

AUDIT OF LOCAL GOVERNMENTS: A COMPARATIVE ANALYSIS IN THE EUROPEAN UNION

SUMMARY



AUDITORES

INSTITUTO DE CENSORES JURADOS
DE CUENTAS DE ESPAÑA

Published by
**Instituto de Censores
Jurados de Cuentas de España**

Editorial office and administration:
**Paseo de la Habana, 1
28036 Madrid**

Phone:
+34 91 446 03 54

e-mail:
comunicacion@icjce.es

Coordination:
Departamento de Comunicación

Address:
Departamento de Comunicación

Work Team:
**Isabel Brusca - Universidad de Zaragoza - España
Vicente Condor - Universidad de Zaragoza - España
Francesca Manes-Rossi -Universidad de Nápoles Federico II-Italia
Jorge Olmo- Universidad de Zaragoza - España**

ISBN 978-84-15354-94-9

Main conclusions

This study compares the situation of local government audit in the European Union (EU) Member States, aiming at evidencing how auditing is implemented in the local government sector and the level of harmonization within the EU.

- 1.** The implementation of accrual accounting systems in the local government has the objective of providing useful information both for the accountability and for the management of these entities, where accountability is a paramount requisite due to the use of financial resources of citizens for providing services to them. This characteristic has led most countries around the world to pass legislation requiring transparency for public administrations and demanding them to publish financial reports on their websites or via other channels, so that citizens and other stakeholders can have access to the information. This is the case in most European countries, where a transparency law requires local governments to make public their financial information.
- 2.** Financial reporting is the main medium for accountability in the public sector, and the audit function guarantees the adequacy and reliability of the information prepared by the entities and reinforces transparency thus, promoting confidence in the information while facilitating the evaluation and identification of risks. Audit plays a key role to ensure that the reported information is accurate, reliable and relevant. For this reason, the implementation of modern accounting systems must be linked to effective auditing systems that verify their adequacy and guarantee the transparency of the information provided.
- 3.** In the framework of the enhanced Economic Governance package, the EU adopted in 2011 the Council Directive 2011/85/EU of November 8, on requirements for budgetary frameworks of the Member States. Article 3 of this EU Directive requires Member States to have public accounting systems comprehensively and consistently covering all sub-sectors of general government and containing the information needed to generate accrual data with a view to preparing data based on the European System of Accounts (ESA). It also requires that the public accounting systems be subject to internal control and independent audits.
- 4.** Since the approval of Directive 2011/85, the modernization and harmonization of the accounting systems of public administrations has been a challenge for the European Commission. Several efforts have been made in the last ten years, aiming at the development of a set of European Public Sector Accounting Standards in order to improve the quality and comparability of the information disclosed by these entities. For the moment, the standards have not been approved.
- 5.** Although the process is still ongoing, and there has been no practical implementation, the efforts and initiatives for accounting harmonization have not been accompanied by similar attempts in the field of auditing, so that, each country has its own system of internal control and auditing, and decides on the applicable auditing standards.
- 6.** This study analyses the situation of the audit of local governments in the European Union Member States in order

to evidence the level of implementation and comparability of audit requirements across countries, as well as the compliance with the EU Directive 2011/85.

7. Data for the study have been collected through a questionnaire sent to academics of the 27 EU Member States. Previously, we tested the adequacy of the questionnaire for the different contexts and regulations by submitting a first draft to some academics based in four of the countries observed. The questionnaire was sent using Google Drive Platform to two academic experts in local sector accounting in each of the 27 countries analyzed. The information has been completed with literature review and previous research about auditing practices in the observed countries, with the collaboration of national professionals.

8. The results obtained reveal the existence of great differences among countries in terms of the level of audit implementation in the local government sector. Some countries do not have an internal control system in place, thus questioning the compliance with the EU Directive. Differences appear even between Regions in the same country.

9. The results confirm that all the countries have implemented a model of external control of the local government sector, but, in some of them, some entities are not subject to an annual financial audit. That is, all or a significant part of the entities included in the local government sector is not subject to an audit, this leaving a high percentage of public expenditure unaudited and therefore, compromising the quality and transparency of the information. In accordance with Directive 2011/85/EU, public accounting systems must be subject to independent audits and therefore, it should be understood that these audits should be performed at least annually.

10. Table 1 summarizes the frequency of the local entities' audits in Member States (only for the principal entity), including the existence of internal control and annual external controls. In Latvia and in some Regions of Belgium, internal control is not mandatory, which is against the requirements of Directive 2011/85. For the external control, the Table also contains information about the entity in charge of the external audit, differentiating between annual audit by private auditors, annual audit by National Audit Institutions (NAIs) and annual audit by Regional Audit Institutions (RAIs). An "X" means "yes", while an empty box indicates that it is not carried out. As it can be seen, only in 16 countries there is an annual external audit of all entities, while in two countries the annual audit for larger entities is mandatory. Fundamentally, these are countries in which contracting private auditors to perform the annual external audit is required.

11. Taking into account that in most countries local governments also have some dependent entities to provide public services, such as owned enterprises, foundations, or other entities, Table 2 summarizes the audit obligation for those entities. It has been differentiated by type of auditor, including private auditor, National Audit Institution (NAI) and Regional Audit Institution (RAI). Table 2 also contains references to the audit of consolidated financial statements, but it must be noted that only in some countries, preparation of consolidated reports of the local government group is mandatory. For example, in Spain consolidated statements are required for large entities since 2022. These consolidated financial statements will be audited by National and Regional Audit Institutions, although, probably, just a sample of them.

