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PUBLIC INTERNAL CONTROL IN THE EUROPEAN UNION

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Abstract. Public internal control differs from country to country as it has to fit into the respective overall governance arrangements with the government and the supreme audit institution as well as the accountability arrangements that exist between stakeholders. The aim of this research is to find out common and different internal control elements in twelve European Union (EU-12) countries. The tasks of this research are: to analyse revenue indicators in the EU countries, to analyse internal control systems in the EU countries, to make conclusions and to make proposals for further research tasks about the internal control of the administration of Latvia and improvements of the internal audit systems. The methods of this research are economic analysis (monograph) method and graphic method. The main results from this research – not all of the countries interpret the concept of internal control in the same way – some countries have special independent internal control institutions, in some countries, decentralised system of internal control is embedded and forms an integrated part of the administration. More and more countries also require top managers to apply systems for managing or mitigation of the risk of not achieving set objectives. Almost all of the EU member states have established internal audit function, but do not cover all systems of public administration.

Key words: internal control, audit, public administration
JEL code: M42

Introduction

Reforms in European Union Member States public administration systems could be explained by the objective need to adjust general reforms and could also be related to trends, such as recognition of the need to manage risk since 2000. In this period, public internal control system has developed into a widely used, integral and vital part of most governance systems in Europe (Compendium..., 2014).

Internal accountability arrangements are also a determining factor, as is the content of accountability of those responsible for carrying out public tasks. A distinction can be drawn here between legal accountability for compliance with rules and regulations and managerial accountability for the use of public resources to achieve goals. Budgeting and accounting

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arrangements also have to be taken into account. The need to establish an internal control, report on it, and apply a risk management approach can be set out explicitly in laws and regulations or derived from existing legal basis. In decentralised systems, top managers have to report on the functioning of the internal control systems. Many countries also require top managers to apply systems for managing or mitigating the risk of not achieving the set objectives (Compendium..., 2014).

The aim of this research is to find out common and different internal control elements in twelve European Union countries.

The tasks of this research are: to analyse the revenue indicators in the EU countries, to analyse the internal control systems in the EU countries, to make conclusions and to make proposals for further research of the internal control of the public administration of Latvia and improvements of the internal audit systems.

The methods of this research are economic analysis (monograph) method and graphic method.

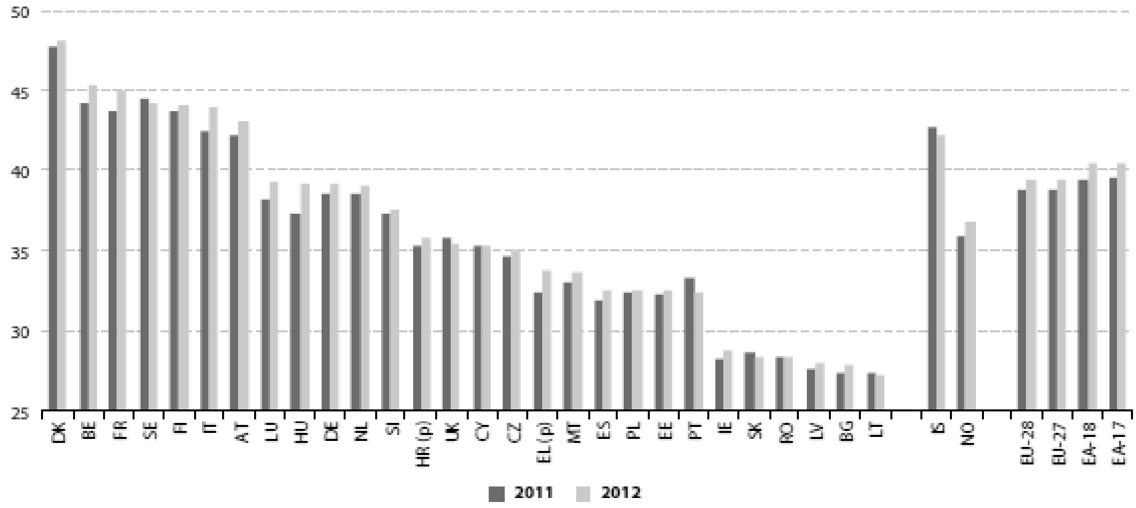
EU countries in taxation perspective

For illustration of differences in all European Union Member States author has compared Member States tax revenue indicators.

