEU, initiated as a ECA decision
<i>Frequency</i>	Annual	Annual	As decided by the ECA
<i>Opinion</i>	Statement of Assurance	Statement of Assurance	Non-standard
<i>Scope of the report</i>	Reliability Legality & Regularity -	Reliability Legality & Regularity -	- Compliance Performance

Source: European Court of Auditors, 2017a, p. 92

The reports produced by the ECA must have the following qualities:

<i>Quality</i>	<i>How to achieve</i>
<i>objective</i>	judge actual performance against objective criteria
<i>complete</i>	include relevant aspects of the matters reported
<i>clear</i>	use straightforward language and a clear structure and headings
<i>convincing</i>	present arguments persuasively, with illustrative examples
<i>relevant</i>	ensure contents are important and timely for the report's users
<i>accurate</i>	ensure findings are correctly portrayed to ensure credibility
<i>constructive</i>	be balanced
<i>concise</i>	use short and simple sentences and paragraphs

Source: European Court of Auditors, 2017a, p. 93

Usually the audit reports refer to third parties involved in the audited transactions. The ECA may include such references in its reports only if there are specific circumstances, i.e. if it is necessary and proportionate in view of the report's objective, if it the party in question has been given the right to submit its observations with regard to the relevant points of the report and if the duty of care relating to the verification and interpretation of the fact under audit has been duly exercised. Particular reference is to be made to the Statement of Assurance provided by the ECA according to Art. 287(1) TFEU. Its main objectives are to assure that the annual accounts of the auditee are a) reliable i.e. they present fairly, in all material respects, the financial position, operations and cash flows of the auditee and were prepared in accordance with the applicable financial reporting framework, and b) legal and regular i.e. the transactions underlying the annual accounts comply with the applica-

ble legal and regulatory framework. The structure of this document reflects its objective. Therein based on the consolidated accounts, the auditors determine and describe key matters, taking into account areas of higher assessed risk of material misstatement, significant auditor judgements or the effect of significant events or transactions during the period audited. The reports provide unmodified opinions (conclusions that the annual consolidated accounts of the EU have been prepared, in all material respects, in accordance with the applicable financial reporting framework, because the auditors obtained reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error), or modified opinions (conclusions that the accounts are not free from material misstatement or the underlying transactions do not comply in all material respects with authorities, or the auditors have been unable to obtain sufficient appropriate audit evidence). The types of modified opinion are as follows:

Types of modified opinions

<i>Nature of matter giving rise to the modification</i>	<i>Auditor's judgement about the pervasiveness of the effects or possible effects on the annual accounts or underlying transactions</i>	
	<i>Material but not pervasive</i>	<i>Material and pervasive</i>
Annual accounts are materially misstated, or underlying transactions do not comply, in all material respects, with the legal and regulatory framework	Qualified opinion	Adverse opinion
Inability to obtain sufficient appropriate audit evidence on which to base the opinion	Qualified opinion	Disclaimer of opinion

Source: European Court of Auditors, 2017a, p. 106

Furthermore, the ECA, although not an investigative body and lacking the legal authority of determining if a particular transaction is fraudulent, has to assess the compliance of the audited transaction with the relevant legal framework and report its findings to both the auditee and the appropriate EU body, namely OLAF (see European Court of Auditors, 2017a, p. 91-115 for more details on the reporting phase).

In addition to these general aspects of the financial and compliance audits, there are some elements, specific for each one of them.

1.2. EU Financial Audit - Verification of the Reliability of the Accounts

The accounts to be audited by the ECA comprise the financial statements and the report(s) on implementation of the budget for the financial year. Such audits are conducted in respect of the European Union and institutions, the European Development Fund, agencies, joint undertakings, European Schools, and any other relevant body set up by the Union insofar as the relevant constituent instrument does not preclude such an examination. Their reliability is established when they are found to be free from material misstatement and bias, and that they can be depended upon by users to represent faithfully that which they claim to represent or could reasonably be expected to represent. Faithful representation requires that transactions and other events are a) presented in accordance with their substance and not merely their legal form, b) neutral or free from bias, c) prudent, so that assets or revenue are not overstated and liabilities or expenses are not understated, d) complete in all material respects, and e) comparable over time and between entities. The relevant financial statements for a given year must completely and accurately report the cash flows and financial results for that particular year, including all assets and liabilities, thus providing a true reflection of the auditee's financial

position (see European Court of Auditors, 2017a, p. 125).

The objective of the financial audit is to determine whether the accounts present fairly, in all material respects, the financial position, results and cash flow for the year, in accordance with the applicable financial reporting framework, which, in the case of the EU, includes the Financial Regulation and the accounting rules developed by the Commission's Accounting Officer (see European Court of Auditors, 2017a, p. 126).

The ECA's financial audits seek to ensure that the assertions made by the auditee with regard to the reliability of its accounts are satisfied through the collection and evaluation of sufficient, relevant and reliable evidence. These assertions are relevant to:

- **transactions for the period under audit**, i.e. a) transactions having actually occurred (occurrence), b) transactions having been recorded as planned (completeness), c) amounts having been recorded appropriately (accuracy), d) transactions having been recorded in the correct accounting period (cut-off), e) transactions having been recorded in the proper accounts (classification) and f) budgetary appropriations are available (legality and regularity).
- **transactions at period-end**, i.e. the existence of assets, liabilities, and equity interests, the control or holding of the rights to assets and the existence of obligation (liabilities), the assets, liabilities and equity interests having been recorded as planned, the assets, liabilities, and equity interests are included in the financial statements at appropriate amounts and the relevant valuations or allocation adjustments are appropriately recorded.
- **Presentation and disclosure**, i.e. the disclosure of transactions and events having occurred, the disclosed transactions having been recorded as necessary, the financial information is presented appropriately and disclosed fairly at appropriate amounts.

Furthermore, the audit seeks to verify the assertions relating to the Notes to the accounts, i.e. their commentary. Finally, the audit reports on budgetary implementation focus on changes in the consolidated resources and their coherence with changes in the reserves, funds and capital as disclosed in the Balance Sheet, on the amounts of financial commitments, the individual legal commitments, and the payments (per instrument, policy area, etc.) being supported by appropriate documentation, on the reliability of the financial information, and on the proper presentation and disclosure of the relevant items by the Notes (see European Court of Auditors, 2017a, p. 127-129).

An overview of the financial reporting requirements with regard to reliability audits performed by the ECA is as follows:

Audit scope	Format of audit report	Legal base for the audit
Consolidated financial statements and the reports on implementation of the general budget, which present in aggregated form the financial information relating to the institutions and bodies	Statement of Assurance (SoA) opinion + supporting observations	Art 287 of the Treaty on the Functioning of the European Union
Financial statements and report on financial implementation of the European Development Funds	SoA opinion + supporting observations	Art 287 TFEU (by analogy) and EDF Financial Regulation
Accounts of the European Schools	Report on the accounts	Financial Regulation of the European Schools
Accounts of agencies, offices and other bodies	SoA-type opinion	Relevant Council Regulation for each agency and satellite body

Source: European Court of Auditors, 2017a, p. 181

1.3. EU Compliance Audit – Legality and Regularity

Compliance audit comprises the assessment of whether activities, financial transactions and information are in accordance with the legal and regulatory framework which governs them, such as budgetary laws or resolutions, other relevant laws, regulations and agreements, or specific rules. EU primary law (Art. 287 TFEU) has granted the ECA with the authority to conduct two different types of compliance audit: a) The legality and regularity audit of the underlying transactions for the European Union, as well as for all bodies set up by the Union insofar as the relevant constituent instrument does not preclude such examination (aiming to produce the Statement of Assurance and to provide evidence for the Annual Reports of the ECA), and b) selected compliance audits which are undertaken on the basis of their priority, as determined by ECA, on specific financial management topics or budgetary areas (see European Court of Auditors, 2017a, pp. 187-188).

Taking these definitions into account, the aims of compliance audits are straightforward: to report to the discharge authority and other stakeholders on whether the activities, financial transactions and information are, in all material respects, in compliance with the legal and regulatory frameworks which govern them. The objectives of a legality and regularity audit are to ensure that, in all material respects, the transactions conform to the relevant requirements of the relevant EU primary and secondary legislation, the transactions are eligible under the double legal basis principle (see below), the budget line to which the transaction was charged has been approved, and the transaction has actually occurred and been properly recorded. Within the framework of the selected compliance audits, emphasis could be placed on one or more of these objectives, depending on the subject matter (see European Court of Auditors, 2017a, pp. 189).

One of the key concepts in the compliance audit scheme is the term “underlying transactions”. The ECA defines them as transfers of funds from the Union’s budget to final recipients of EU spending, and transfers of revenue from Member States to the Union’s budget. These transfers may go through different stages of the expenditure cycle (budgetary and legal commitment, validation, authorisation and payment of expenditure) and give rise to several entries in the Commission’s budgetary accounts or financial statements. The Commission’s budgetary accounts capture the payment cycle of expenditure on a cash basis. A transfer of funds generally results in more than one payment, which may take different forms serving different objectives. Pre-financing payments (advances) are intended to provide the beneficiary with a float and are provided after the signature of the delegation agreement, the contract or grant agreement or after receipt of the grant decision. Interim payments are made as a counterpart of a partial execution of the action. Final payments are intended to pay the balance of the amounts due where the action is completely executed. The Commission’s financial statements, in accordance with the principle of accrual-based accounting, reflect economic reality. Entries are booked in the accounts when they occur and not when cash is actually paid or recovered. Payments of funds may be booked as a pre-financing or other asset in the balance sheet or as an expense in the economic outturn account (see European Court of Auditors, 2017a, p. 190).

The ECA’s judgement on legality and regularity of transaction is made when it has passed through the whole transfer cycle (committed, validated, authorised and paid) and there is sufficient evidence about the economic reality underlying the transaction, i.e. it is substantiated by expenditure incurred at the level of the final recipient. The audit is extended from the level of central management of the Union institutions to the level of the final recipients or those providing the Union with

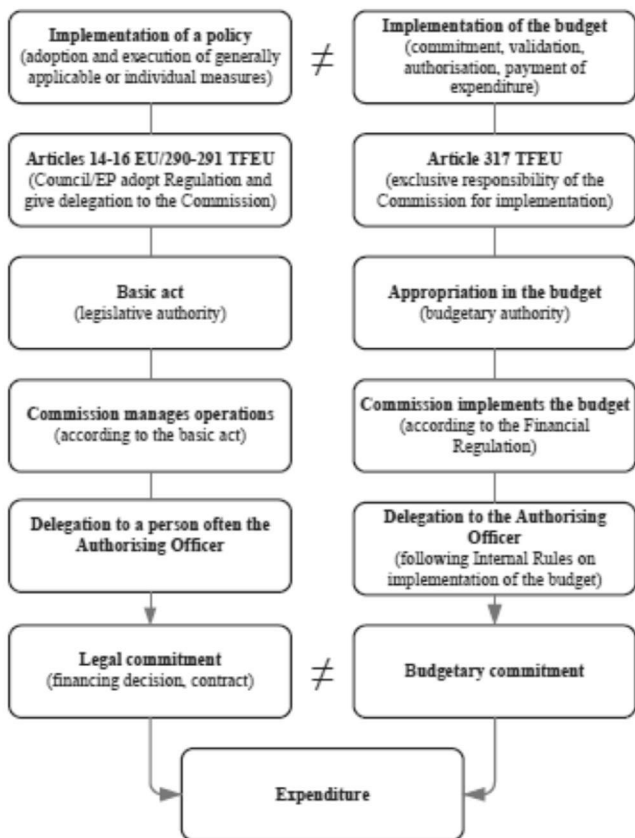
own resources. The means employed are actions, procedures, processes or documents, of a legal, administrative, financial or banking nature, as well as any physical events or factors which underlie them to the extent necessary to form a robust judgement. With regard to EU expenditure, underlying transactions to be audited include a) payments of the entire amount due, b) interim payments by the Commission (partly) reimbursing expenditure incurred at the level of final recipients, as well as the related pre-financing registered in the EU's balance sheet or expenses registered in the EU's economic outturn account, c) final payments by the Commission (especially those expenses based on the final validation of expenditure incurred at the level of final recipients). Advances paid by the Commission to public authorities managing EU funds or final recipients are not included in the audit sample population and the same applies to interim payments by the Commission reimbursing advances establishing or contributing to funds, e.g. financial engineering instruments or reimbursing advances paid to final recipients. With regard to EU revenue, given the audit's objective, the underlying transactions are those having reached a final stage and the revenue is due for collection, and the Commission has established the amount receivable and applied recovery procedures. Most of revenue is represented by own resources which are generally cashed before the corresponding recovery orders are issued. But the recovery orders issued in the audited financial year will form the core of the relevant audit sample (see European Court of Auditors, 2017a, pp. 191-193).

