



JOINT ICAEW-PWC SERIES ON SUSTAINABLE PUBLIC FINANCES – EU PERSPECTIVES

Restoring trust in public finances – the value of audit insights

Summary of discussion on 15 February 2016



Introduction

The financial and economic crisis has inevitably increased scrutiny within the EU of public finances, not surprisingly given that public expenditure accounts for almost half of GDP on average across the EU.

As fiscal leeway is limited in many member states by the level of public debt and budget deficits, unparalleled attention has been drawn to the use of public money, with particular focus on value for money as well as on regularity and legality of expenditure, all within a wider debate about public reporting and democratic accountability.

The joint ICAEW-PwC initiative Sustainable Public Finances: EU Perspectives started in 2013 and is designed to address a wide variety of public sector financial management and accounting challenges. We do so by drawing constructive insights from a variety of perspectives and from a range of different stakeholders to help move the EU's accounting reform agenda forward in the interest of achieving more robust public finances.

On 15 February, we organised the seventh informal dinner debate in our series, focused on the value of audit insights. The debate brought together high-level participants from different backgrounds to enhance understanding of how audit, as part of a holistic financial management approach, can enable Europe to restore citizens' trust in public finances.

This brief summary seeks to capture the key elements of the discussion to encourage feedback and further development of the ideas raised. It aims to inform other key stakeholders who have an interest in the overarching theme of sustainable public finances in Europe and who may wish to contribute to the next discussions taking place in late 2016.

We would be delighted to receive your comments on the summary, please send them to:

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Restoring trust in public finances – the value of audit insights

Independent audit to enhance the reliability of financial information is a critical building block for improving democratic accountability and trust in public sector financial management. This is not new – indeed Aristotle saw the value of audit in the public sector for functioning democracies, writing that where ‘offices handle the public money, there must of necessity be another office that examines and audits them’. There is a great deal to be gained from exchanging public sector audit experiences from across the EU on how this role can be best played. The debate on 15 February generated important insights from the perspective of key EU and national stakeholders as well as practising auditors, drawing from member state experiences and considering the European Court of Auditors’ (ECA) role in relation to the EU budget.



It doesn't matter if local, regional, national or EU funds are mismanaged – it is all taxpayers' money which needs to be protected

Effective public scrutiny in the interest of EU citizens

The ECA's annual report on the EU budget tends to generate considerable media attention and discussion about the proper and effective use of EU funds. One of the main tasks of the Luxembourg-based auditors is to audit the budget in terms of revenue and spending. The lion's share (about 80%) of the overall EU budget of approximately €45bn/year (2015 figures) is spent under what is known as ‘shared management’, with individual EU member states distributing funds and managing expenditure. This requires close cooperation between the ECA and national audit institutions as well as between national and EU parliamentarians, to ensure democratic control at all levels in the best interest of all EU citizens. However, while there is a good cooperation between audit institutions, there appear to be some shortcomings in the cooperation between parliaments to the detriment of effective public control. A more collaborative system of scrutiny between EU and national parliamentarians may be needed to close this gap.

The degree to which national and European-level audit functions succeed in promoting an overall culture of continuous improvement in financial management clearly depends on the support of elected politicians. This is why auditors have an interest in strong and engaged parliaments. Equally, parliaments have an interest in strong and independent auditors which can draw unbiased attention to financial management issues. At stake are opportunities to increase efficiency, address financial management shortcomings and detect major risks to the public purse. Open communication between auditors and parliamentarians can ensure that both work towards the same objective.

But the extent to which audit findings encourage not only EU institutions but also member states to ‘learn from past mistakes’ and derive full value from the audit process also depends on wider public scrutiny and pressure, which could be encouraged by the media. One could see the wider public as ‘armchair auditors’ and there are

interesting models emerging across the EU to get the public more involved, for instance by making it easier to access information on government finances through open data platforms.

While the ECA's report often generates headlines, national findings sometimes seem to attract less public interest. The reasons for this differ across the EU, but experience from a number of member states suggests that a strong communication strategy is central to increasing public engagement. In the best scenario, however, low levels of public interest in auditors' findings can also be a reflection of insignificant error rates and good performance.



When you change the approach, you don't change reality within one day, but you change the future direction'

Measuring value for money performance

Another key issue from the perspective of auditors is achieving better value for money in the public sector. In its latest annual report, the ECA called for a 'wholly new approach' for investing and spending in the EU. At the centre of this approach is a proposed shift away from focusing solely on compliance towards a model that places greater focus on the results of the public expenditure. Performance audits are integral to this approach, as they can help policymakers and the wider public to assess whether money is spent in a worthwhile way.

