

## SECTION II FINANCIAL AND ACCOUNTING POLICIES

### POSITIONS AND CONVERGENCES OF THE SUPREME INSTITUTIONS OF AUDIT IN ASSESSING FINANCIAL POSITION AND PERFORMANCE OF PUBLIC ENTITIES

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**Abstract:**

*The analysis of the issues addressed by the supreme audit institutions, as directions to guide their activity, clearly shows that they can provide relevant information on the position and financial performance of public entities, as well as information on the accountability's level and at the public sector's level, while providing support to the audited public authorities on the adoption of strategies and the formulation of forecasts.*

**Keywords:** *supreme audit institution, financial position, financial performance, public entity, strategies.*

**Clasification JEL:** *M42*

#### 1. Introduction

Although international auditing standards give Supreme Audit Institutions (IAS) a unique role in formulating audit opinions about the position and financial performance of a public entity, we identify a first paradox in substantiating these opinions, which cannot be sufficiently argued. based on the analysis of synthetic documents, such as the balance sheet, the income statement and the explanatory notes annexed to the financial statements. The Fund Manager must consider, in addition to the analysis of these general financial reports, the existence and evaluation of appropriate reporting mechanisms to provide accessible information to citizens, the performance achieved by the audited entities in relation to the objectives formulated for each level of administration and the perimeter and performance of anti-corruption and anti-fraud actions, at the level of the entire public administration process. Thus, the implementation phase of a public policy is indispensable in the evaluation of information on financial position and performance, as it involves the coordination of programs and processes, the development of their specific activity and the permanent monitoring of budget execution. Also, monitoring the results of a public policy has a decisive role in understanding the weaknesses or vulnerabilities of a program as well as in overcoming the difficulties encountered, by identifying actions that have proved successful, establishing monitoring and evaluation mechanisms to either integrated into the design phase and can be used as feedback in future planning process.

#### 2. Literature review

According to the study of David Hay, who analyzed the theoretical and conceptual framework governing private sector auditing but also the public sector, in order to identify ways in which public sector auditing can bring added value, it was shown that these modalities are correlated with a number of complementary elements, including management control, governance, compliance or assurance.

The reporting of sustainability in public sector organizations has been rather little studied, compared to corporate reports. In 2017 Ana Rita Domingues published an article based on a study that provides a critical analysis of the relationship between sustainability

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reporting (PAHO) and organizational change management for sustainability (OCMS), which shows that the public sector is beginning to use sustainability reporting as a communication tool. The conclusion is that the publication of such reports is still a voluntary process and many public sector entities have not published such reports.

In 2005 Alnoor Bhimani and Kazbi Soonawalla analyzed the link between compliance and corporate performance, starting from the fact that they are positioned at essentially different ends of the same continuum. The argument put forward in this regard is that corporate financial reporting and corporate governance responsibilities, together with possible reporting requirements on corporate social responsibility as well as value creation reporting, need to be integrated notationally into -a common spectrum so that compliance reporting and performance reporting can be presented in a fully interconnected manner. The tools by which information on the degree of compliance or level of performance reached by a public entity is either public reporting (self-reporting), usually on an annual basis, or reporting by state supreme audit institutions, to interested third parties. Through an article published in 2015, Alexandra Oțetea reveals that in recent years, the Supreme Audit Institutions (SAIs) have shown a growing concern to increase the value of the work they do. Although the impact of their work is quite difficult to quantify, its existence is certain, usually the Fund Manager bringing added value to a sector they evaluate. These aspects have been studied in recent years, either by case studies conducted at the small number of supreme audit institutions, or by conducting a multi-case study.

### **3. Research methodology**

In the present study, the research is carried out through a detailed analysis of information on financial position and performance at the level of a public authority, obtained by the approach of the supreme audit institution in our country, in the international context provided by studies of the Organization for Cooperation and Economic Development on a portfolio of ten Member States (United States, Brazil, Poland, Chile, Canada, Finland, Korea, Portugal, France and South Africa).

The study is based on a rather extensive verification research which is based on a direct collection of data, in the form of quantitative variables, using complex statistical tools.