The criteria for an act to be found illegal are set out in Article 263 TFEU: lack of competence (of those adopting the act), infringement of an essential procedural requirement, infringement of the Treaties or of any rule of law relating to their application, and misuse of powers. An act (or omission) is irregular (according to Regulation 1995/2988 on the protection of the

European Communities financial interests [1995] OJ, L 312) if it infringes a provision of EU law and has, or would have, the effect of reducing or losing revenue or including an unjustified item of expenditure. The ECA does not make a distinction between the two concepts (see European Court of Auditors, 2017a, pp. 193-194) seeking the verification of legality and regularity of an act or omission on its compliance in all material respects with the relevant parts of the legislation.

The legality aspect entails also the double legal basis necessity for the EU expenditures which is practically the implementation of the principles, provided for in paras 3 and 4 of Art. 310 TFEU (see Skiadas, 2020, p. 24-27). This scheme entails, at first, the adoption of a basic legal act which provides the foundation necessary for the Union measure and the related expenditure. Then there is the legal commitment which is the act whereby the authorising officer enters into or establishes an obligation which results in a charge. It may consist of a financing decision or contract. The financing decisions, which are required for all operational expenditure, are taken by the Commission. These decisions specify the activities which will be undertaken to implement the budget for a given year. In order to be implemented, they must be followed by award decisions. The award decisions (e.g. contracts) are separate implementation decisions generally taken by the responsible authorising officer, on the basis of a financing decision already adopted by the Commission. An award decision specifies to whom contracts or grants are awarded. Finally there is the budgetary commitment which is the operation reserving the appropriation necessary to cover subsequent payments to honour a legal commitment. It is based on an appropriation made available in the budget by the budgetary authority. Revenue and expenditure are shown in the budget in accordance with a binding nomenclature which reflects the nature and purpose of each item, as imposed by the budgetary authority

(see European Court of Auditors, 2017a, pp. 194) This scheme is highlighted as follows:



Source: European Court of Auditors, 2017a, p. 195

Overall the legality and regularity audit aims to verify the existence and accuracy of underlying transactions, their eligibility with regard to criteria set, their compliance with other regulatory requirements, the correctness of the relevant calculations, and the completeness and accuracy of accounting, meaning that all transactions are accounted for, are not included more

than once, and are recorded in the correct accounting period and at correct value (see European Court of Auditors, 2017a, pp. 196).

1.4. The EU experience of financial and compliance audits

The audit work performed by the ECA, especially with regard to financial and compliance audits, in order to provide the required Statement of Assurance provides with interesting relevant insights.

The key element, for obvious substantive as well as political issues, is for the ECA to provide an unqualified (“clean”) opinion in its Statement of Assurance for all items under audit. Since the introduction of this document in the EU audit framework, in 1994, providing such an opinion has been originally impossible for the ECA, a situation which changed gradually.

As noted above, the ECA, in order to provide assurance as to whether the payments comply with the legal and regulatory framework, draws on the results of its examination of both supervisory and control systems and representative samples of the transactions (payments) themselves, reaching to the level of the final beneficiaries. The ECA compares the estimated error rate based on the results of its representative samples of transactions against what is deemed to be a tolerable limit - or materiality threshold - to determine the nature of the opinion to be given. In the absence of a political decision setting a tolerable level of error, the ECA, using its professional judgement, has set and applied always a threshold of two percent (2%) by value of the population under audit. The estimated error rate is thus an indication of the percentage of funds that should not have been paid out. Errors of more than 2% of the expenditure category are considered material, as are facts and events that may change the perception of the reader of the accounts if disclosed. If the level of error is judged not to be material the ECA

issues an unqualified (i.e. “clean”) opinion. Where the level of error is material, and depending on how pervasive it is, the ECA issues a negative (called “adverse” for more serious cases or “qualified” when the negative aspect is quite minimal) opinion (see Caldeira, 2008, p. 12, European Court of Auditors, 2014b, p. 22).

It has been suggested that the adoption of a political decision on the tolerable level of risk (and error) is necessary due to the complexity of the EU financial management and audit system, especially as it entails the three types of centralized, decentralized and shared management. Establishing extensive schemes of lower-level financial controls, such as on-the-spot audits, is going to be very expensive, thus creative alternatives must be sought. Therefore, the following have to be agreed upon (see Caldeira, 2008, p. 19):

- Not all final beneficiaries can be checked on-the-spot, and consequently there will always be some residual risk of error, so it is imperative to set that risk at an appropriate (tolerable) level.
- Costs of control are an important issue, both for the EU budget and Member or beneficiary States.
- The cost/risk balance in individual policy areas is of such importance that it should be approved at the political level (i.e. by the budget/discharge authorities) in the name of the citizens of the Union
- If a scheme (e.g. political initiative, programme, etc) cannot be satisfactorily implemented at an acceptable level of cost and with tolerable risk it should be reconsidered.

In the ECA’s audit approach, the errors arise when payments are neither legal nor regular, (e.g. when claimed by ineligible beneficiaries), for expenditure that should not be financed by the EU, or when the conditions for receiving the aid are not

followed. These problems (reported as errors) occur because (see European Court of Auditors, 2014b, p. 22):

- beneficiaries make incorrect declarations
- beneficiaries do not comply with the conditions for getting and using the EU support. Complex and wide-ranging conditions can make it difficult both for beneficiaries to comply with, and for managers to establish compliance. Unclear conditions can be open to interpretation and lead to expenditure being accepted in a spending culture (i.e. where there is pressure to spend the budget available without regard to whether it meets genuine needs)
- checks and controls by the Commission, the Member States' managing bodies and other auditors certifying the expenditure fail to prevent, detect and correct erroneous expenditure declarations
- Member States and others charged with spending the budget focus on using it (absorption of expenditure) within the required time period, at the expense of using it properly or effectively, rather than losing it.

Such circumstances have caused the ECA to refrain, for several years, from providing in its Statements of Assurance unqualified opinions on the accounts of the EU. For the EU accounts till 31.12.2006, the ECA's opinion on their reliability was qualified i.e. it accepted in principle that these accounts provided a fair presentation of the Union's financial situation, but it was accompanied by a series of observations regarding identified errors, complex systems of financial management and reservations put forward by authorising officers (see for instance European Court of Auditors, 2006, p. 10-11, European Court of Auditors, 2007, p. 9-10). For the economic year 2007 (i.e. EU accounts till 31.12.2007), the ECA provided, for the first time, an opinion accepting practically the reliability of the ac-

counts as a whole (see Caldeira, 2008, p. 12), identifying as risks some weaknesses noted in the Union's accounting systems (see European Court of Auditors, 2008, p 11-12). Since that time the ECA's opinion on the reliability of the EU accounts has remained positive and its observations have been gradually removed.

However, this did not prevent the ECA from maintaining from 1994 till 2016 its negative opinion on the legality and regularity of the transactions underlying the accounts. For instance, during the period 2009–2012, the estimated most likely error rate affecting the EU budget has varied between 3.3% – 4.8% of the total expenditure (see European Court of Auditors, 2014b, p. 22), exceeding the threshold set by the ECA. Thus, in the relevant Statements for Assurance produced by the ECA from 1994 till 2015 (the EU accounts till 31.12.2015) while the revenue accounts were found to be legal and regular in all material respects (an opinion which has been maintained till now), the expenditure accounts were found to be materially affected by error thus leading to a adverse opinion by the ECA (see for instance European Court of Auditors, 2016, p. 11). However, for the EU accounts of the year 2016, the ECA took notice of the sustained improvement in the estimated level of error in the payments made from the EU budget over the last four years till then: for 2013 4.7% (see European Court of Auditors, 2014c, p. 10-11), for 2014 4.4% (see European Court of Auditors, 2015, p. 11), for 2015 3.8% (see European Court of Auditors, 2016, p. 11), and for 2016 3.1% (see European Court of Auditors, 2017c, p. 10-11). Despite the figure being still above the 2% threshold set by the ECA, it was deemed not to be pervasive as the payments made on an entitlement basis (the main item in the audit sample – these payments are made to beneficiaries for meeting conditions rather than to reimburse costs) were not affected by a material level of error (see European Court of Auditors, 2017c, p. 10-11). Thus the

ECA expressed a qualified (instead of adverse) opinion on the legality and regularity of payments underlying the accounts. Subsequently, this qualified opinion has been maintained for the legality and regularity of payments underlying the 2017 EU accounts and the 2018 EU accounts, despite the fact that the estimated level of error has fallen to 2.4% for 2017 and to 2.6% for 2018 (see European Court of Auditors, 2018, p. 10-11, European Court of Auditors, 2019a, p. 10-11).

A final relevant issue is the key audit matters, i.e. matters that, in the ECA's professional judgement, were of most significance in its audits and although addressed in detail in the context of the audits of the financial statements as a whole, and influenced the ECA's opinion, it has not been deemed necessary to provide a separate opinion on them and they have been included in the overall opinion delivered. For instance, such matters for 2017 included the accounting treatment of the European Fund for Strategic Investments (EFSI) guarantee for the equity portfolios due to the complex accounting issues arising from the arrangements between the EU and the EIB, as the EU guarantee granted to the EIB was treated as a) a financial guarantee liability for the Infrastructure and Innovation Window debt portfolio, b) a financial provision for the 'Small and Medium-sized Enterprises Window debt portfolio, and c) as a derivative (financial asset or liability at fair value through surplus or deficit) for both equity portfolios (see European Court of Auditors, 2018, p. 11). For 2018 one such matter has been the potential impact of the United Kingdom's withdrawal from the Union on the EU accounts (see European Court of Auditors, 2019a, p. 11). On both occasions, the ECA concluded that there has been no financial impact on the EU accounts, and they provided a true and fair view of the Union's financial position.



Performance Audit in the EU Budgetary Governance

2.1. General Remarks

Seeking the verification of good performance in the preparation and implementation of public policies has been an idea introduced and established in the late 1980s and early 1990s as an alternative to the existing, till then, template of public governance.

That template had been based on the weberian concept of bureaucracy and had been developed globally, entailing various ways of policy drafting and implementation through the executive branch of state authority, all of them being, however, based on the element of bureaucratic/technocratic expertise. The term “bureaucratic expertise” captures the idea that a full-time official will have the requisite expertise over a certain policy area, depending, in any case, on the duration of the official’s service in the relevant public authority, or the nature of the official’s work. The “translation” of this bureaucratic expertise into technocratic/technical expertise has been challenged both on terms of actual performance as well as on terms of scientific pluralism, in the sense that the answers provided by the expert bureaucrats, to problems that needed to be dealt with,

based on their scientific knowledge, have not been considered as “objective” anymore, but they are contentious in scientific terms, and that any one version of the scientific solution may embody value judgements of a social, moral or political nature, even if such factors are not immediately apparent on the face of the decision (see Craig, 2015, p. 701-702). There had been various surveys examining the efficiency of the bureaucratic schemes of various states in Europe, using various criteria, which demonstrated that there are delays or low quality of service and significant instances of fraud and corruption, albeit with variations of size and intensity between the various states (see, for instance, Sotiropoulos, 2004). In that context, the changes in the predominant political ideologies regarding the shape and function of the state and public administration as well as the technological changes, have caused the questioning of the public sector having a monopoly on public goods and public service delivery, in favour of the private or even the voluntary sector (see Bourn, 2007, pp. 2-3).

The result of these developments was a main change in the organization and operation of public governance which has been expressed by the introduction and use of the New Public Management concept. This concept consists of ideas originating from private sector administration practice and emphasizes on cost control, financial transparency, decentralization of management authority, creating market mechanisms with regard to purchasing and providing goods and services, enhancing accountability to recipients of public goods and services (defined as “customers”) with regard especially to the quality of operations and results via the creation and use of performance indicators. It has been understood as an effort or a desire to replace the presumed inefficiency of the hierarchical bureaucracy with market-efficient schemes, one of the most radical characteristics of this approach being the provision of accountability not only in terms of conformity to legal

provisions but also to in terms of performance, i.e. the taxpayers should be able to know that their money is spend economically, efficiently and effectively (see Power, 1997, p. 43-44 and the references therein).

In a more theoretical context, the requirements set by the public choice school in public finance, especially by highlighting the elements of bureaucracy and constitutions in the relevant decision making process, necessitate the intervention of the State in the form of providing services and goods through its function, an intervention that has to be efficient in allocating public resources, and this efficiency depends on the organization and operation of administrative functions in an optimal manner, i.e. by providing all necessary services at a minimal cost and by assuring that those services respond to social demand, as this demand is revealed through the proper democratic procedures. Achieving sound financial governance allows for more goods and services to be provided without substantially increasing taxation and supports the reduction of the costs of supplying goods and services. Thus the legal functioning of the state's institutions must be accompanied by their efficient functioning. This can be achieved by providing for public control institutions that carry out audits and can be used as potential sources of information for policy makers as well as for the society, in order for them to identify possible inefficiencies and demand or undertake the relevant actions to improve efficiency (see Crespo, 2005, pp. 4-5). It must be noted that control, and particularly management control, is a dynamic function, with the following sequence: analysis of public management – carrying out of audit – evaluation of audit findings – effects on public management – changes in management. Obviously, this sequence depends on the competence of the public audit institutions to make recommendations on specific management issues either to the legislative or the executive branch of the state's government. These ap-

proaches have been expressed in the New Public Management concept, which necessitates that in every democratic system all of the government's results, in terms of performance, must be justified to the citizens, as they provide the resources for the state's activity, through taxes. The resulting concept of social, political and financial responsibility of public authorities reinforces and widens the content of public accountability. The public audit schemes verify the compliance of public action in relation to the relevant legal rules as well as the justification of their performance (see Crespo, 2005, pp. 8-10).

