

## AUDIT AND INTERNAL CONTROL INDISPENSABLE TOOLS IN SUCCESSFUL IMPLEMENTATION OF EU PROJECTS

**Lilian ONESCU**

Secretary General – National Agency for Fiscal Administration  
lilian.onescu@anaf.ro

**Abstract:** *The last years have brought a significant dynamic at the European Union level, in a domain that is still under a consolidation process – the territorial cohesion. EU objectives are based on the concepts of a balanced, coherent and harmonious territory development, in terms of economic and social activities, in terms of environmental quality and accessibility, and also in terms of the existence of equitable living and working conditions for all the citizens, regardless of the place they live in. European Union's objectives are achieved through the successful implementation of projects, which, although at first sight are seen to be independent, in fact, their results lead in a bigger or smaller proportion to achieve the major proposed objectives. However, in order for each project to achieve its expected results, it must be permanently monitored and controlled, primarily by the beneficiary. The lack of internal controls or the incorrect application of its principles is one of the main risks leading to non-compliance with the contractual requirements of projects funded by the Structural and Cohesion Funds. The aim of the work focuses primarily on clarifying the importance of the control system, focusing on internal control in European projects and raising awareness of stakeholders about this need. The research focused, on the one hand, on the systematization and synthesis of the concepts contained in the literature and the legislation in the field; as well as the qualitative and quantitative research of the irregularities identified in the implementation of the projects with non-reimbursable financing.*

**Keywords:** *audit, internal control, European funds, projects with European funding, standards*

**Classification JEL:** *F36, F43, M42*

## **1. Introduction**

Today more and more organizations base their work on development projects, even the European Union's objectives are achieved through the successful implementation of some projects which, although at first sight are seen to be singular, in fact, their results every lead in a bigger or smaller proportion to achieve of the major objectives proposed for each programming period. The EU's regional policy is based on transfers of funds from rich to poor countries in order to encourage development in regions lagging behind, to support the professional insertion of young people and long term unemployed, to revitalizing declining industrial areas, to modernize farming and to help disadvantaged rural areas, protecting the environment and preserving natural resources.

Audit activity is the basis of integrity, ethical values and behavior of employees, it is found in the philosophy and style of the management of operations, in the assignment of responsibilities and authority, and last but not least in the company's organization and development system employees.

Control system performance is assured by efficiency, effectiveness, economy and quality and aims the management of risk, ongoing assessment of the public entity's control system and ensuring a high level management.

Therefore it is important that, from the conceptual stage, after each step or stage of the project to provide for a phase control enabling decision-making imposed by practice. Their remediation cost is even greater as are identified later.

## **2. Control of project beneficiaries**

### ***2.1. Internal control at the level of project beneficiaries***

Internal control is a set of procedures (accounting or otherwise, depending on the type of the project and beneficiary organization) or a system designed to promote the implementation efficiency, avoiding fraud and error. The control system is defined by the organizational structure of the project beneficiary, the integrated processes (human resources, management structure, etc.) and aims to support the achievement of project scope and objectives.

The absence of the internal control system or the incorrect application of its principles is one of the major risks for the effective and in accordance with contractual requirements of projects financed through the Structural Funds and Cohesion.

The principal models of internationally recognized internal control designed for organizing the internal control system, in order to respond risk management requirements are:

- **The COSO model** - SUA;
- **The COCO model** - Canadian.

**a. The system by internal control / management - COSO model**

COSO model, an integrated approach on internal control (Internal Control Integrated Framework), launched by the European Commission in September 1992. The model name comes from the report of the COSO (Committee of Sponsoring Organizations of the Treadway Commission's Committee of Sponsoring Organizations)<sup>1</sup>.

The COSO comprises five stages which are integrated management process to improve the quality of the activity of the entity, to prevent losses and ensure a rapid response to changes occurring in the system:

- **The control environment within the organization:** establishes the system of internal controls by providing a structure and general subjects. It also sets out a series of principles such as integrity and ethical values, employee skills, management philosophy and style of application, human resources development and management directives.