In previous researches author has found government revenue as a one of indicators for implementing internal audit systems in Latvia local governments.

The first effects of the global economic crisis were felt on revenues already in 2008 even though in the European Union the annual growth turned negative only the following year — growth slowed down substantially during the third quarter of 2008 and turned negative in the last quarter.

The crisis and the measures of fiscal policy adopted in the European Union countries have a strong impact on the level and composition of tax revenue in 2009–2013, although the first effects had already become visible in 2008.



Source: DG Taxation and Customs Union, Eurostat

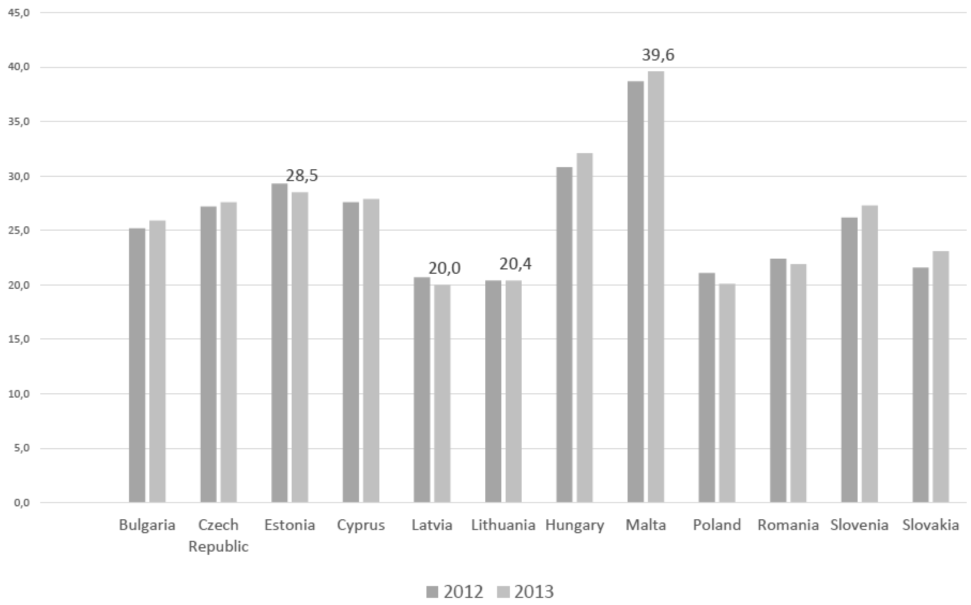
Fig. No.1 **Tax revenue (including social contributions), 2011-2012, % of GDP**

In 2012, tax revenues in percentage of GDP increased in 22 European Union Member States.

In 2013, estimates from main aggregates of general government and quarterly data show that tax revenues as a percentage of GDP are set to continue rising (Taxation Trends in the EU…, 2014)

Author in previous researches has found for Latvia situation government revenue as a one of indicators for implementing internal audit systems in Latvia local governments.

In this research, twelve European Union Member States since 2004 and 2007 have been compared (Bulgaria, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, and Slovenia).