A notion of central importance for such audit functions is the notion of value for money. It is based on three elements: economy, efficiency and effectiveness. Economy means that the provision of goods or services, in the light of any given policy, at any given time, is required to be made at minimum cost. This requirement must be assessed in terms of quantity and quality and the required resources are to be calculated in money terms. Economy is the simplest to apply since it is possible to set standards of expenditure by means of budgets and it is relatively easy to see if these are met, on the assumption that the required quality of services is indeed provided. Efficiency means achieving maximum output from the resources provided for meeting the requirements and is thus closely related to economy. Efficiency is more difficult to achieve because it means ensuring that the objectives aimed at are in fact met. The crucial point is that efficiency can be achieved without economy and vice versa, thus calling for a specification of the precise quantity and quality of services required as against intended expenditure and to see that not only is that expenditure not exceeded but also that the objectives in terms of quantity and quality are also achieved. Effectiveness means ensuring that the intended result is fully attained from the application of the resources. It relates to the extent to which the real aim of the policy makers is achieved, this being the

most problematic point: how to establish this aim, or, in other words, the particular values to be aimed at. Effectiveness may be expressed as output in value divided by input in economic terms, but this is not always calculable as both (input and output) are not always measurable in terms of the same units. This is further highlighted by the fact that there is no standard definition of the values in the activities of government, as some analysts limit the scope of value in its monetary (economic) aspect while others extend this scope to the wellbeing (non-economic aspect) achieved through the expenses incurred for the relevant goods and services, an approach that brings forward a subjective approach towards welfare, the attainment of which is not always measurable (see Glendinning, 1988, p. 43-45).

A crucial issue before examining the operational aspects of performance audit in the EU is to examine its relevance to a similar concept, the concept of evaluation. An evaluation has multiple purposes comprising the contribution to the design of intervention (including the provision of input for setting political priorities), the assistance in allocating efficiently the available resources, the improvement of the interventions' quality and the report on the interventions' achievements. This definition demonstrates that both evaluation and performance audit involve a) the examination of policy design and of implementation procedures and b) the assessment of an entity's activity with regard to economy, efficiency and effectiveness. Thus they require similar knowledge, skills and experience and involve similar methods for collecting and analysing data. However they differ significantly with regard to their purposes and the context within each takes place. Performance audit is superimposed on an accountability framework entailing the obligation of the auditees (responsible for the management of funds) to provide meaningful and reliable information to demonstrate and take responsibility for performance in light of agreed ex-

pectations. Such audits require the auditors' independence to select and determine the manner in which to conduct their work and report the relevant results. It is not rare for performance audits to include evaluative elements of selected subjects and consider evaluation systems and information with a view to assessing their quality and, when they are considered to be satisfactory and relevant, use evaluation information as audit evidence (see European Court of Auditors, 2017b, p. 11).

Thus, one understands that the ECA's performance audits do not aim to provide comprehensive evaluations of EU activities, as such a task falls within the competences of the auditees, i.e. the Commission, Member States' authorities and other managers of EU activities. These audits are used to verify the soundness of the EU financial management i.e. whether the Union manages its financial resources in an economic, efficient and effective manner (see Strasser, 1992, p. 279, James, 1984, p. 475). Their legal definition is provided by Art. 33(1) of the current Financial Regulation and it entails the following: a) the economic management relates planned input of resources to the actual input, determining whether the least expensive means of achieving a given target have been used or not (examination of alternatives), b) the efficient management concerns the relationship between actual input (resources) and actual output (results achieved), determining whether the means adopted were employed in the most appropriate manner (examination of performance), and c) the effective management refers to comparing actual output with planned output, determining whether the purpose has been achieved or not (success rate).

2.2. EU Performance Audit – Seeking Value for Money

Performance audits seek to provide information that is oriented towards the performance achieved. Thus they concentrate on inputs, outputs, results and impacts, the assumption being

that, if the performance achieved is satisfactory, there is little risk of serious problems being present in the design or implementation of the activity or control systems. Such an endeavour necessitates the existence of suitable criteria to measure quantity, quality and cost of inputs, outputs, results and impacts. Where the performance achieved is found to be unsatisfactory, the activity and control systems are then examined to the extent necessary to identify the related causes (see European Court of Auditors, 2017b, p. 15).

The audit of control systems is designed to determine whether the auditees have designed and implemented management and monitoring systems so as to optimise economy, efficiency and effectiveness within the given constraints. The audit work involves analysing, reviewing and testing the key components of such systems. The examination is often extended to the consistency of the audited measures with the policy objectives, and whether the latter have been translated into operational plans containing operational objectives, the achievement of which is subsequently measured. It also considers whether the systems in place produce relevant, reliable and timely information on the development of financial, human and other resources (inputs), the carrying out of activities (processes) and the delivery of outputs, which are compared with the operational objectives by way of performance indicators. The treatment of any discrepancies through timely and appropriate remedial action is examined as well. This approach involves an examination of the evaluation system and information in order to assess their quality and, if considered to be satisfactory and relevant to the audit objectives, to use evaluation findings, conclusions and recommendations as audit evidence (see European Court of Auditors, 2017b, p. 16).

The main starting point in organizing a performance audit process is to analyse the audited intervention as a set of financial, organisational and human resources mobilised to achieve,

in a given period of time, an objective or set of objectives, with the aim of solving or overcoming a problem or difficulty affecting targeted groups. The use of logic models can help the audit team to identify and set out the relationship between the socio-economic needs to be addressed by the intervention and its objectives, inputs, processes, outputs, and outcomes, which include results (immediate changes that arise for direct addressees at the end of their participation in a public intervention) and impacts (longer-term effects of the intervention). Within this approach, the auditor is not supposed to cover a simultaneous and comprehensive examination of all aspects of economy, efficiency and effectiveness, but rather examine certain issues related to economy, efficiency or effectiveness, or to a combination thereof, based on the significant potential risks identified (see European Court of Auditors, 2017b, p. 17-18).

The element of economy (within a performance audit), aiming at the significant reduction of the costs of inputs for a given level of outputs or results, focuses on risks such as wasting resources, overpaying for goods or services or gold-plating i.e. paying for goods or services of a quality higher than necessary. Thus the auditor has to examine whether the auditee a) acquires the appropriate type, quality and amount of resources at the minimum cost, b) manages its resources with a view to minimising overall outlay and c) designs and implements its interventions in ways resulting in lower costs (see European Court of Auditors, 2017b, p. 18-19).

The element of efficiency (within a performance audit), aiming at the increase of the amount or quality of outputs or results without increasing the use of resources, focuses on risks such as leakages (i.e. used resources that not lead to the planned outputs), non-optimal input/output ratios, slow rates of the interventions' implementation, or failure to identify and control externalities. Efficiency is closely related to the concept of "productivity" and the key question is whether outputs or

results have been maximised in terms of quantity, quality and timing for the level of resources available. The auditor examines issues such as the cost-effective production of outputs or results and the possibility of avoiding bottlenecks or unnecessary overlaps (see European Court of Auditors, 2017b, p. 20-21).

The element of effectiveness (within a performance audit), aiming at producing the expected outputs, results or impacts, focuses on risks such as faulty policy design or management failures. The auditor seeks to verify the achievement of operational objectives (the extent to which the intended *outputs* have been produced through the internal operations of the auditee), immediate objectives (the clear and positive nature of the results achieved for all participants) and intermediate and global objectives (the impact of the intervention on the wider social, economic, political, institutional, etc landscape). The difficulty with the latter type of objectives is their expression in such broad terms, not allowing their association with measurable indicators and thus impeding the verification of their achievement, while the assessment of outputs is easier, especially when the objectives are expressed in the so called SMART template (specific, measurable, achievable, relevant and timely) which provides a clear and suitable reference basis for assessing effectiveness (see European Court of Auditors, 2017b, p. 22-23).

Performance auditing calls for the so called SMARTEST approach in order to lead to high quality outcomes, which entails the auditor ensuring the following (see European Court of Auditors, 2017b, p. 24):

- **S**ound judgement is exercised throughout the audit process.
- **M**ethodologies are appropriate and combined to capture a range of data.
- **A**udit question(s) are set which can be concluded against.
- **R**isks to delivering the audit report are analysed and man-

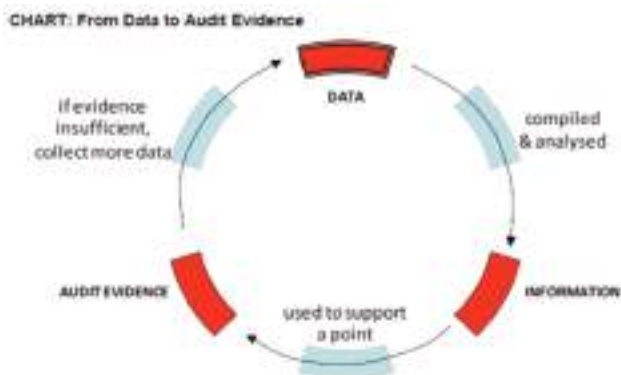
- aged.
- **T**ools are employed to help achieve successful delivery of the audit.
 - **E**vidence is sufficient, relevant and reliable to support the audit findings.
 - **S**ignificant / substantive conclusions and recommendations to the final report are considered from the planning phase onwards.
 - **T**ransparency - a 'no surprises approach' - is adopted with the auditee.

The nature of performance auditing calls for the use of intellectual functions such as judgement and interpretation, in all the stages: setting the audit objectives (or audit questions – one main question analysed in sub-questions, whose contents must be both mutually exclusive and collectively exhaustive and the replies to which should include yes/no answers subject to further development), defining relevant audit criteria, establishing an appropriate quantity and quality of audit evidence, deriving audit findings, drawing conclusions and reporting (see European Court of Auditors, 2017b, p. 24)

The main instrument for the audit's planning phase is the Audit Planning Memorandum, a document that defines the contents of the audit, the product to be delivered, the resources to be employed, the delivery date, the risks to sound financial management (i.e. events or actions that may adversely affect the auditee, and which may be inherent i.e. factors that make sound financial management hard to achieve, no matter how well the entity is managed, or refer to control i.e. how well the entity manages performance), the audit questions as described above, the audit criteria (based on legislation, regulations, professional or other standards, etc), and the evidence to be collected (it needs to be sufficient, relevant and reliable). It is a sort of contract between the actors involved in the auditing

process. Its preparation requires preparatory work which depends on the auditors' knowledge of the policy field or the organization to be audited. Updating all relevant knowledge is imperative. This allows the understanding of the logic of the audited intervention, which, in turn, provides the basis for the determination of the human, administrative and financial resources to be employed (see European Court of Auditors, 2017b, pp. 32-47)

The audit examination phase takes place on the basis of the audit planning already undertaken and the planning documents thereby developed. Its main purpose is to collect the evidence deemed necessary for the auditors in order to reach conclusions on the audit questions. This process entails an analysis of the evidence ("what is") which is evaluated against the pre-determined audit criteria ("what should be") in order to derive audit findings, focusing on the causality links (cause-effect) of the findings. Such audits are more judgement-based, with the result that audit evidence tends to be more persuasive ("points towards the conclusion that...") than conclusive ("right/wrong") in nature. The "transformation" of data collected to audit evidence is presented in the following graph (see European Court of Auditors, 2017b, p. 58):



The sufficiency of audit evidence relies on its capacity to persuade a reasonable person that the audit findings and conclusions are valid, and that the recommendations are appropriate. Its relevance relies on its clarity and its logical relation to the audit questions, the audit criteria and the audit findings. Its reliability is acknowledged if the same findings arise from repeatedly carried out tests or when the same information is obtained from different sources. The criteria for these audit evidence qualities are the purpose of their collection, their materiality/significance in relation to the audit scope, the independence of the originating sources, the cost of obtaining additional evidence, the risk of reaching incorrect conclusions, and the care taken in their collection and analysis. The sources of audit evidence entail data obtained directly by the auditors, data provided by the auditee and data provided by third parties. Such data may be physical (e.g. Notes, photographs, charts, maps, drawings, samples, etc), documentary (e.g. other reports, policies & procedures, system descriptions, contracts, etc), oral (e.g. information from interviews, expert panels, etc) and analytical (e.g. ratio analyses, regression analyses, benchmarking, etc). The evidence is used to determine whether any detected deficiencies are isolated instances or results of systematic problems, to identify their causes and impacts as well as the possibility of the auditee to address them internally or to seek external assistance. There might be quantitative or qualitative findings, and all are being treated in the appropriate manner. Performance audits focus on providing a balanced view of the topic under audit, presenting not only deficiencies but also, when appropriate, positive findings and indications of good practice. The overall emphasis is to formulate audit findings in a constructive and balanced way. The preliminary audit findings are communicated to the auditee, in a context of constructive interaction, in order for other views and counter-arguments to be explored, the accuracy of the facts to be es-

tablished and any corrective action undertaken to be verified, all these being significant elements for the audit's report (see European Court of Auditors, 2017b, p. 59-69).