- **Risk Assessment:** involves the evaluation and analysis made by management, not by the internal auditors, the risks that may affect the targets

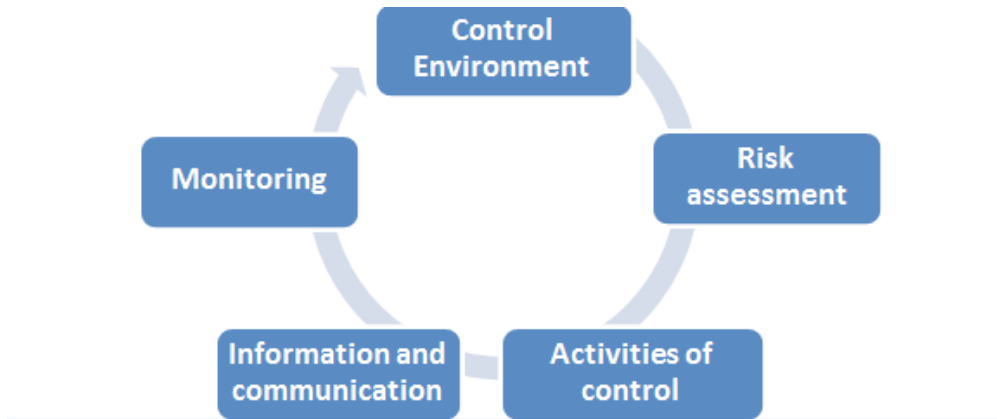
- **Control activities risk:** policies, procedures, controls and other practices which aim is to ensure that the objectives set by management are achieved and possible risks are addressed. **Information and communication:** supports all other components of COSO by communicating to employees the responsibilities for control and providing information in an appropriate and timely format.

- **Monitoring:** involves overseeing internal controls by management, overseeing the process from other external members (internal audit, monitoring bodies, etc.), or the application of methodologies or procedures independent of the type of standard questionnaires completed by employees of the internal control process.

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<sup>1</sup> In 1985 Senator Treadway, established „The Commission Treadway” (known as by National Commission Against Reporting Fraudulent) which had as main objective the analysis of causal factors that lead to fraudulent financial reporting done by companies in the United States. Following the recommendation of this committee was formed Committee of Sponsoring Organisations. Committee brought together specialists in internal and external audit, internal control have developed work - Internal Control Code, to demonstrate that the internal control activity has no direct connection with the inspection and verification activities

Figure 1. The five components of the COSO model



*Source: own processing*

In his work „Theory and practice of internal auditing,“ Jacques Renard (2002) shows that the 5 elements of internal control in the COSO model, internal audit could be added, motivation based on the fact that the internal audit contributes to the improvement of internal control systems, however, without exempt entity management obligations and responsibilities regarding the discovery and prevention of fraud and errors in the system.

Today COSO model is increasingly applied more structural funds management due to its applicability in increasing organizational efficiency in terms of managerial, financial and human resources.

### **b. The system of internal control/the managerial - The COCO**

It was developed in 1995 by the Canadian Institute of Chartered Accountants (CICA) is composed of the same elements as COSO model, but otherwise grouped.

According to the Canadian Institute (COCO) - Internal control means all elements of an organization (culture, structure, processes, tasks and resources), which helps the staff to achieve the organization’s objectives.

According to this model the personnel responsibilities is based on:

- The ability and skills that employees have (you can do);
- Understanding of job duties and objectives to be achieved (to know what to do);
- Wishing to accomplish tasks correctly and on time (to want to do);
- Performance monitoring and environmental monitoring to learn to adapt to change (adapt to change).

COCO model is considered by experts as the weak model for control, although it is more formalized than COSO.

Making a parallel between the two internal control models we can say that:

- according to the COSO model, internal control:

- is a process implemented by all employees of the entity;
- it has a relatively providing reasonable assurance regarding the achievement.

achievement.

- according to the COCO model, internal control:

- it creates a greater emphasis on the means implemented than employees;
- it has an indicative character, not give absolute assurance considering that „helps achieve the objectives.”

In Romania, specific legislation system of internal control / management include:

- Minister of Public Finance Order no. 946/2005, (2005) republished in 2012;
- Government Ordinance no.119/1999 (1999) on internal control and financial control;
- Government Decision no. 48/2015 on the establishment of management and control system for managing the funds granted to Romania by the Multiannual Financial Framework 2014-2020, in the field of internal affairs.