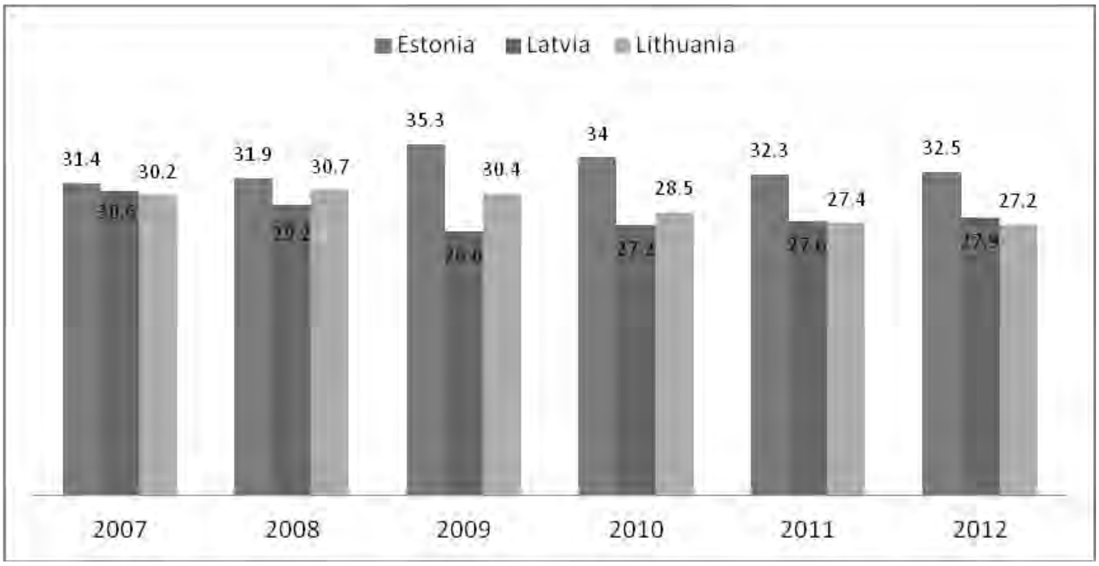


Source: author's construction based on Eurostat data

Fig. No.2 **Total general government revenue, percentage of GDP**

In fig. No. 2 is shown the total general government revenue, percentage of GDP: Lithuania and Latvia have similar indicators, but Estonia has the first place of all Baltic States and Malta has the highest level of total government revenue. All new countries, except Hungary and Malta total general government revenue, are at the average of about 25% of GDP.

The tax-to-GDP ratio of Baltic states – Estonia, Latvia, and Lithuania (including the social contributions), since 2007 Estonia has a higher ratio than the other Baltic States, and Latvia has the lowest indicators except for the year 2012.



Source: author's construction based on Taxation trends..., 2014

Fig. No.3 **Development of tax revenues** (tax-to – GDP%)

In the fig. No.3, the ratio in Estonia has decreased in comparison with the level of crisis years (peak in 2009 at 35.4%). In comparing the performance of the Baltic States, in year 2012 the Lithuanian tax-to-GDP ratio (27.2%) was close to Latvia (27.9%).

Accession to the European Union has clearly been of fundamental importance for the way in which the newest Member States have reformed their public administration in general and their public internal control systems in particular. (Compendium..., 2014)

Like tax revenue indicators differences in all European Union Member States and similar closed indicators in Baltic States internal control systems in public administration show similar picture.

Internal control and internal audit in EU member states

There are countries where administrative reforms have been aimed at fundamentally devolving or decentralising central public powers (for example Italy and Spain). In other countries reforms have been based in part of the view that some services that are delivered today by non-public or partially competitive organisations (for example Sweden and United Kingdom).

The most striking developments in public internal control components in Europe have resulted from an increasing attention to objectives and performance management, to risks and governance as a whole, including accountability, as well as to the quality of service delivery and cost efficiency. These developments have led to the wide introduction international or national standards; clearly defined legal basis and clearer mandates for control, internal audit and- where it exists – financial inspection. The functional independence of internal auditors has increased, and they are expected to deliver new or wider services, focusing on economy, efficiency and effectiveness.