The audit reporting phase includes drafting of the final reporting document, approval of the preliminary observations by the Audit Chamber within the ECA, the adversarial procedure with the Commission, adoption of the final reporting document by the ECA, translation, presentation to the discharge authority and publication. Performance auditing in the EU audit system leads to the production of Special Reports by the ECA. There are also the so called "Presidential Letters", i.e. notes sent by the ECA's President to the person in charge of an auditee (President, Director, etc) in order to inform their recipient about the ECA's findings during a particular audit. Based on the replies of the auditee the ECA will decide whether it is going to keep the matter on a bilateral level or to issue a Special Report on it or even to include it in its Annual Report (see Themelis, 1984, p. 122).

The ECA's reports, entailing performance auditing results, must be objective (i.e. adopting an independent, unbiased, balanced viewpoint with neutral tone and fair approach), complete (i.e. contain all relevant information), clear (i.e. with easily identifiable and understandable messages), convincing (i.e. with persuasively presented observations, supported by sufficient data and documentation), relevant (i.e. with timely and up-to date information – keeping in mind the 13 months time limit set in Art 259 of the current Financial Regulation – and providing added value and new information on the topic under audit), accurate (i.e. with true evidence and correctly portrayed findings), constructive (i.e. to provide assistance to the auditee in overcoming or avoiding problems), and concise (i.e. the report's size should not exceed the length necessary to convey the audit's message, avoiding extraneous details and immaterial findings) (see European Court of Auditors, 2017b, p. 73-75) .

The conclusions of the audit are drawn up near the end of the audit work and this outline is the basis for a more detailed drafting plan. This plan is based on the audit work undertaken with regard to the audit questions answered, the evidence obtained, the key conclusions and the need to present material observations in the most useful and relevant way to the non-expert reader. The report sets out the materials and relevant observations and conclusions, with a clear link between the two. This is further enhanced by using cross-references of each observation (per auditee) to the corresponding audit findings. The structure of the report is as follows: executive summary, introduction, audit scope and approach, observations and conclusions and recommendations. Its contents entail data and information essential to understanding, as well as information (not overly detailed) on budgetary expenditure (commitments and payments) in relation to the audit's scope. The wording must be accessible to the average reader, consistent throughout the text, unambiguous and conclusive (with affirmative assertions). The Adversarial Procedure, as provided for in Art. 259 of the current Financial Regulation, i.e. the meetings between the audited institution and the ECA, aim to resolve, firstly, any disagreements over the facts and, secondly, any differences of opinion between the ECA and the auditee over interpretation of the evidence. This allows the auditee to finalise its replies to the ECA's observations. Finally, the follow up of the reports allows the assessment of any measures taken, by examining the extent to which the auditee has addressed the findings and recommendations contained in the ECA's special reports. The effectiveness of the actions taken by the auditee may be examined in a further detailed audit enquiry (see European Court of Auditors, 2017b, p. 76-88).

2.3. The EU experience of performance audits

ECA's performance audits have been very useful as well as informative with regard to the EU's financial management. The most common problems identified as causes for poor value for money in the EU are the following (see European Court of Auditors, 2014b, p. 23-24):

- the purpose of the funding is not clear, or there is no preliminary (*ex ante*) evaluation, or assessment of the actual funding needs
- there are too many objectives, or unclear objectives that can be interpreted in different ways, making it difficult to establish priorities
- the needs of potential beneficiaries are not adequately assessed, or the possible impact of EU funding is not properly considered
- aid is not targeted at beneficiaries, areas and projects most in need, or the selection criteria for individual projects are insufficient
- eligibility criteria are unclear or inconsistently applied by the bodies approving EU support (grants, loans, etc)
- EU funds bring some benefits to the beneficiaries, but there is no special EU dimension to the actions over and above what is already funded by the Member States at national, regional and local levels
- there is no assessment of the reasonability of costs charged to EU actions
- EU funds are used to purchase goods and services of unnecessary high quality
- purchasing rules are not followed in the procurement of goods and services
- it takes too long to carry out the actions
- the EU budget may be used to fund actions and projects which are not self-sustaining or maintained once the EU

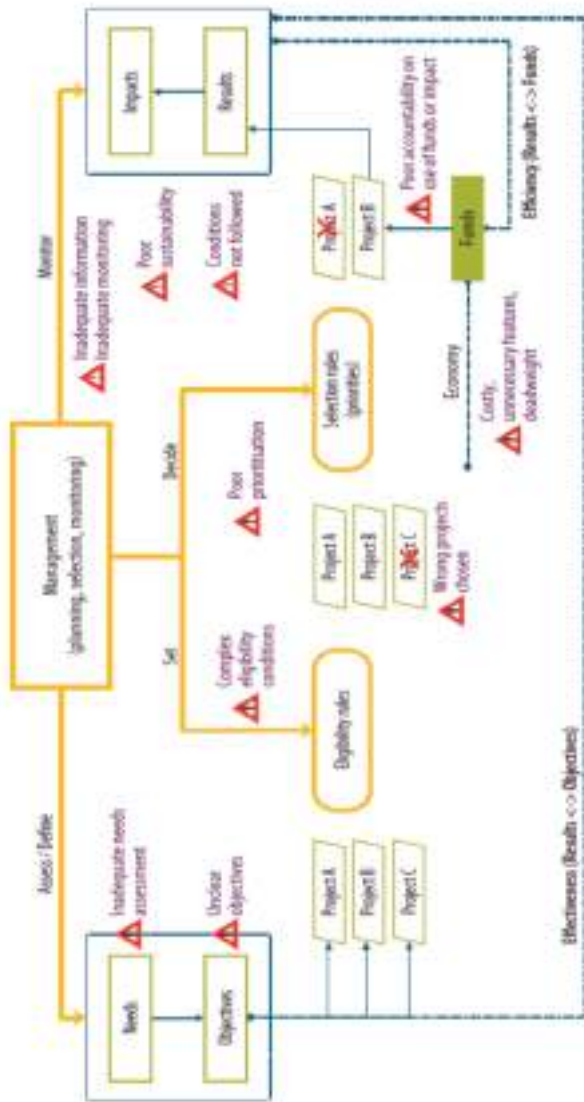
- funds are no longer available
- there is a lack of information about what was actually achieved and the benefits it brings

The ECA has prepared a very indicative diagram in that respect (see following page).

The necessity of audit reporting on performance has been confirmed by the ECA as reliable financial information must be matched by reliable nonfinancial information, and the EU's focus on compliance should be matched with a focus on results. The ECA's findings in various performance audits entail inadequate monitoring and evaluation arrangements and the need to improve the relevance, reliability and timeliness of performance data provided by management systems. The lack of clear and measurable objectives in EU funded programmes is not negligible and it causes severe difficulties for the auditors to determine the soundness of EU financial management, thus reducing the accountability element for the managers (at EU and national level) of the relevant funds. Therefore, three main challenges have been identified in EU performance auditing: a) adopting consistent performance indicators and obtaining reliable information, b) setting up systems that produce accurate information on results, and c) improving the Commission evaluation report in terms of the results achieved, an issue which the ECA has highlighted as it considered the first such reports of the Commission as vague, short on substance and with limited EU added value (see European Court of Auditors, 2014a, p. 51-52).

Achieving EU added value through the programmes funded by the EU budget is of significant importance in the ECA's performance audit approach. According to this approach, expenditure programmes which do not add European value are by definition unlikely to be an effective and efficient use of the EU taxpayer's money. The principles put forward by the ECA

The most frequently reported problems in the Court's Special Reports



Source: European Court of Auditors, 2014b, p. 24

in order to further articulate this concept in the framework of its audits are the following (see Caldeira, 2008, p. 21):

- Expenditure from the EU budget within the Union must offer clear and visible benefits for the Union and its citizens which could not be achieved by spending only at national, regional or local level, but could rather, by reason of the scale or effects of the proposed action, be better achieved at Union level
- Expenditure with trans-frontier effects or common interest is *prima facie* a stronger candidate for EU financial support than expenditure with limited geographical effects
- Reasonable concentration of expenditure is *prima facie* likely to support the objective of adding value
- For expenditure outside the Union, such as on development assistance, value added is also likely to be enhanced by a selective approach, using selection criteria such as the existence of global donor endorsement for areas in need of assistance, or the existence of EU expertise in the supported activities.

In the ECA's point of view, such principles could be embodied in a suitable political declaration or even in EU legislation, and provide criteria for the guidance of the Union's political authorities, like the principles of subsidiarity and proportionality.

There are various examples of the performance audits' usefulness in improving EU financial management, in various EU policy fields.

With regard to the revenue of the EU budget it has been found that there is considerable scope for simplifying the relevant arrangements and making them more transparent. The existing system of the EU's own resources has been found to be excessively complex, not very transparent, incomprehensible for EU citizens, and not fully auditable. For instance:

- The VAT-based resource resembles national contributions based on statistical data and estimates in addition to VAT actually received. Their calculation is complex and is the result of a number of detailed adjustments. There is no direct, clear relationship between VAT paid by the taxpayer and the “VAT-based” resource.
- The GNI-based own resource is based on macro-economic statistics for which harmonization could still be improved.
- The various correction mechanisms linked to the correction of budgetary imbalances introduce great complexity into the VAT and GNI call-up rate.
- The underlying data can be audited directly only in the case of traditional own resources (customs duties, agricultural duties and sugar levies).

The overall design of the EU revenue system is a matter of political decision by the EU political authorities. The ECA has called repeatedly for such decisions (see Caldeira, 2008, p. 25).

With regard to the EU expenditure, one of the policy areas audited on several occasions is the EU Cohesion policy, especially after the administrative reform and the managerial reorganisation of the Commission’s financial management system and structures realised during the 2000-2006 programming period, in the aftermath of the 1999 events. The major rise in audit resources focusing on this policy field has been identified as an “audit explosion”, with stricter enforcement of rules, increased supervision, and more audits of programmes at EU and national level. These changes focused mainly on improving the compliance audit mechanisms of verifying legality and regularity of expenditure and emphasis was placed on the sanctioning tool of financial corrections and recoveries. Priority was given to obtaining assurance of compliance and facilitating the discharge procedure. Especially in a field such as

EU Cohesion policy, which is implemented under the shared management scheme, compliance has been deemed more important than performance given the high degree of delegation risk caused by the devolved and dispersed delivery model of this field. The perception of performance has been seen as a secondary priority despite the formal declaration of the EU adopting a New Public Management approach (for a detailed analysis of this issue see Mendez & Bachtler, 2011).

Nevertheless, the ECA has sought to examine the soundness of the EU's financial management in the field of EU Cohesion policy. One of its remarks has been that during the last ten years (2010-2020) there has been a significant increase of provisions in the EU secondary legislation regarding the introduction of elements which refer to key features on the establishment of an effective system of performance management including definitions of performance and sound financial management, the use of robust objectives and indicators, and structured evaluation of what has been achieved. Thus, while initially there were general references to sound financial management and its economy element, in the 1990s the cost-effectiveness aspect and the requirement for quantified objectives were introduced, and afterwards, in 2002 the SMART scheme for objectives-setting and the full-scale concept of sound financial management with its three elements (economy, efficiency effectiveness) were established. In 2010, the results-driven budgeting process was introduced, followed, in 2011, by the formal definition and use of the concept of EU added value, while in 2015 reforms were introduced aiming at improving the EU regulatory and budgetary governance by orienting them towards achieving better results. Finally, in 2018, the current Financial Regulation established requirements concerning the focus on performance through the setting up of *ex ante* objectives and the monitoring of their attainment by using performance indicators (both "output" and "result" indicators), and by examining the EU

added value of the relevant programmes (see European Court of Auditors, 2019b, pp. 12-13).

In terms of substance, the ECA has developed a set of 14 guiding principles focusing on making Cohesion policy performance-oriented. These principles reflect the main issues identified in the ECA's performance audit work in this policy field, by relating to the full cycle of managing the policy, from planning at the outset to evaluation on completion. The ECA has elaborated on the relevance of these principles to each of the five management stages of Cohesion policy. It has been found out that since 1988 (the landmark year in EU Cohesion policy development) there has been a steadily increased relevance between the management stages of Cohesion policy and the ECA's principles (see the following tables).