Data collection was ensured by adopting a multi-angle collection model, in order to guarantee the internal validation of the research and to avoid significant errors. Research is an analysis associated with textual analysis and observation. This started from the allocation of information to one of the sections established by the external public audit methodology adopted at SAI Romania, by horizontal textual analysis, followed by a vertical textual analysis, in the sense of allocating those sections to the components of the theory, respectively position and financial performance and responsibility of the public entity.

### **4. Financial and non-financial information prospective and relevant for the evaluation of performance at the level of public authorities**

The analysis of the issues addressed by the supreme audit institutions, as directions to guide their activity, clearly shows that they can provide relevant information on the position and financial performance of public entities, in addition to information on the level of accountability at the level of public sector, while providing support to the audited public authorities on the adoption of strategies and the formulation of forecasts. In six cases out of the ten IAS analyzed by the OECD study, the capacity and effectiveness of central government units was tested by measures to ensure long-term visions, harmonized with other key documents (fiscal plans) and by concrete measures that reflect long-term vision in the institutional plans of the ministries. In seven of the ten cases subject to evaluation, a division

of responsibility was found between the various actors involved in strategic planning. Thus, SAI Brazil (TCU) evaluated the institutional planning system of the central public administration from several perspectives. Through an evaluation on the strategic planning and investment department but also on other affiliated entities, the analysis of the adequacy of some programs and result indicators of the objectives formulated by government policies was taken into account.

The analysis carried out by the OECD showed that nine out of ten IAS evaluated used information from previous experiences in the planning process. This involves analysis of the relevance and reliability of the data, the mechanisms that previous programs have used to achieve performance and outcome indicators, and the mechanisms for integrating future trends and risks.

Moreover, some supreme audit institutions considered that the assessment of human resource planning can provide meaningful information on the position and financial performance of the public pension fund in the future.

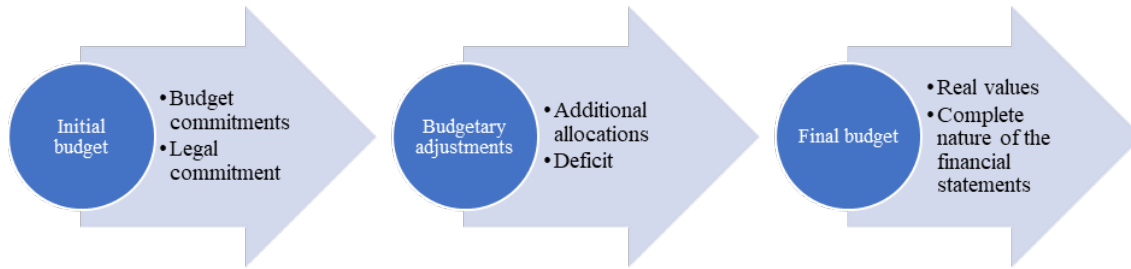
In 2012, SAI Korea (BAI) conducted an audit on the management of the pension service of government employees and the pension fund of teachers, in order to determine the stability of the pension system and restore public confidence in them. Given the low birth rate and the aging population, BAI found that the management and stability of the public pension fund affects the entire population, not just retirees. Weaknesses were found in the management of securities and in other operations undertaken with the two pension funds, including erroneous valuations of securities, oversized payments compared to other pension funds for the same services and overvalued income. Illegal beneficiaries of pensions and unjustified payment situations were also identified. BAI made recommendations to improve management and notified the line ministers of illegal beneficiaries so that they could start recovering the amounts.

#### **4.1. Budget planning**

According to IPSAS, it is necessary for the financial statements of entities that conduct accrual-based accounting and have public budgets to include a comparative statement between budget values and actual values from budget execution, as well as explanations of the reasons for that there are significant differences between them.

Thus, public sector entities will ensure public accountability and increase the transparency of financial statements, demonstrating compliance with the approved budget and financial performance in achieving budget results by preparing the budget and financial statements on the same basis. In the case of state economic entities, those provisions apply on a case-by-case basis, as they apply IFRSs, the obligation to publish the budget not applying to all legal entities of this type. However, IPSAS clearly states that it establishes the obligation to publish the budget and not to present comparisons through the financial statements, if the budgets are not public.