## ***2.2. The external control system of beneficiaries of non-reimbursable funds.***

In Romania, external audit is performed by the Audit Authority (AA), in accordance with national and european audit authority. The Audit Authority is an associate of the Court of Accounts, without legal personality, operationally independent of the Court of Auditors and, at the same time, independent of the Managing Authorities and Certifying Authority (Law no. 200/2005).In field of fight against fraud and / or irregularities, the national institution is the **Fight Against Fraud Department (DLAF)** (Emergency Ordinance no. 66, 2011), the body that cooperates with European Anti-Fraud Office (OLAF). Anti-Fraud Department ensures the protection of EU's financial interests in Romania, cooperate with OLAF anti-fraud coordinate activities nationwide that perform spot checks for projects financed from European funds.

At the level of Management Authority the control system includes:

- Ensuring the correctness of operations financed through operational programs and the implementation of internal controls in accordance with the principles of sound financial management and transparent;
- Ensuring that procedures for keeping an adequate audit trail;
- Conduct spot checks;
- Monitoring and verification by the Intermediate Bodies training a separate accounting system;
- Providing information on funds absorption;
- Validation and submission to the Paying Authority verified cost claims and requests for funding;
- Submission to the Paying Authority reports on the recovery of unduly and those unused.
- Making financial corrections, etc.

### ***The control system in the European Union:***

In most European Union states there is an internal audit function, but it does not necessarily cover all institutional areas. The main objectives of the audit targets a relevant coordination and harmonization. Compliance supplemented traditional financial audits are becoming more advisory services and performance audit which employs a staff of internal audit professional and well trained. Regarding external audit, in the EU Member States there is a permanent and complex working relationship, between entities which run public internal audits and those who run external audits. This relationship has developed over time, in some countries it is officially entered in laws and regulations, but in all cases even initiative is based audit organizations to avoid duplication of work and facilitate the process in terms of auditees.

### **3. Romania, net beneficiary of European Union membership**

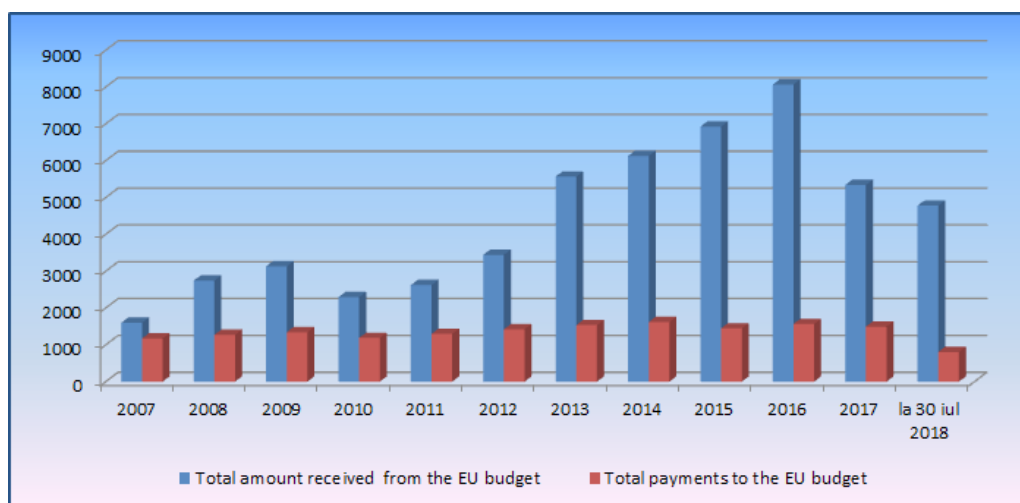
European Union is one of the most prosperous economic areas in the world. However as we point out, there are certain disparities regarding the productivity and prosperity between member states which may lead to major structural weaknesses. Since the integration, in May 2004 and January 2007, of the new 12 member states such disparities have become even more striking. As a result, European funds do not represent an inward purpose, but instruments in reaching the objectives established at the level of the European Union, of the EU member state, based on the implementation documents. Given the communitarian budgetary limits, obtaining the favorable effects of the

cohesion policy must be also supported by an integration strategy providing the cohesion of the national and communitarian policies for the purpose of achieving a balanced development in the Community.

Almost 12 years, after joining the European Union, Romania is one of the 18 member countries (Poland, Romania, Greece, Hungary, Czech Republic, Spain, Slovakia, Bulgaria, Portugal, Lithuania, Croatia, Latvia, Estonia, Ireland, Slovenia, Malta, Cyprus and Luxembourg), which received more money than paid to the EU budget (Figure 2).