Management Stage of Cohesion policy	ECA Guiding Principles
Strategic Planning	GP1: The EU has articulated a clear and consistent of what it wants to achieve with Cohesion policy funds, which needs to be owned and operationalised
	GP2: The allocation of funding to Member States takes account of identified needs and is informed by performance information
Programming	GP3: A clear intervention logic exists
	GP4: Funding is well targeted
	GP5: A simple and consistent performance measurement framework is in place
	GP6: Mechanisms to incentivise performance are in place
Implementation	GP7: Member States spend their Cohesion policy funds in a timely way
	GP8: There is a performance-oriented approach when selecting and implementing projects
	GP9: Revisions of programmes are informed by performance considerations including results
Monitoring and Reporting	GP10: Monitoring systems ensure timely performance data of good quality
	GP11: There is clear accountability for performance
	GP12: Performance information is used to take remedial action and support the strategic planning process
Evaluation	GP13: Evaluations at programme and policy level are used for decision making
Cross Cutting GP14: Sustainability is built into the cycle to ensure the longer-term effectiveness of public interventions	

Source: European Court of Auditors, 2019b, p. 11

	1989-1993	1994-1999	2000-2006	2007-2013	2014-2020	2021-2027
Principles governing strategic planning						
1. The EU has articulated a clear and consistent vision of what it wants to achieve with Cohesion policy funds, which needs to be owned and operationalised						
Existence of an overarching EU-wide strategy				X	X	
EU strategic objectives translated into objectives for the Cohesion policy					X	
2. The allocation of funding to Member States takes account of identified needs and is informed by performance information						
Allocation method set out in the legislation	X	X	X	X	X	X
Allocation based on GDP	X	X	X	X	X	X
Allocation based on needs in specific areas					X	X
Allocation informed by past performance information						
Principles governing programming						

3. A clear intervention logic exists									
Existence of a mandatory national strategy (e.g. National Strategic Reference Framework, Partnership Agreement)	X	X	X	X	X	X	X	X	X
Definition of objectives/priorities at national level	X	X	X					X	X
The common EU wide strategy translated into national level objectives with targets (main results expected)								X	
Identification and articulation of needs at the national level								X	
Existence of mandatory programmes			X				X	X	X
Identification and articulation of needs at programme level								X	X
Definition of objectives at programme level							X	X	X
Definition of actions addressing the objectives at programme level								X	X
Standardised programme template describing the intervention logic in a harmonised way								X	X
Breakdown of financial data by codes of intervention at programme level							X	X	X

The Managing Authorities confirm the reliability of performance data to the Commission in their management declarations							X	X
The Audit Authorities confirm the Managing Authorities' assessment on reliability of performance data in audit opinions							X	X
Monitoring Committee examines and confirms the quality data transmitted by the Managing Authorities to the Commission								
Commission's role in examining the data is set out in the Common Provisions Regulation								
Commission can suspend payments there is a serious deficiency in the quality and reliability of the monitoring system or of the data on common and specific indicators							X	
11. There is clear accountability for performance								
Requirement for the Member States to transmit to the Commission data on performance of programmes for all funds	X				X	X	X	X
Mandatory annual implementation reports by Member States					X	X	X	X

Strategic reports required from the Commission			X	X	X		
Performance data is readily and publicly available online					X		X
Commission is required to explicitly accept the outputs and results achieved at programme closure							
12. Performance information is used to take remedial action and support the strategic planning process							
Performance information is envisaged to be used for decisions at strategic level (mid-term review)							
Performance information is envisaged to be used for decisions at programme level (performance reserve, mid-term review and corrections for underperformance)			X		X		
Formal approval of performance of programmes by Commission			X	X	X		
Formal approval of performance of programmes by monitoring committee			X	X	X		
Annual review meeting between Commission and Member States to examine the performance of each programme					X	X	X

Member States required to examine if beneficiaries have sufficient resources to cover operational and maintenance costs										X
Major projects (> €50 million) are to be accompanied by the cost-benefit analysis encompassing financial viability of projects				X		X				X
Beneficiaries have the obligation to maintain the projects (projects/productive investment and infrastructure) for at least 5 years				X		X				X
<i>Ex ante</i> conditionalities or enabling conditions require strategic framework ensuring sustainability of investments										X

Source: European Court of Auditors, 2019b, pp. 47-51

It must be noted that performance audits have been often criticized, throughout the EU, for not leading to action. Such criticisms were also voiced, as noted above, with regard to the performance audits conducted by the ECA. In that respect, the real challenge facing all audit institutions, including the ECA, is the potential lack of implementation of their recommendations. In order to meet this challenge, they must study and understand the socio-cultural contexts of organizations with their cognitive, normative, and regulative elements, that shape the organisational landscape and behavior in which they operate. There are various configurations of performance audit, adjusted to these contexts and reflecting them. The New Public Management concept promoted a performance logic, or managerial logic that became embedded with other, already existing logics, rooted in geographical and cultural differences and broader belief systems. It has been noted that performance audit was more fruitfully adopted by countries with a common law tradition than by those with a strong administrative tradition. This demonstrates that the necessary, but not sufficient, condition for performance audits to generate impact is the relevant legal framework. The absence of legal requirements shows a lack of political will that leads to shortages of resources with which to carry out performance audits. This necessitates the implementation of the recommendations of such audits. Otherwise, performance audits become a source of waste and the resources employed could be better used for other purposes (for a detailed analysis see Torres, Yetano & Pina, 2016).

3

Compliance or Performance? An audit dilemma

3.1. The co-existence of audit systems

The “competition” between financial/compliance audit and performance reflects a steady development of responses provided by public authorities in order to meet accounting needs, especially in the public sector, as this sector’s accounting scope has been constantly expanded in order to include as much levels and forms of government as possible e.g. central government, local government, state government, federal government, etc., depending always on a country’s model of organizational and constitutional structure as a federal or a unitary state. The starting point has been the financial accounting and audit scheme, whose basic objective is to provide financial reports furnishing relevant economic information to decision makers who require financial statements with reliable information on economic resources and obligations (balance sheet), profitability (income statement), and other relevant data (e.g., statement of cash flows, contingent liabilities, and accounting policies). Furthermore, the compliance element has been introduced, requiring the auditors to express opinions on the conformity of the financial statements with standards set by the appropriate authorities. Last, but not least, the

use of private sector standards focusing on management and the audited entity's performance with regard to the impact of its decision on its income has been accepted as a valid option. These developments have caused the simultaneous conformity with at least two types of accounting and auditing rules, leading to the adoption of "negative standards" i.e. the formal declaration of non applicability of a category of rules in case of conforming with another one (see Reinstein & Lander, 1997).

The institutional consequences of these developments have been materialized in the form of the establishment of various types of public audit institutions, each one reflecting different cultures in political, social, economic and legal processes. Within this variety two broad traditions may be distinguished. The first is a common law tradition, in countries of the British Commonwealth, the USA, and some Scandinavian countries, where the main emphasis is upon the audit institution's responsibility to report its findings to the legislature who will then decide what recommendations to make to the government. But the audit institution in this tradition has no legal powers to punish the offences identified in its report and in some cases it does not even have the authority to acknowledge them as such. The second tradition is the so called Roman law tradition, according to which public sector audit is conducted by a court, which can hold hearings, and whose decisions and punishments have legal force, as for instance the Cour des Comptes of France, the Corte de Conti in Italy, the Tribunal de Cuentas in Spain, the Court of Audit in Greece etc (see Bourn, 2007, p. 4).

These two broad traditions may be further divided into groups, taking into account two dimensions: the degree of professional autonomy enjoyed by the audit institution and the degree of external influence exercised over it. Such considerations demonstrate that the optimal situation is an audit institution with a high degree of professional autonomy and

a low degree of influence from outside, highlighting overall independence as the ultimate quality in the audit function. Usually independence from the Executive is the main cause of concern, by also a degree of independence from the Legislature is also important, in order to allow the audit institution to develop its own identity, or even to prevent its indirect control from the Executive through the political parties' machinery in the Parliament (see Heald, 2018, p. 319-320). Thus, more types of audit institutions are identified, the grid of their resulting relationships being formed as follows:

Degree of external influence over institution	High	Low
Degree of professional autonomy exercised by institution	High	Low
High	Political (eg US Government Accountability Office)	Professional (eg UK National Audit Office, collegiate bodies)
Low	Hierarchical (government department)	Legal (Court of Accounts)

Source: Heald, 2018, p. 320

The “Legal” cell (Low:Low) entails the characteristics from judicial or quasi-judicial audit institutions, which are thus protected from external influence but their reasoning is marginalized from economization and their discourse is shaped in terms of legal duties and rights. The “Hierarchical” (Low:High) cell includes public audit institutions which are construed as government departments, sometimes within the civil service, thus not being arbiters providing assurance about a principal-agent relationship but rather being viewed as enforcer on

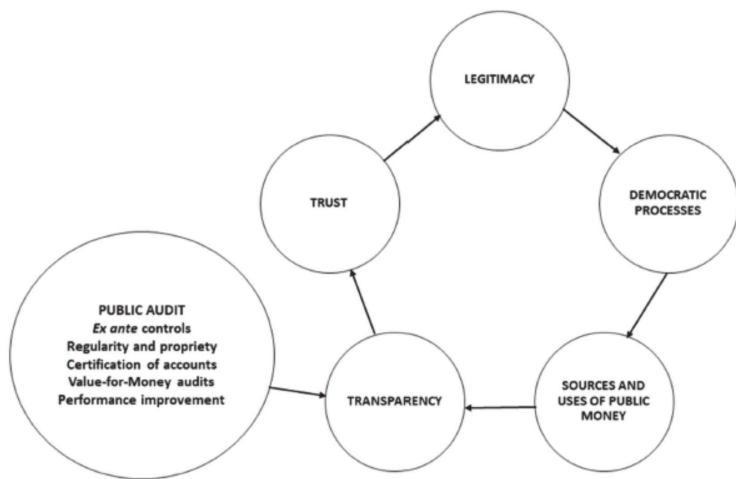
behalf of the principal (government), and this, by definition, affects their objectivity. The “Professional” (High:Low) cell refers to public audit institutions that report to the Legislature rather than the Executive, and whose functions are not seen as administrative or legal, an arrangement that provides the advantage of protecting the audit institution against an “aggressive” auditee, such as the Ministry of Finance, but, at the same time, creates forms of dependency upon persons holding the key positions, as there are risks regarding professional independence and integrity (vital for the audit institution’s autonomy) as well as external influence (vital for relevance and perhaps institutional survival). The “Political” (High:High) cell reflects regimes with strong arrangements regarding the separation of powers, thus leading to significant depoliticization of the public audit institution, allowing it to be an actor of its own in the democratic political system (see Heald, 2018, p. 330 and the references therein).

In any case, these types of public audit institutions reflect the culture or beliefs established at national, supranational and international level with regard to the public audit’s position in the political, constitutional, and institutional environment of a democratic regime. In all versions, however, the public audit enhances the element of transparency.

It is obvious that the public audit scheme encompasses all types of control and audit operations, such as *ex ante* controls before public money is disbursed, providing assurance about regularity and legality, providing certification of government accounts, undertaking assessments of value for money, and improving public financial managerial performance (this latter element has influenced reforms leading to the focus being shifted to *ex post* public audits, as the *ex ante* controls increasingly acquire an internal nature, being relinquished to the auditee’s administrative authorities).

The schematic representation of this model entails a cycle

with all the main elements of the relevant system, and the public audit operating as a catalyst of the system's transparent operation, as follows.



Source: Heald, 2018, p. 321

Such theoretical considerations and institutional arrangements have been adopted, perhaps due to institutional isomorphism, within the EU's public audit system. This system is predominately characterized by the co-existence of financial and compliance audit with performance audit, as it has been described in the previous chapters.

This co-existence, nevertheless, has not eliminated the differences between these types of audits. On the contrary, it has brought them to the foreground, as a means of defining the limits of the audit function within the EU budgetary governance. These differences refer to specific aspects of the audit process as follows:

ASPECTS	Performance audit	Financial and Compliance audit
Purpose	Assess whether EU funds have been used with economy, efficiency, effectiveness.	Assess whether financial operations have been legally and regularly executed and accounts are reliable.
Focus	Policy, programme, organisation, activities and management systems.	Financial transactions, accounting and key control procedures.
Academic basis	Economics, political science, sociology etc.	Accountancy and law
Methods	Vary from audit to audit.	Standardised format
Audit criteria	More open to the auditors' judgement. Unique criteria for the individual audit.	Less open to the auditors' judgement. Standardised criteria set by legislation and regulation for all audits.
Reports	Special report published on an ad hoc basis. Varying structure and content, depending on objectives. A macro view on performance of the EU budget is included in a dedicated chapter of the Annual Report.	Annual report in a more or less standardized template.