Internal accountability arrangements are also a determining factor, as is the content of accountability of those responsible for carrying out public tasks. A distinction can be drawn between legal accountability for compliance with rules and regulations, and managerial accountability for the use of public resources to achieve goals. Budgeting and accounting arrangements also have to be taken into account. The need to establish an internal control, report on it, and apply a risk management approach can be set out explicitly in laws and regulations or derived from existing legal basis. In decentralised systems, top managers have to report on the functioning of internal control systems. Many countries also require top managers to apply systems for managing or mitigating the risk of not achieving the set objectives. (Compendium..., 2014)

Not all countries interpret the concept of internal control in the same way – some countries have special independent internal control institutions, in other countries decentralised internal control system is embedded, and forms an integrated part of the administration. The need to establish an internal control, report, on it, and apply a risk management approach can be set out in regulations and laws or derived from existing legal basis. Some European Union countries also require top managers to apply systems for managing or mitigation the risk of not achieving set objectives (Compendium..., 2014)

Almost all European Union member states have established internal audit function, but do not cover all systems of public administration. Internal auditors use formal and informal ways to achieve a relevant level of coordination and harmonisation. Traditional compliance and financial audits are increasingly supplemented by various consultancy services and audits of performance that require a professional and well trained internal audit staff. Some of the member states have established audit boards or audit committees. The coordination and harmonisation of the internal control and internal audit in the public sector at large or in the government sector is achieved through many different means (Compendium..., 2014).

There are not many comparable internal control indicators for all 12 European Union member states because of the different ways and systems of internal control and internal audit approaches.

Internal control and internal audit systems in 12 European Union countries were established in a period of three years:

2000- **Latvia**, Malta;

2001- Bulgaria, **Estonia, Lithuania**, Slovakia;

2002- Poland, Romania, Slovenia;

2003- Hungary, Check Republic, Cyprus.

Internal control and internal audit systems were one of the major elements for pre-accession in the European Union. All these countries joined the European Union in 2004, except Bulgaria and Romania, which joined the European Union in 2007.

All Baltic States established an internal audit system almost simultaneously in 2000 and 2001.

Audit activity of an effective public sector

European Union Member States are in different situation with internal audit implementation, internal audit system in public sector.

Future plans for some countries are stated (Compendium..., 2014): reforms in public administration or public internal control system, decisions to establish reporting, accounting, internal control and audit systems at regional/local government levels or for non-public/partly public services, with the ambition of ensuring and equal level of protection, transparency and effectiveness, irrespective of where public resources are spent (Estonia, Lithuania, Romania). Estonia, Lithuania, and Hungary are going to introduce systematic quality assessments, quality monitoring (review systems). The Czech Republic, Latvia, and Slovakia plan to simplify the streamline control and audit systems within the government sector, but also in other parts of the public sector.

Public sector audit activities must be configured appropriately to enable public sector organisations to fulfil their duty to be accountable and transparent to the public while achieving their objectives effectively, efficiently, economically, and ethically.

Author fully agrees that nine key elements of an effective public sector audit activity (IIAs 2010 Global Audit Survey – 13500 responses around the world): are comprehensively

1) Organizational independence;
2) Formal mandate;
3) Unrestricted access;
4) Sufficient funding;
5) Competent leadership;
6) Objective staff;
7) Competent staff;
8) Stakeholder support;
9) Professional audit standards (Supplemental guidance..., 2012).

The opinion of the author of the paper is that in Latvia some political influence to organizational independence in internal audit function is the key factor for the law added value of our internal audit in public sector institutions.

Latvia legislation rules require a certification for audit function leaders and experience in internal audit field. Changing of the internal audit function staff cannot provide a competent and objective staff. There is no summarised data about Certified Internal Auditors (CIA) in

Public administration, but there are two internal auditors Certified Government Audit Professional (CGAP).

Conclusions, proposals, recommendations

1. Many countries also require top managers to apply systems for managing or mitigating the risk of not achieving set objectives.
2. Not all of countries interpret the concept of internal control in the same way- some countries have special independent internal control institutions, in some countries decentralised internal control system is embedded and forms an integrated part of the administration.
3. Almost all EU member states have established internal audit function, but do not cover all systems of public administration.
4. Public sector audit activities must be configured appropriately to enable public sector organizations to fulfil their duty to be accountable and transparent to the public while achieving their objectives effectively, efficiently, economically and ethically.
5. The opinion of the author of the paper is that in Latvia some political influence to organisational independence in internal audit function is the key factor for the law added value of our internal audit in public sector institutions.

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