Figure 2. Amounts received compared to the amounts paid to the EU budget after Romania's accession of the European Union

million Euro



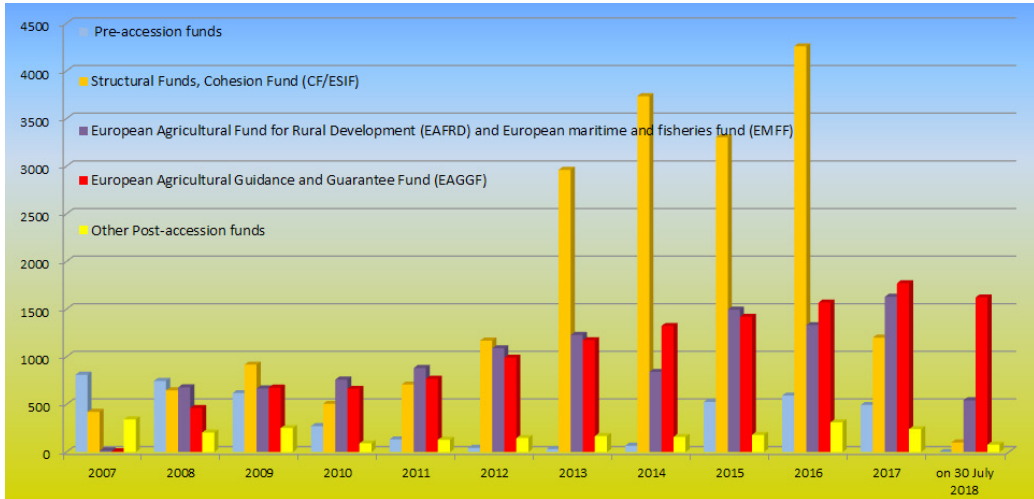
Source: own processing based on data provided by:  
European Structural and Investment Funds (2018)

For the programming period 2007-2013, funds of over 42 billion euros had been allocated to Romania, including the Cohesion totaled 19 billion euros, of which have managed to absorb 90-91%.

For the 2014-2020 financial period, almost 45 billion euros are allocated to Romania, of which approximately 22 billion euros for ESI funds (European Structural and Investment Funds). On 30 July 2018, the Ministry of European Funds announced an absorption of EUR 933 million, plus another EUR 3.9 billion absorbed by the European Agricultural Guidance and Guarantee Fund (Figure 3).

Figure 3. Amounts received compared to the amounts paid to the EU budget after Romania's accession of the European Union

million Euro



Source: own processing based on data provided by:  
European Structural and Investment Funds (2018)

Although Romania has been confronted during the period 2007-2013 and especially in the first years of this programming period with many problems in absorbing European funds that led to blockages and suspensions of payments, we finally had a high absorption rate. However, there are still a number of irregularities identified by the control bodies leading to the failure of the projects, many of which could be avoided if beneficiaries of non-reimbursable funds would pay due attention to monitoring and self-monitoring activities.

#### 4. Categories of irregularities in the management of EU funded projects

At the beginning of 2017 the Audit Authority (Court of Auditors, 2016) announced that for the 2007-2013 programming period, of the total expenditures of ROL 18,593,383 thousand, certified and declared to the European Commission in 2016, the Audit Authority verified expenditures in the amount of RON 5,441,502 thousand, respectively 29,26%, with



irregularities with a financial impact amounting to RON 240,733 thousand (of which approximately 50% were financial corrections for infringements of public procurement rules).

The most frequent irregularities identified during the verification of the 1,152 requests for reimbursement of the Community funds made in 2016 were:

- insufficient capacity of the management and control to detect - through first level controls and verification procedures in place - all deviations from the applicable legal framework both within procurement and regarding the declaration of expenditure from EU funds;
- how to conduct checks first level of the responsible authorities continue to represent the area where there is the highest risk of error both in regards the compliance with the rules on eligibility of expenditure, and the rules applicable to procurement by beneficiaries of funds;
- **breach of procurement rules as well:**
  - dividing the estimated contract value or purchase goods without a proper tendering procedure;
  - use of restrictive criteria for eligibility of tenderers;
  - declaring the winner of irregular offers;
  - infringement of the rules concerning conflict of interests;
  - unjustified increase value of contracts by addenda signed without ensuring adequate competition in the absence of extreme urgency brought about by unforeseeable events.