Source: European Court of Auditors, 2017b, p. 10

When deciding on the type of audit to use in the EU, one should remember that EU policies are realised partly by budgetary instruments and partly by legal and regulatory instruments. The

budgetary instruments entail primarily the funding provided by the EU budget for the implementation of the Union's policies, while a number of these policies are also financed from national budgets, and to a lesser extent from other sources of funding (such as leverage of private finance). The legal and regulatory instruments encompass the numerous legislative instruments enacted by the EU every year, which set rules or standards in policy areas such as the single market, environmental protection, social policies and competition (see European Court of Auditors, 2014a, p. 50).

Consequently the contents of the audit process have to be arranged accordingly and it is, therefore, obvious that certain elements of financial and compliance audit aspects can also be included in a performance audit, when they refer to wider horizontal issues, e.g. environmental considerations in the context of sustainable development. An audit combining these aspects is called a "comprehensive audit". Adopting such an audit approach is a matter of professional judgement and is a decision to be taken on a case-by-case basis. It must be noted that out a comprehensive audit is a very demanding task. Therefore, it should be considered with great care and undertaken only in cases where it is clear that it will be possible to obtain sufficient, relevant and reliable audit evidence and deliver clear, useful and timely messages at the reporting stage to satisfy performance, compliance and/or financial audit objectives. The various elements must be clearly distinguished in the Audit Planning Memorandum and the Audit Programme, so that the audit team is clear about and gives due consideration to the differing audit objectives within the audit task. These clarifications will help also labeling the audit (the classification of the audit engagement), as such overlaps between other types of audit and performance auditing may be resolved by determining the primary purpose of the audit in question (see European Court of Auditors, 2017b, p. 10).

This approach is also seen in the relevant reforms undertaken by several countries in the EU, the common objective being to extend the scope of public audit institutions' functions and to grant them statutory authority to carry out performance or value for money audits, even if that required a institutional overhauling of the public function, like for instance in the case of the United Kingdom, where the audit institution was formally placed within the purview of the Parliament and was granted the authority to carry out examinations of the economy, efficiency and effectiveness of public financial management, thus eliminating the oddity of this institution auditing the Treasury while being audited, at the same time, by the Treasury, a situation exemplifying the concept of conflict of interests (see Bourn, 2007, pp. 4-5).

The impact of performance audits varies according to the broader institutional and administrative culture of the state: In the so called "Anglo-American" model, the impact of performance audits is mainly due to the implementation of recommendations by the entities audited. The change process initiated by the recommendations finishes with the follow-up audits. There are countries, especially in Europe, which have adopted a similar approach, but moving away from their traditional administrative culture has not been found to be easy, leading to delayed audit reports and the employment of private auditors for some audits. In general, in the so called "Continental-European" model, the effect of performance audits comes primarily from the reforms promoted by the Parliament, thus leading to low levels of follow-up audits but increased parliamentary debates between the auditees, the auditors, and the relevant political authorities about the results of the audits and the reforms undertaken. The legal background of the audit institutions' staff necessitates the use of external experts on performance audits. This is particularly obvious in countries with judicial bodies as public audit institutions, in which the audit

recommendations should be directly implemented by the entities audited, and thus performance auditing seems testimonial (see Torres, Yetano & Pina, 2016, pp. 22-23)

3.2. The audit's output: judgement, decision or political statement?

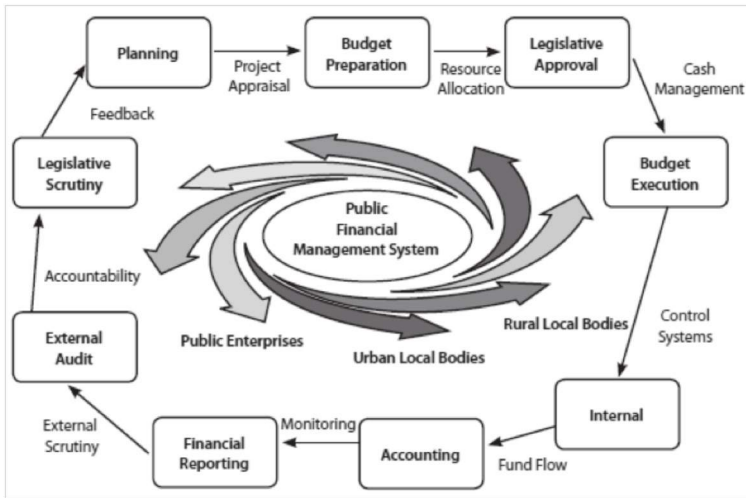
One of the most notable aspects regard the function of public audit, at all levels (including the EU), is that it relies on human activity. The auditors are called to find evidence, to study them and to reach conclusions regarding the objectives of their mission. In order to understand the nature of their conclusions one has to define two concepts which are quite relevant to audit or to each other in the audit context: the concept of judgement and the concept of decision.

In general, a judgement is defined as the set of evaluative and inferential processes, entailing personal assessment or other evaluations, that people have at their disposal and can draw on in the process of making decisions (see Koehler & Harvey, 2004, p. xv, Brown, 2005, p. 239). A decision is the broader process within which a choice among specific options is made, determining what action is to be taken, based on risk assessment and choice, under social, emotional and cultural influences (see Brown, 2005, p. 1 and 237, Koehler & Harvey, 2004, p. xv). Both these processes are employed in the main activities of auditing, i.e. the compilation of data, the appraisal of data against specific criteria and the production of financial or non-financial reports (depending on the type of audit) which are used as source of information for all interested parties. Despite this co-existence, judgement formulation has been distinguished clearly from decision making (see Kotchetova & Salterio, 2004 p. 556). For example, when focused on a specific financial-statement assertion and account balance the auditor

must *judge* the significance of the balance and assertion, the level of misstatement risks, how to best produce evidence to confirm or disconfirm this assertion, how much such evidence should be produced, and when, during the course of the audit, it should be produced. Subsequently, the auditor must evaluate the resulting evidence and form a judgement about its meaning. In concert with similar judgements for other accounts and assertions, the auditor then must integrate these findings and decide what to communicate to the financial-statement users, i.e. choose the audit report to be issued (see Solomon & Shields, 1995, p.139).

An interesting characteristic of the judgements and decisions in auditing processes is the employment of mental accounting (for this concept see Sunstein, 2002, p. 231-232), i.e. the use of frames that result in mental accounts through which losses and gains (including those in simple monetary terms), are not fungible with each other. Decisions are thus organized in terms of separate budgets and accounts, and these accounts are often segmented. This is a means of financial control and the auditors are bound by the scope and the mission of their activities to use such schemes in their thinking, providing a paternalistic model of approach. The audit function prevents managers from making choices as they wish and the use of separate mental accounts serves as the limitation tool. Such tools may prove to be quite effective as they will provide the bases for audit findings regarding the revenue and expenditure of the auditee, by explaining the mentalities behind the budgetary behaviour (collection of revenue and payment of expenditure) of the auditee's managers and identifying patterns of behaviour that might need to be amended, thus necessitating also organizational, procedural and operational amendments. All in all, the practice of mental accounting on behalf of the auditor allows for the auditees to develop creative policymaking in order to adapt to the audit's recommendations.

The importance of the public audits' outputs is highlighted when considering the position of public audit in the overall System of Public Financial Management & Accountability. Such a System is provided for within the framework of each public entity at subnational, national, supranational and international level. The EU, of course, is no exception to that rule. The System contains several components which are all interconnected in such a way that the good performance of one affects the others. The interconnection of the components and the functional logic of the System are based on the accountability relationships between the various actors such as the executive and the legislature. The System serves its purposes by providing, through its components, the systemic tools for an overview of the budgetary governance landscape, starting from the perspective of focusing on regularity of cash in-flows and out-flows (compliance) and extending the scope of audit to a broader set of parameters that incorporate several inputs from a economic development perspective such as cash and other assets—financial and physical, as well as human resources and the relevant outputs, outturns and development outcomes. Thus the issue of good or sound budgetary governance is raised and addressed, through controlling the use of public resources, for which the provision of information – financial and non-financial is of vital importance, as it will demonstrate whether the budgetary governance is value based (see Sahgal, 2007, p. 57). The entire System of Public Financial Management & Accountability can be seen as follows:



Source: Sahgal, 2007, p. 55

The position of audit in the System, both as internal and external audit, provides the basis of the System's effective operation. In the EU context the dual scope of audit (financial/compliance audit and performance audit) has led to the production of audit outputs, in the forms of judgements or decisions which have contributed significantly to the quality of the Union's budgetary governance.

With regard to financial and compliance audits, the main concern is for the audit institution to provide assurance on the reliability of the accounts and the legality and regularity of the transactions. This will be provided as an opinion to the recipients of the audit report, which in turn, will be based in judgements resulting to a decision. The credibility of the audited issue is based on the credibility of the audit itself. In order to provide such credibility the audit institution must also provide assurance, and not just by default, that it is in a position to conduct audits with regard to its organizational and

operational aspects. Observing or measuring audit assurance is not an easy task. There are various elements, both quantitative or qualitative, that may affect the cost-assurance relation between the costs of audit itself (e.g. audit resources employed such staff or time, quality and quantity of the data under audit, etc) and the quality of the reasoning forming the basis of the relevant judgement that would lead to the relevant decision of the audit institution with regard to the issue under audit. No definitive solution may be provided over the template of the “perfect audit”, but its characteristics may be sought among those that have been proved successful when they conform to organizational options and operational procedures which have stood the test of time (see Power, 1997, p. 28-31).

Further to the substantive aspect of this issue, there have been considerations from a legal point of view, in the EU context, regarding the operation of the ECA, and the credibility of the auditing process. The Court of Justice of the EU has ruled that there are two separate levels of examining the legality of transactions in the context of the EU budget. Its own (judicial) authority refers to the review of the legality of the EU secondary legislation which is the substantive basis of all such transactions, while the ECA’s authority is to examine the legality of expenditure with reference to the budget and the relevant legislative basis i.e. the relevant EU secondary legislation (see C-294/83, *Parti ecologiste “Les Verts” v European Parliament*, [1986] ECR, p. 1339–1373, at p. 1367). The ECA, during its audit operations has to apply the EU primary and secondary legislation regarding the financial management of the Union, including the so called “budgetary rules” provided for in Art. 310 TFEU and the current Financial Regulation, as well as the established auditing standards and practices (see Orsoni, 1991, p. 81-83). Thus, the financial and compliance audits have to meet certain standards, set also by law, in order to be considered as adequate and credible in the context of the ECA’s rele-

vant activities.

Similar issues regarding the credibility and the appropriate nature of the auditing process and the relevant judgements and decisions, have been identified also with regard to the performance audits. It has been noted that the contents of the audits in general are quite popular with the Media as they provide materials that can be presented to the wider public in the effort to inform the public opinion on the use of the public resources (see Skiadas, 2020, p. 42-44). In the case of performance audits, however, their popularity with the Media is of particular interest, due to the relevant reports' contents, which are not of only technical and economical nature but they provide also more general – and thus more accessible and comprehensible for the non expert audience – overviews of the audited issues. The Media have been trying to establish an active relationship with the public audit institutions, but these efforts have not been always successful for reasons that involve the public authorities (auditees), the audit institutions as well as the Media themselves. Such reasons include a well established tradition of secrecy regarding public financial management (usually in the effort of the public authorities to declare their “feuds of power” and to “save face” by avoiding embarrassing revelations), the old (and sometimes obsolete) legislative frameworks on public audit which reflect outdated points of view (e.g. the audit is to serve the authorities in charge), the various phenomena of corruption caused by the lack of proper accountability mechanisms, the absence of bureaucratic performance orientation which makes public authorities (not the political officials) very reluctant of divulging information about their successes of failures in general, and the “criminalization” of politics, i.e. the use of audit produced information for political purposes and gains such as creating impressions and putting forward accusations against politicians, the validity of which is not completely established but is enough to dissuade the electorate from elect-

ing the persons concerned (see Anam, 2007, pp. 102-105).

If one considers carefully these reasons, one interesting point arises: it is the content of the performance audits themselves which cause or at least contribute to the creation of such situations. Their non-economic nature is converted to political, in the eyes of those seeking to learn how their money is collected or spent without, however, knowing the mentality of compiling a performance audit report. And this is perhaps one of the gravest dangers for public audit, especially for institutions such as the ECA that operates in a heavily politicized environment.