**Figure no.1-Recent approaches of public external audit on the position and financial performance**



Source:Own projection

By including in the financial statements comparative data on the initial and final budget values as well as the presentation of the real values on a basis of comparison with the provisions of the budget which is public, the accountability cycle is completed, allowing users to assess whether resources have been established. and used in accordance with budget approvals. Explaining by notes to the financial statements the significant differences between real and budgetary values, the necessary support will be provided to users in order to understand the reasons for the existence of significant deviations from the approved budget, giving a complete character to the financial statements.

In the context of understanding the role of an extensive budgeting and a review that the central government wants on the budgetary processes and instruments used, the traditional competences and abilities of the Fund Manager to be independent, objective and rigorous extend to the area of budget building processes. income and expenses. Supreme audit institutions are involved in the budget planning phase, from the stages of ensuring understanding and overseeing activities to the stage of debating the budget, when time allows. There is even a tendency for the Fund Manager to increase the use of forecasts in audit actions, while assessing the reliability of fiscal projections, in order to ensure that the assumptions underlying the budget are correct. Thus, the Fund Manager can provide support by assessing the existence of clear limits on fiscal policy, budget reliability and long-term sustainability.

In recent years, OECD Member countries have increasingly sought to develop a target for achieving results with certain attributes, with a variety of approaches, all aimed at assessing budget performance.

In an attempt to better correlate the national strategy with budget execution, the performance of the budgeting process requires effective communication and coordination between central public administration bodies. Among the countries that have had such audits, we mention Australia, the United Kingdom and Norway. The OECD recommends that budgetary instruments used in medium-term budget execution or instruments based on subdivisions of the budget classification be used in a prudent macroeconomic context, based on responsible risk management and an appropriate fiscal framework. Thus, budgetary policies will ensure expenditures and revenues at a sustainable level in the short and medium term. For a longer-term perspective, the most useful analytical tool would be a projection on taxation that incorporates the demographic or socio-economic trend. Trend analyzes and fiscal risks can be useful in testing assumptions about the tendency of revenues to vary due to the assumptions on which public finances are based.

Eight out of ten SAIs assessed took into account the degree of understanding, reliability and accuracy of the budget as well as the degree of compliance of budgetary information with accounting standards. According to professor Ana Stoian, “one of the

informational interests honored by accounting, considered by some authors to be the main one, is the fiscal one. For accounting, there has always been the problem of reconciling it with taxation. The perpetual cause of such a situation was generated by the fact that not in all cases the accounting principles on economic valuation and calculation are convergent with the fiscal ones, which are not subordinated to the presentation of a true picture of the operations that take place in the enterprise. Fiscal principles aim at either stimulating or inhibiting certain activities. By the Fourth Directive of the C.E.E. the interactivity between accounting law and tax law has been established. This is done through the fiscal management of the enterprise ”.

Nine of the ten IAS evaluated considered the impact and quality of the overall budget implementation framework, in order to promote the optimized allocation and implementation of resources as well as the evaluation and review of budget execution. Thus, we exemplify through the case of SAI Mexico (ASF), which analyzed in 2012 how to substantiate decisions on the budget deficit. In its report, the FSA criticized the increase in the budget deficit, noting that the economic situation did not justify the decisions taken. Five criteria for measuring the increase in the deficit were also highlighted and recommendations were made to avoid future discrepancies.

In 2014 the Supreme Audit Institution of the United Kingdom (NAO) prepared a government forecast report on the added value obtained through the policies developed, which made findings on the shortcomings of forecasts and forecasts as well as on the significant errors that led to increased costs for taxpayers. The report highlighted that insufficient documentation at the level of the departments involved in these processes caused problems and caused negligible added value.

Nine of the ten SAIs considered the adequacy of budget planning processes, including the possibility of aligning the budget with strategic objectives, ensuring the reliability and quality of the instruments used in substantiating the budget, public debt management, ensuring long-term sustainability, guiding allocation processes of resources for multiannual programs. For example, the Fund Manager Portugal took into account the adequacy of the budgetary planning process of the audit action within the general consolidated budget. At the level of the Supreme Audit Institution of South Africa (AGSA), an evaluation of the budget and strategies is carried out annually. Although this action is officially considered a financial and compliance audit action, it still has a component that assesses the achievement of the objectives set by the budget. AGSA assesses in particular the relevance and measurability of predefined objectives but also the measurability of targets in order to help ministries identify shortcomings in the planning they have adopted.