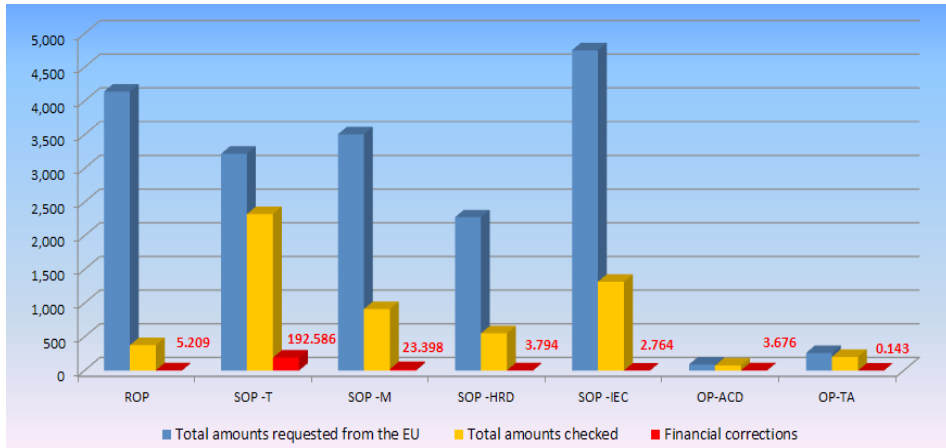
• **expenditures that were not eligible to be reimbursed by the European Commission.** Irregularities found were due completely to non-compliance with the eligibility requirements established by normative documents or procedures contained in the financing agreements or have been determined by inadequate enforcement of the work procedures. Therefore, several cases were identified as well as: granting funding for non eligible activities, non eligible projects or ineligible beneficiaries or is suspected to have been created artificial conditions to obtain financing; which have not fully accomplished the eligibility requirements or related projects were canceled; authorizing the payment of expenses doubled, unjustified expenses or not covered by in the financing, expenditure affected by errors of calculation or unreasonable values.

• **delays in the implementation of all recommendations made in previous audit reports.** The measures imposed by authorities were insufficient.

As of irregularities found on each operational program, the top irregularities is situated Sectoral Operational Programme Transport (SOP-T) with 192.586 million lei, followed by Sectoral Operational Programme Environment (SOP-M) of 23.398 million lei.

Figure 4. The impact of the financial result of checks carried out in 2016 on each operational program

million lei



Source: own processing based on data provided by: Court of Auditors (2016)

Inside of Sectoral Operational Programme Human Resources Development (SOP-HRD), have been found most serious irregularities of all the 7 operational programs for structural and cohesion funds. Deficiencies were identified at the Management Authority and the Intermediate Bodies but mostly the beneficiaries. Within the MA/IB, the main gaps identified were: quality of management checks, unrealised all on-site verification missions planned, deficiencies in the monitoring system and the financial reporting for the purposes of recording incomplete or incorrect information on rates or unrealised of conciliation between the data input by the Managing Authority and Certifying Authority and data reported to the European Commission. The among beneficiaries were identified: deviations from the rules on eligibility of expenditure with a financial impact amounting to 3,8 million lei, representing unjustifiably salaries payable management team members or implementation for a number of hours unrealistic or out provisions established by the applicable legislation, the equivalent of doctoral fellowships requested to reimbursement for PhD expelled with doctoral program or for Ph.D who have not completed

the doctoral program, leasing purchases of goods not specified in the grant application or have not demonstrated the necessity for the project, etc.

## **Conclusion**

The control system, regardless of how it is designed and operated can only provide reasonable assurance and not an absolute entity that objectives are fulfilled. The probability of their achievement is affected by the inherent limitations of internal control. This fact is attributed to internal and external factors which were not and could not be taken into account in the design (design) system of internal control.

Internal control should be effective, will not determine additional costs and allow saving material resources, financial and human.

The control system must be regarded as a management instrument and not as a control mechanism, because it has the role of „early warning system” allowing corrective action to achieve the project objectives. The main objective of the control system is continuous measurement of project progress, pursuing issues such as procurement management, financial aspects, but also the benefits for the target group. The purpose of collecting information is to be able to determine whether the project is proceeding as planned, if they achieve their goals and objectives declared in accordance with the time limit proposed or are needed implementation of changes.

Not least the control activity is an information component of donors and those who implement the project beneficiaries on project progress and the progress of the project.

A problem will turn into a positive change only when it can not be resolved without affecting the constraints of time, money and quality.

In conclusion, a reasonable and flexible control system that can change depending on the realities, manages, not absolutely, but within certain limits, to ensure managerial objectives with greater probability and better conditions.

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