More specifically, it could be argued that, at least in theory, enhancing the audit function with non-economic elements, thus providing it with an evaluative role could contribute to the political system's improvement, increasing its stability and its effectiveness. However, such an approach would overlook the paradoxes noted in the actual political and institutional environment, the main one being that the rationalization of the budgetary governance through, *inter alia*, the extension of the public audit scope, would threaten the internal coherence of the political system, as several of its weaknesses would be revealed, and this would actually contribute to the entire system's destabilization (see Gray, Jenkins & Segsworth, 1993, p. 9). Thus, performance audits do not include the evaluation of the purpose selected which is a question of political choice (see Orsoni, 1991, p. 83). This applies to the ECA's performance audits, during the conduct of which the ECA is not entitled to question policy decisions but only to investigate the financial and other consequences of such decisions and their implementation (see O' Keeffe, 1994, p. 188). This deprives the ECA of any legal authority to decide or even to express an opinion on whether the Union should introduce a particular kind of policy and limits its competence only to the production of a report as to whether that chosen line of policy is being con-

ducted in a cost effective way (see Swann, 1995, p. 65). In order to achieve such as a delimitation of the audit's scope, the ECA has to resort to the use of the so called "effectiveness auditing" i.e. auditing that focuses on the extent of goal achievement, the effects and/or effectiveness of the policy as well as the efficiency of its implementation. Such an approach allows the ECA to a) refrain from evaluating policy goals and b) distinguish between goal achievement and effectiveness, as not every goal achievement can be the result of the implemented policy under audit (see Leeuw, 1993-1994, p. 17).

An imperative condition for the ECA to conduct (by employing its judgement and reaching its decisions) its performance audits properly in the above mentioned context of effectiveness auditing, is that the political authorities have set clearly the objectives of their selected policy (see Lelong, 1983, p. 105). This is done by accompanying all appropriations in the budget with a commentary in which there is an analysis of the legal basis of the respective expenditure, as well as a statement of political aims or a reference to an act of political context, like a resolution (see Dashwood, 1996, p. 126).

More specifically, the audit of financial management, in practice the analysis of the relevant systems, consists primarily of assessing the results or efficiency of the activities. Among the criteria for the assessment of these results, an essential element is the reference to the general goals set by the political authority and to the specific targets imposed on the organization by a higher authority or set by the organization itself. In so far as these goals and targets are clearly defined, the assessment of results will consist essentially of assessing how far the results were in accordance with the goals and achieved the targets. The assessment of results or efficiency pinpoints a number of shortcomings or weaknesses (results contrary to the goals and targets, results falling short of the targets). This method is a modernized form of the classical 'cost/benefit' or

'cost-effectiveness' analyses. Whereas, however, these analyses apply, case by case, to the specific elements of management activity, the ECA, when assessing a financial management, must satisfy itself not only that, in the cases examined, the relationships between inputs and outputs are the best possible, but also, and above all, that the management systems and procedures, whether defined by legal provisions or worked out by the managing bodies themselves, are constantly aimed at achieving soundness of financial management and do attain them at each stage of implementation of a policy, measure, programme or plan (Strasser, 1992, p. 279).

If such an arrangement is not achieved, the audit of economy and efficiency cannot draw the necessary attention to misuse of resources, while effectiveness in achieving policy aims cannot be judged (see James, 1984, p. 476). The less precise is the auditee in defining its objectives, the more difficult it is for the auditor to distinguish between questioning the merits of policy objectives (which falls beyond the limits of audit) and assessing whether value for money has been achieved in the pursuit of those objectives (see Harden, White & Donnelly, 1995, p. 615). This is a very "delicate" issue as the ECA's mandate refers only to the financial management of the Union's resources and even the hint of the ECA "overstepping the mark" by indirectly dictating policy decisions, based on its findings, would lead to a political positioning of the ECA, thus threatening its credibility as an independent auditing body (see Skiadas, 2000, p. 24).

An interesting variation of this issue refers to the audit of medium to long-term budgetary programming. More specifically, it has become practically common ground for all states to prepare medium to long term budgetary frameworks in which various categories of revenue and spending are provided for. Such an approach, known as "packaging", is used in order to provide an idea of future estimates and ceilings of revenue

and expenditure but, at the same time, it allows for a common treatment of all calls at the public purse, shifting the focus to the demand of spending increases rather than cuts. And this is made on the basis of the quantity of resources available, not the qualities of the policies to be funded, attributing more significance to the question “how much is spent?” than to the question “what is it spent on?” and allowing greater discretion in spending (see Wildavsky, 2002, p. 256-258). Thus the comprehensiveness of the budgetary documentation is reduced. This has been further justified by the conclusion reached by some that it is much more effective to control expenditure, in a complex budgetary governance system, by affecting the demands of public resources at their source than by setting up and applying a strict, extensive financial control system, leading to sanctions (see Wildavsky, 2002, p. 352). The EU has formally adopted this approach by establishing in Art.312 TFEU the Multiannual Financial Framework as a mechanism of ensuring that EU expenditure develops in an orderly manner and within the limits of the EU own resources. The ECA has taken advantage of the general clause regarding the scope of its audit mandate, as provided for in Art. 287(4) TFEU (“[...] *The Court of Auditors may also, at any time, submit observations, particularly in the form of special reports, on specific questions and deliver opinions at the request of one of the other institutions of the Union*”), and has provided remarks and observations (initially to the Council of the EU and the European Parliament, as EU “co-legislators” comprising the budgetary authority) on the European Commission’s proposal for the Multiannual Financial Framework of the period 2021-2027. The ECA’s comments referred to four specific aspects: a) the process of setting spending priorities based on strategic considerations, b) the flexibility of the EU budget and the proposed allocation of funding, c) the simplification and performance orientation in spending programmes and d) the accountability arrange-

ments, while at the same time the ECA stated that it is not its role to assess the proposed political priorities or allocation of funding in the new MFF (see European Court of Auditors, 2019c, p. 6).

In a more general context, it has been noted, however, that such policy audits, i.e. examinations of whether political programmes are appropriate from a financial perspective, could be performed by the public audit institutions. Large-scale policy programmes (such as foreign policy) or projects (such as an event of global reference e.g. Olympic Games) usually fall formally beyond the scope of performance audits. It has been suggested to grant the authority of policy audit to public audit institutions to examine how a ministry manages, for instance, a crisis situation, or to review whether a large scale project has achieved its anticipated financial success, or to focus on other time-limited projects with specific policy goals (see Grönlund, Svårdsten & Öhman, 2011, p. 111 and the references there in.)

This suggestion, although challenging, is not in conformity with the constitutional arrangements of at least the EU and its Member States, as it will lead to the formal dispute of the political decisions of elected officials by a non elected mechanism, such as the public audit institutions, a development that may challenge the democratic legitimacy template of the political choices. In general, performance audits are not (designed to be) concerned with the determination of general policy, the responsibility for which lies with the elected officials, in the executive and the legislative branches of government. On the other hand, how policy, once determined, has been carried out must be officially scrutinized. The performance audit efforts are directed towards ensuring that good judgement is exercised by policy makers in establishing the objectives regarded as providing value for money, meaning that values most appropriate to the situation have been recognised. Policy makers have to specify what in their view must be provided as the

more appropriate reflection of the values desired by their own particular community in the light of resources available to provide them and, once these values are specified, to ensure that those particular requirements are met. Identifying values (and the resulting policy objectives) commonly accepted in a community is very difficult, especially when it comes to providing quantitative aspects to them such as their monetary worth. Similar difficulties are identified with regard to the perspective of a policy. Usually a policy which produced results at the short term is more preferable by the policy decision-makers as they will be in a position to enjoy political gains while a policy with more long-term results, even if it is accepted by the community, will not be popular among the elected officials due to lack of timely political benefits. A performance audit will not determine the conditions of political opportunism. It needs, however, the establishment of clear aims that will be used as criteria against which the outputs of the policies will be compared and judged (see Glendinning, 1988, p. 47- 48)

A final issue refers to the performance of the audit itself. Despite the public audit's critical role in enforcing accountability through its functions, it must be noted that there are considerations regarding its performance. Such considerations are based both on the human nature of the audit's function, as well as the institutional and operational limitations identified in several cases.

As a human activity, an auditor's judgement may be influenced by various factors. Three such categories have been identified: task factors, environmental factors and personal factors. The task factors consist of the composition of information, the relevance of information and the complexity of the tasks. Environmental factors consist of pressures, feedback, regulations and standards while personal factors consist of knowledge, skills, abilities, gender, culture and moral development. Within that context, it has been found that performance

incentives (such as financial incentive in the form of bonuses) increase the performance of audit judgement, and the same applies to the obedience pressures (from persons with superior authority), whereas the ethical perception has no effect on audit judgement (see Nugrahanti & Jahja, 2018, p. 225). Such findings cast doubts on the overall performance of public audit schemes as they may lead to the loss of professional culture and attitude on behalf of the auditors, as well as the loss of public confidence and of social credibility for the audit scheme.

Furthermore, at the institutional level, it has been found that the institutions which are responsible for public audit, on some occasions, are not created by legislation providing them with adequate independence and freedom from executive interference. Even in cases in which there are sufficient auditing mandates for the public audit authorities, they may lack the additional investigative powers to enable them to follow-up on apparent violations and support the prosecution of relevant agencies or individuals. Similarly, there are public audit institutions that do not have adequate powers to decide what should be audited or how the audit findings should be presented. Also the lack of skilled staff to perform the tasks of financial/compliance audit as they have evolved till now or the tasks of performance audit that set challenges for the traditional audit understanding is a significant drawback. The financial constraints on public audit authorities are not negligible, depriving them from adequate infrastructure and equipment to conduct effectively their work. The audit reports' impact is, sometimes, a victim of the time constraints of the reports' recipients, thus the most critical findings contained therein are not taken up by the proper political, administrative or even judicial authorities (see Ramkumar & Krafchik, 2007, pp. 26-27).

These drawbacks are even more obvious in regimes with little or no political competition. Political competition indicates the strength of opposition that a politician expects to en-

counter in future elections and it increases the long-run costs to politicians for ignoring pre-election agreements. The public audit system under normal circumstances, in a democratic tradition, is intended to act as an independent provider of assurance with regard to the veracity of the audit reports and their contents. The lack of political competition distorts this aim as it refocuses, formally, the public audit's operation on the fight to protect the state's financial interests against fraud or corruption. Thus the assurance on the audit's performance is provided to the government, not the people of the state, or any other interested party. The audit thus acquires the characteristics of internal audit, limiting its scope to managerial and compliance issues, and the reports refer to low level managerial accountability but not to high level managerial accountability or even political accountability with regard to the management of public resources, thus reducing their credibility (see Mir, Fan & Maclean, 2017).

Such a scenario is not possible within the EU as the ECA is by definition the external auditor of the EU, and due to its institutional positioning outside the political developments of the EU, it is empowered to provide the assurance on the reliability of the accounts and the legality and the regularity of the underlying transactions, as well as to verify the adherence of the principles of economy, efficiency and effectiveness, in pursuit of the soundness in the EU budgetary governance.

Conclusion

The financial crisis of the 2008-2012 period, as well as the subsequent fiscal austerity policies adopted throughout the EU, and globally, have highlighted the importance of the public audit, in terms of the audit scope and the audit institutions' independence. The introduction of the New Public Management concept in the 1980s had given an expanding boost to the public audit's remit, by introducing the performance or value for money audits and by increasing the demand for accrual-based financial reporting. Now there is a mixed outlook, as there are those expecting public audit institutions to be bloodhounds, not just watchdogs, i.e. to develop even stricter audit methods and even to acquire the authority of imposing sanctions (in some EU countries there are such public audit institutions but not the ECA), and there are those who wish to limit the public audit space through curtailing audit activities, outsourcing of large segments of certification audit to the private sector, and expressing increased resentment of performance auditing as incompatible with the conditions created by the unprecedentedly long period of fiscal austerity, which has reduced the public authorities' financial capabilities (see Heald, 2018, p. 332).

In such a context, the public audit function, even in the EU, has to consider its evolution. A possible starting point is to become more relevant, i.e. to be seen as an institutional actor with its own added value in the democratic regime within which it operates. One way to do that is to seek to improve the dissemination effects of its findings as objective results of a well documented and methodologically proper audit procedure. Thus, the two main accountability components in auditing have to be balanced: the focus should not be only on measuring how a particular public authority is functioning, but also on infor-

ming the public of what has been found. And this information should not be subjected to compromises but to allow anyone interested to formulate a valid picture of the actual situation of the issue or organization under audit. Yet, given that the public audit, both at institutional and operational terms, cannot be insulated from the wider political environment within which it exists and operates, caution must be exercised in avoiding any sort of affiliation to political partisanship, as this would nullify the public audit's greatest asset, its independence (see Chelimsky, 2007).

The public auditors' independence and the objectivity stemming thereof, are being challenged when the audit entails performance evaluations which may rely on subjective approaches with regard to data collection and analysis. The conclusions reached in such a procedure are easier to challenge since they may be indicated by the auditees as being based on outdated evidence and erroneous understanding of the auditees' objectives, especially when a change of the persons who are politically responsible has occurred, usually after an election process (see Heald, 2018, p. 332). Furthermore, in the context of continued austerity and divisive arguments about the size and scope of the state, as these have dominated the agenda of public discourse and political action, at EU level as well as at global level, during the last two decades, the relevant public audit institutions (including the ECA) need to re-examine their position and function within a public policy space characterized by intensive challenges by other actors of the relevant institutional landscape, one of the main tendencies being collibration, i.e. a biased approach against the balance reached between public audit institutions and auditees. There are direct or indirect efforts to change the jurisdictional features of public sector auditing, such as the public audit's institutions independence from executive government, their competence to reach and write their conclusions without interference from

other political or institutional actors, their investigative rights with regard to the collection of audit evidence, the size of the public audit institutions' staff or their remuneration, all these that could affect the quality of public sector audit (see Bourn, 2007, p. 358).