Six out of ten evaluated IAS considered the accessibility of budgetary planning processes, including the existence and adequacy of realistic and participatory debates on budgetary options. It aims to inform citizens, the legislature and stakeholders about the real position of public finances. For example, the SAI of the United States of America (GAO) reviewed in 2010 the process of drafting the budget of the US Army Corps of Engineers and made recommendations aimed at improving transparency in the decision-making process regarding project priorities.

#### **4.2. Regulatory policies, non-financial information**

Regulations are an important tool that governments can apply in pursuit of economic, social growth and environmental goals. However, regulations can also cause unjustified burdens, generate inefficiency and their use should be justified, especially in the case of tax constraints.

At the level of OECD Member States, supreme audit institutions carry out actions that take into account several issues relevant to the establishment of regulatory policies, aiming at the formulation of explicit regulations incorporating ex-ante and ex-post tasks. An OECD

study found that in 20% of the states evaluated, the executive considered that supreme audit institutions have a role in evaluating government regulations, and in none of the states analyzed was the SAI considered to have a role in designing or improving these regulations. As a rule, the supreme audit institutions do not have a role in deciding the political issues nor in detailing them, as they are matters proper to the Executive and the Legislature, assumed for the electoral mandate. However, approximately 42% of the evaluated states were involved in evaluating the processes aimed at developing regulatory policies. In France, Korea, Portugal and South Africa, these activities are periodically covered by sectoral audits or audits carried out at relevant entities.

All ten supreme audit institutions considered the processes of developing regulatory policies and rules, including issues related to the clarity of the objectives of the regulatory policy framework, the incorporation of risk management, the accessibility and consultation of the process, the correlation of regulations with international principles.

Five of the ten SAIs assessed the effectiveness and efficiency of the application of regulatory instruments, including the diagnosis of regulatory issues intersecting several levels of government, impact assessment ex-post reviews of existing regulations and reports on revenue performance from regulations.

According to the OECD supreme audit institutions can assess and support public authorities through their actions on regulatory coherence and ensuring compliance.

The effects of risks can never be completely eliminated, and internal control and audit can only provide reasonable assurance as to the adequacy of risk management. The management of the central government should establish an acceptable level of risk in the process of pursuing objectives. An organization's "risk appetite" will determine the amount of risk to which the entity is prepared to expose itself before performing any activity. The Fund Manager can pursue and support this key function through guidance activities on internal control and risk management, as well as by providing audit evidence to underpin the decision-making process.

By evaluating the efficiency and effectiveness of internal controls and risk management, the supreme audit institutions were able to collect data on what works but also on the non-functional aspects. Fundraisers are also active in the process of developing guidelines on internal control and risk management. Some IAS are responsible for the full development of these guidelines. According to the study conducted by the OECD in 2016, it showed that eight of the ten supreme audit institutions evaluated took into account the risk management system in audit actions performed on state-owned entities.

It is therefore noted that the Fund Manager plays a unique role in terms of internal controls. Auditing compliance with internal controls and government regulations are core tasks of the Fund Manager, but they extend beyond basic compliance verification, as shown below. It has become a habit to have permanent working relationships and, in some cases, to develop such relationships between the internal public audit and the Fund Manager. In some countries, these relationships are established in laws and regulations. Relationships are often based on ad hoc initiatives of audit organizations, to avoid duplication, inefficiencies and duplication of work, as well as to facilitate the process and ensure cooperation from the audited entity. The internal audit is able to provide the Fund Manager with information on the effectiveness of the systems used. However, the Fund Manager should be fully responsible for the conclusions drawn from such information.

### **4.3. Coordination and communication**

These functions specific to the public policy implementation process adopted by a public entity are closely related to the information needs of third parties, whether they are

beneficiaries of the services provided, providers of resources managed for this purpose or partners of the entity in this process.