A performance audit is an independent, objective and reliable examination of whether undertakings, systems, operations, programmes, activities or organisations are operating in accordance with the principles of economy, efficiency and effectiveness, and whether there is room for improvement. They can provide valuable insights on financial performance of governments and thereby complement compliance audits, which focus on legality and regularity, examining whether all revenue has been received and all expenditure incurred in a lawful and regular manner.

Echoing the auditors' call for a stronger focus on outcomes, the European Parliament's Budgetary Control Committee (CONT), which is responsible for the democratic oversight of the budget, has increasingly pushed for visible benefits for EU citizens. The independent expert assessment carried out by auditors, including of performance, is a powerful tool in the hands of EU and national parliamentarians and key to greater democratic accountability. Recognising this potential, the European Commission is now planning to put stronger emphasis on performance in an attempt to further step-up EU financial performance. The recent initiative **EU budget focused on results** can be seen as part of this wider effort.

Many EU member states are also increasingly interested in benchmarking information that can help to create a culture of sound financial management in the public sector, for instance through greater use of key performance indicators (KPIs). The danger of indicators, however, is that they can be driven by a political agenda.



There is no meaningful comparison if there is no set of harmonised accounting standards

Audit, financial information and comparability

To reap the full benefits of the audit processes at EU and national level, member states need to have the right systems in place to provide and process reliable, comprehensive and comparable financial information. Ultimately, with financial matters, an auditor can only be as effective as the accounting standards he/she audits against.

Broad agreement on the need for more comparable accruals-based accounting in the public sector throughout the EU is a main driver behind an important EU reform project, initiated by Eurostat, the EU statistical arm, which seeks to achieve greater harmonisation of accounting practices across all the 28 member states. This could be achieved by using similar high-quality accounting standards, such as International Public Sector Accounting Standards (IPSAS). Eurostat is currently encouraging individual member states to move to accruals accounting. The reform's success will be central to EU financial stability aims, allowing greater cross-border comparison and assessment of member states' financial performance. Auditors can make important contributions during the reform process, for instance during transition towards accruals they can accompany the process and support preparers by acting as a sounding board. Auditors can play a role in assessing enforcement of standards and help to improve the exercise along the way.

Moving the EU reform debate forward requires strong political support at EU and member state level. In the European Parliament, the Economic and Monetary Affairs Committee (ECON) is the lead committee, but has only shown limited involvement to date. In contrast, the Budgetary Control Committee (CONT) is very keen to generate momentum and is getting increasingly engaged in the discussion. The committee benefits from high quality accruals-based financial information that the European Commission provides on a regular basis and therefore knows the advantages from first-hand experience.

Generally, policymakers and the media tend to be more focused on budgets and future spending priorities. But in order to have a meaningful debate on what can be afforded in the future, governments must have a clear understanding of their current financial situation. Financial statements can provide this deeper insight into how much of the budget has already been committed by disclosing future liabilities. As in the private sector, the credibility of government financial information needs to be ensured through the work of independent audits, which provide an opinion on the 'true and fair view' of financial statements.



Better standards are only part of the solution; skills, ethics and integrity need to form part of the wider effort to enhance public financial management

Ethics and integrity – the role of auditors

The qualifications and ethics of senior finance professionals in government administration play a key role in this context. How can we expect junior and mid-level public servants to act with integrity if the leadership does not behave accordingly? The role-model function of senior officials cannot be underestimated. To live up to these expectations, the right training and skills are required. It is also important to admit mistakes and learn from them. This requires the right processes to identify issues and structures to promote change.

A system of strong audit institutions and high quality accounting standards is essential. They can provide the necessary backup, for instance in committee hearings or for senior officials. As such, auditors also have an important function in maintaining discipline and integrity across finance functions in government. They can support public servants by providing the rigour that is needed to withstand pressure.

There are many other structural elements which are important for good public financial management eg, clear lines of responsibility and accountability, transparent reporting and auditors who engage with the wider public. There are good examples across the EU of supreme audit institutions engaging with media. The timing and choice of audit topics can also play a role in increasing interest.

It is important that member states learn from each other's experience and share best practices on these topics, for instance through platforms such as the EU Public Internal Control network (PIC). The Commission launched the PIC network in 2012, responding to a demand from member states to have a regular exchange between administrations on internal control issues. The initiative aims to improve public sector governance structures across the EU to meet the challenge of achieving more with less. The PIC network, made up of the European Commission and internal control specialists of all 28 EU member states, meets regularly and has produced several papers which are **available** to the public. Nearing is the role of the Contact Committee of the EU SAIs – a forum for collaboration of the national audit institutions and the ECA. It fosters the exchange of professional knowledge and experiences on the audit of EU funds and other EU-related issues, it provides mutual support and initiates and coordinates common activities in the EU field. **The Contact Committee** promotes contacts and exchanges information with interested others. Similar platforms could be helpful in other areas as well, to strengthen cooperation and promote best practices.

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