The reaction of the public audit institutions (including the ECA) against such aggressive “pushback” and marginalizing initiatives from the executive branch of government or any equivalent schemes, is to ensure the independence and quality of its core activities, and to resist extensions of scope that might compromise its reputation and independence. For instance, it would be erroneous for the public audit function to seek imitation of the instant judgements of the various commentators and the social media. Seeking to be seen as “relevant” in the current reality is understandable, but it should be done with extreme caution as the danger of changing status from an authoritative actor to just another commentator would diminish not only the public audit's prestige but also its credibility, its special institutional weight and, at the end of the day, its added value in the current institutional arrangements (see Heald, 2018, p. 332).

Also, seeking new institutional roles is something that public audit may pursue in the interest of improving the quality of the public sector within which it operates. Public authorities are fundamentally bureaucracies – hierarchies operating by rules – and hence are more inclined to look inwards to processes and procedures, than outwards to results and outcomes for those whom they have the duty to serve. Traditionally, public sector audit, valuable as it could be, through its independence from organisations, and the authority and objectivity this bestows, reinforced the tendency to look inwards by its concentration on seeing that rules and procedures were obeyed and money spent according to them (financial and compliance audits). Thus the focus of audit was on cataloguing failure (es-

pecially detection of fraud and waste of public money), but a mere inventory of failures is not a useful guide, unless it is supplemented by a proactive approach identifying, analyzing and encouraging the successes in the public sector. This entails a new role for public audit, which focuses on entailing coaching and mentoring for the future, not just criticizing for past failures, as this would make the recommendations resulting from the audit process more instructive (see Bourn, 2007, p. 1).

Such a role relies in the quality of the “instructor”. Public auditors (including the EU auditors) are deemed as leading adjudicators, for which they claim expertise and have access to evidence (see Heald, 2018, p. 332). Their departure from an important yet narrow activity, entailing the study of documents and procedures in order to find evidence of broken rules, fraud, corruption etc, towards the use of performance auditing tools and methodologies (such as efficiency measures, cost/effectiveness, targets, governance arrangements, etc), expanded significantly the scope of their work. The danger which is hidden in that development lies with the political aspects of the element of performance audits, and the auditors being lured to allow their work being seen as political. This would rebrand the public audit function as a mere criticizing and complaining operation, eliminating its coaching and mentoring aspect. Yet these two latter aspects are at the core of the public audit’s contribution to the improvement of the provision of public goods and services to their lawful recipients (see Bourn, 2007, p. 364-365)

Thus public audit institutions should maintain their distinct roles from other public authorities, even in cases that their advice is required and provided, such as accounting systems implementation or antifraud measures. This is not just a necessity deriving from the above considerations, but also a democratic requirement, relevant to the legitimacy of all public activity. In a similar approach, the public audit institutions, although

working closely with parliamentary institutions and committees (and, on some occasion being accountable to them), must maintain their independence from the political agendas pursued in the parliamentary environment (see Heald, 2018, p. 332).

All these considerations are applicable in the EU context. As Europe faces ever greater challenges and increasing pressure on its public finances, the role of the European Court of Auditors is of increasing importance. The ECA warns of risks, provides assurance and offers guidance to EU policymakers on how to improve the management of public finances by increasing its soundness. At the same time the ECA provides information in order to ensure that Europe's citizens know how their money is being spent. This is the essence of the ECA's contribution to strengthening the democratic legitimacy and sustainability of the EU budgetary governance.

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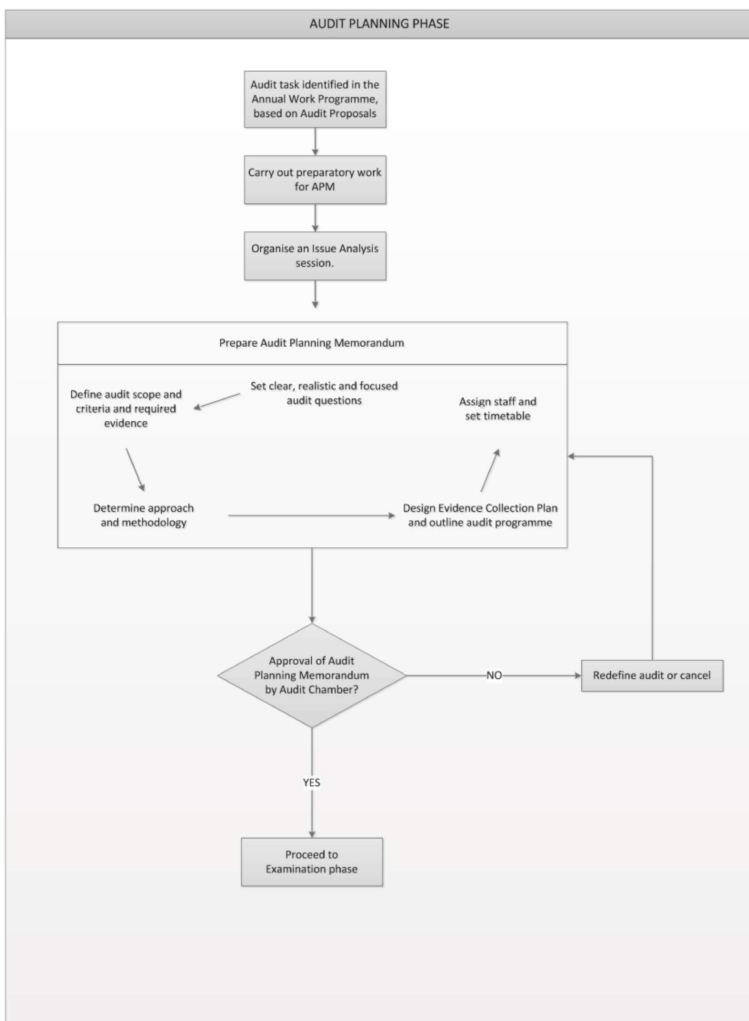
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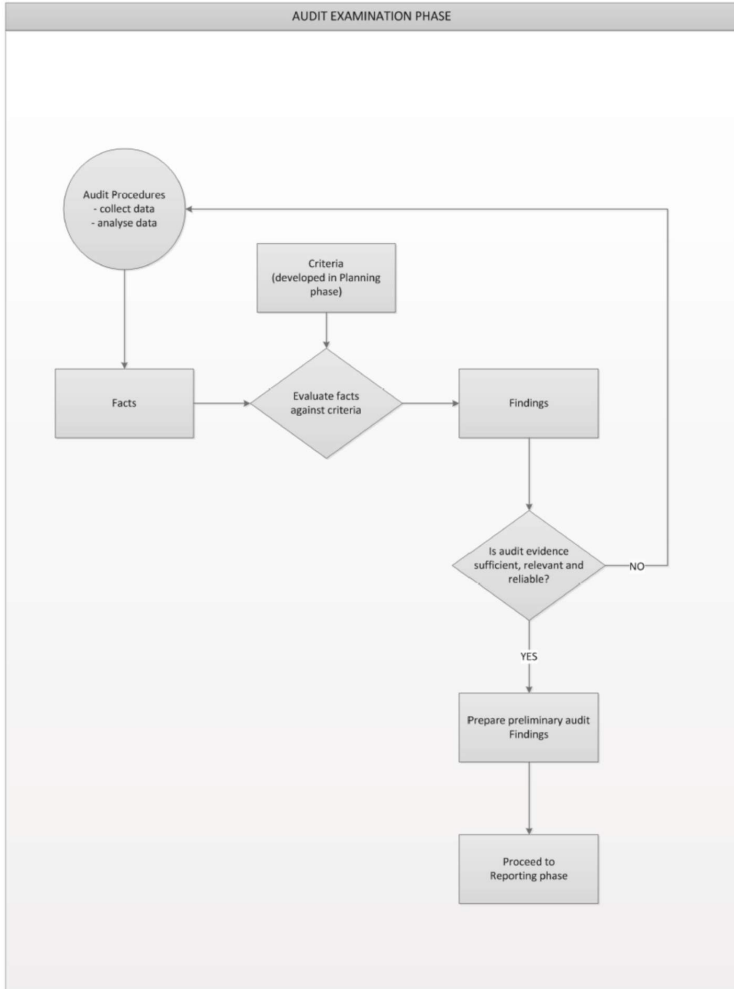
ANNEX

I. Audit Planning Phase



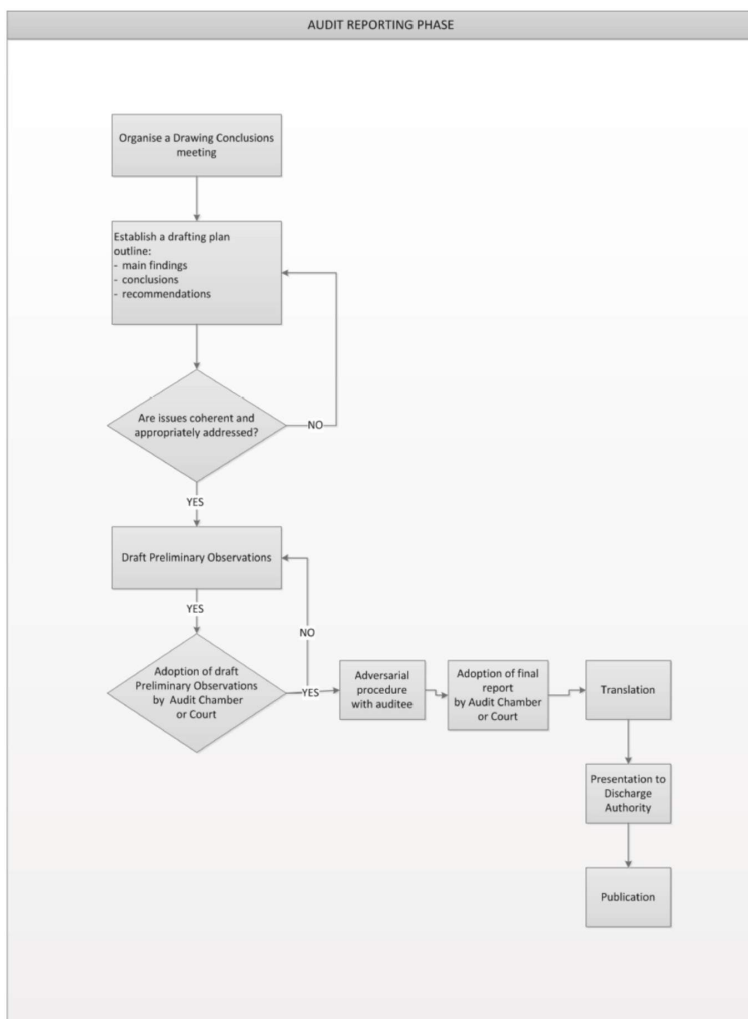
Source: European Court of Auditors, 2017b, p. 31

II. Audit Examination Phase



Source: European Court of Auditors, 2017b, p. 57

III. Audit Reporting Phase



Source: European Court of Auditors, 2017b, p. 72

The book aims to be a point of reference with regard to the national and international bibliography on EU Budgetary Governance and Audit. It will entail a thorough analysis of the entire institutional and legal framework of the audit function, within the overall system of EU Budgetary Governance. The 1999 developments and their subsequent political and institutional options on EU governance, as well as the Lisbon Treaty have established several schemes pertaining the management of EU funds, and the corresponding audit schemes. Furthermore, the EU's response to the financial crisis lead to new schemes of providing financial support to Member States, establishing new lending mechanisms and using the EU budget as collateral. These new arrangements form significant challenges for the EU's Audit institutions at all levels. The books will seek to establish that all these activities and the relevant transactions are being audited in an appropriate and efficient manner, and to examine whether these audit schemes are actually in a position to provide a substantive assurance on the soundness of the EU Budgetary Governance. The entire analysis will seek to establish the legitimacy of EU Budgetary Governance in the weberian perspective (traditional, charismatic and rational-legal legitimacy).

Given the extent of the EU's audit schemes, the book will comprise three volumes.

The third volume will focus on the comparison between the classic/traditional types of audit (financial and compliance audit), as these types have been maintained in certain EU member states as the sole audit method, and the performance (value for money) audit, used by the European Court of Auditors and other national audit institutions as additional audit method. This comparison will help identifying the more suitable type of audit (including the possibility of combining their elements) taking into account the nature of the transactions and policies to be audited.