In order to develop coherent policies and programs that aim to fulfill the government's vision, effective horizontal (intersectoral) and vertical (between entities) communication is needed. Effective communication and coordination presuppose the existence of clear information about programs and services that are communicated to citizens.

Coordination and communication also allow a variety of actors to work together and develop policies and programs, which is particularly important in cross-sectoral policy situations. They experienced a significant evolution in the period 2008-2012 at the level of OECD member countries, increasing up to 59%. Subsequently, in 2014 it decreased to 38%.

Supreme audit institutions are not traditionally interested in assessing elements of coordination and communication but there have been many cases in which the Fund Manager has had the capacity to monitor the communication and coordination but also to make predictions on these issues.

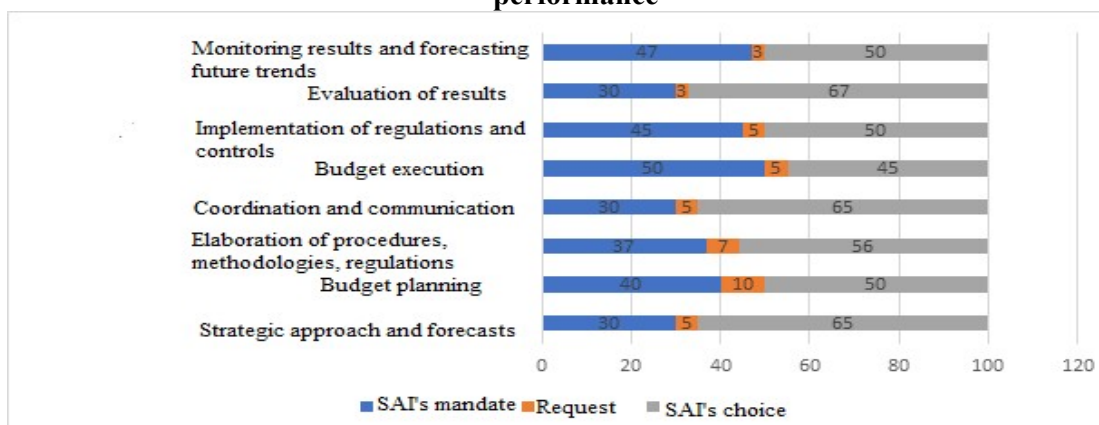
According to the OECD, the central public administration is responsible for the coordination policy 70% of the time and delegates this responsibility 30% of the time. The mission of the central public administration is to ensure coherence by horizontally linking policies at interdepartmental level and between agencies. Of course, divergences often occur in this process, usually between the ministry that manages public finances and the other ministries. But the role of the central administration is a very important one to harmonize the ideal of coherence with the realities of public policy and with the practical limits. Inconsistent policy can increase the risk of duplication, inefficient spending, poorer quality of public services, conflicting objectives and targets and ultimately a reduced ability to govern.

#### **4.4. Budget implementation (execution)**

The budgetary execution of a strategic state refers to the implementation of the budgetary allocations authorized by law, at the level of the entire public administration. Budget execution should only be carried out in the context of internal controls and rules that ensure the efficient and effective allocation of resources and prevent corruption and fraud. In their role of auditing and, in some cases, certifying the accounts, the Fund Manager is traditionally involved in evaluating budget execution. It is essential that the central government remains vigilant in choosing priorities and judging budgets from top to bottom so as to allow ministries to be flexible in budget allocations and reallocations. For this budgeting to be implemented effectively, rigorous and economically prudent forecasts must be combined with complementary fiscal management practices, such as multi-annual budget appropriations. Factors that could influence budget flexibility are the classification into budgetary subdivisions, the use of lump sums, the freedom to reallocate budgetary provisions during the year and restrictions in this regard, as well as the possibility to carry over unused budget appropriations to the following year.

Supreme audit institutions can evaluate and support the monitoring of budget execution, fiscal risk management and quality assurance of audit actions and opinions (Figure no.2).

**Figure no.2-Recent approaches of the external public audit on the financial position and performance**



Source: *Supreme audit institutions and good governance-Oversight, insight and foresight, OECD Public Governance Reviews, 2016*

As a rule, the public budget is primarily focused on budgetary provisions, authorizations and management of financial resources. In this context, the supreme audit institutions played a central role in ensuring the accuracy of the information on the accounts, the probity in the management of public money and, in some cases, the examination of the aspects of costs and effectiveness. Carrying out financial and compliance audits to ensure verification and balance of government expenditure remains a core task of the Fund Manager.

All ten SAIs analyzed considered the effectiveness of the current procedures regarding the management, monitoring and supervision of financial allocations, including compliance and consistency of budgetary reallocations, the level of adequacy of interim budgetary reporting carried out during the year. Also, all ten SAIs evaluated addressed the accuracy and probity of public entities and government as a whole.

Eight out of ten supreme audit institutions evaluated considered the existence of mechanisms to generate and capture information on quality and performance during the budget execution phases. At the same time, they took into account the adequacy of other mechanisms for determining the quality and relevance of budget forecasts and fiscal plans as well as their management accordingly.

Seven out of ten SAIs assessed addressed the clarity of how public authorities reallocate funds during the year.

We exemplify by the case of SAI Brazil, which according to the Federal Constitution of 1988, has the role of examining the annual accounts of the Presidency of the Republic and to prepare an annual report at the end of each fiscal year. In addition a report on fiscal management is generated every four months during a fiscal year to analyze financial-budgetary execution, legality and compliance as well as other relevant issues.

In Canada through its November 2006 report on the “Federal Government Expenditure Management System” the Supreme Audit Institution analyzes the effectiveness of state funding allocations to promote an efficient and accountable public administration.

In 2015 the Auditor General conducted a performance audit, examining whether the Department of Finance and the Tax Agency of Canada had adequately managed state tax revenues and reported clear and relevant information on how to use them. The GA concluded that some improvements are needed to ensure parliamentary monitoring, such as the inclusion of projected and estimated program costs in the coming years and a better indexation of the expenditures to the program to which they belong. In addition, the Auditor General



recommended that the Department of Finance publish more complete information on all expenditures financed from tax revenues and taxes that have been assessed.

In 2012 the SAI Mexico (ASF) identified and reported in an report an unauthorized increase in central government spending and recommended the establishment of mechanisms to review budgetary procedures in federal institutions, discussing accounting procedures and comparing them with the existing regulatory framework and good practices in the field.

In 2011 SAI Poland (NIK) conducted a special audit entitled "Implementing a successful budget process: planning evaluation, monitoring and reporting of processes". Aspects related to the performance of the budget process were audited in relation to the execution of the state budget from 2007-2010. The audit conducted in 2011 targeted 48 entities (Ministry of Public Finance and other ministries and public entities), aiming to assess the degree of implementation of public management responsibilities, respectively planning, monitoring and reporting on the state budget. NIK identified a high risk regarding the level of performance of the budgetary process in the predefined terms for the field of public finances, concluding at the same time that the reporting system is not easy to understand, presenting data collection, verification and processing in correlation with specific tasks. the public sector and its mission.

SAI Korea (BAI) has been active in the field of budget execution, going beyond traditional audits to support the proper execution of the revenue and expenditure budget. By auditing the financial statements, BAI examined, on the one hand, the relevance, position and financial performance of the agencies within the central government, starting with the financial year 2009, and, on the other hand, examined the budgetary provisions. Through the special audit actions, BAI carried out analyzes and evaluations leading to the understanding of some significant social and economic aspects and issues. The number of such actions increased in 2014 to 63% of BAI's activity, through this type of audit offering a systematic diagnosis and analysis on efficiency, effectiveness and economy as well as on damages, in order to promote a correct budget execution.

## 5. Conclusions

At the international level, assessing the financial position and performance of the public sector implies the need to provide useful information, both to the providers of resources consumed in this sector and to the beneficiaries of public services provided, and to those interested in the entity's responsibility or involved in decision-making. The main tasks of Supreme Audit Institutions are usually to verify the accounts and compliance with relevant laws, so that Supreme Audit Institutions provide interested third parties with information on the processes carried out in the public policy implementation phase.

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