12. Local governments' dependent and controlled enterprises are subject to the same legislation that other enterprises in most of the observed countries. This implies that an audit by private auditors is required for those entities exceeding the legal thresholds applicable to any enterprise, which, at the same time, differ among Member States. However, there are some countries where an audit by private auditors is required, independently of the size of the entity. This mainly happens in countries where the local government must contract private auditors, that sometimes perform the audit of the financial statements of all the entities of the group, as well as of the consolidated report. Differences increase for foundations set up by local governments, although, in most cases, the audit by private auditors is required for the entities exceeding the legal thresholds in national regulations. For example, in Spain, it is mandatory to audit the annual accounts of a foundation when two of the following three thresholds are met during two consecutive years: a) Total assets, 2,400,000 euros, b) Net annual income, 2,400,000 euros and c) Average number of workers employed during the year ,50.

13. In many cases, in those countries where dependent entities are subject to the control of National and Regional Audit Institutions, the audit is performed only to a sample of entities. This is the case, for example, of Austria or Spain, where only a sample of the dependent entities are selected for auditing, with differences among Regions.

14. In Denmark, Estonia, Finland, Italy and Luxembourg, all the entities included in the local sector, both the principal and the dependent and controlled entities, are subject to an annual financial and legal audit, in addition to internal control. In Portugal, all the entities of the local government group, as well as their consolidated reports, are subject to an annual financial audit performed by private auditors, while the Court of Auditors carries out the legal control of all the sector.

15. In contrast, there are some countries with low levels of implementation of auditing in the local government sector, where not even the principal entities are subject to an annual financial audit, because the audit is carried out exclusively by the Supreme Audit Institution subject to a sampling selection procedure. The percentage of audited entities varies from one country to another. In this group we can mention some Regions of Germany, Austria, Belgium, Croatia, France, Spain, Slovenia, Hungary and Romania.

16. In some EU countries, local government entities, or at least the principal entity, are required to be subject to financial audit by independent auditors from the private sector, in addition to the audit carried out by the Supreme Audit Institution, thus trying to ensure that all entities are subject to an annual financial audit. In Greece and Portugal, this requirement was incorporated after the 2008 economic and financial crisis in order to improve the management of the public administrations and to reinforce their transparency. In other countries, as Poland or Bulgaria, requirements to contract private auditors only apply to the largest entities according to the budget or the number of inhabitants of the entity.

17. It can be highlighted the case of France, where some weaknesses observed in the local government audit system, such as delays in the audit reports, led the Government to set the objective of overcoming these shortcomings through the collaboration of auditors from the private sector. In 2016, a pilot test was launched, using a sample of 25 entities. For these entities, financial statements would be audited annually by professional auditors from the

private sector. The first audit reports prepared for these 25 entities on a test basis refer to the 2020 financial year. The results of the test have revealed the deficiencies of the accounting systems implemented in the local sector, the lack of information and the scope limitations to perform the audit. Financial managers are aware that the introduction of the mandatory annual audit will be a fundamental drive for improvement and modernization of the accounting systems.

18. The example of France shows that, if the accounting systems are not audited, their adequacy cannot be guaranteed so that, it is essential that all local entities, or at least those of a certain size, are subject to an annual financial audit, just like in the business sector. The control by the Supreme and Regional Audit Institution may not be sufficient when it does not cover all the entities. The collaboration of private sector auditors may be an option to increase the number of financial audits, which should be mandatory for all entities.

19. Differences appear also in the type of audit developed in local governments, especially with respect to performance audits, as in some countries, its level of implementation is still low. Table 3 summarizes the situation.

20. Finally, Table 4 shows the divergence in the auditing standards applied and the lack of comparability of auditing systems, although a high percentage of entities apply auditing standards based on the International Standards of Auditing (ISAs) and/or the International Standards for Supreme Audit Institutions (ISSAIs).

21. To sum up, results show that there is an heterogeneous framework for the audit of local government sector in the EU Member States, with some weaknesses in some countries where annual financial audits do not cover all local governments.

In the private sector, there is a common European regulation applicable to all EU countries (Directive 2014/56/EU and Regulation No 537/2014) in order to achieve convergence and comparability of audit requirements among Member States, as it is understood that audits contribute to the sound functioning of markets by improving the confidence in the integrity of financial statements. Public sector stakeholders also need confidence in the published information and some actions are required to that end. Accounting harmonization efforts at EU level must be accompanied by similar attempts in the auditing systems.

22. In short, for transparency to be effective, it is necessary to establish guarantees that the information disclosed is reliable, and this can only be guaranteed by effective auditing systems, as has been shown in the ongoing pilot test in France.

Table 1. Frequency of Audit in Local Government

Country	Internal control	Annual external audit of all LGvts	Annual ext. audit by private auditor	SAI: annual audit of all	SAI: annual audit of a sample	RAI: annual of a sample
Austria	X				X	X
Belgium	(**)			Provinces		(**)
Bulgaria	X	Budget > 5,1 mill. euros	Voluntary		X	
Croatia	X				X	
Cyprus	X	X		X		
Czech Republic	X	X		X		
Denmark	X	X	X			
Estonia	X	X	X		X	
Finland	X	X	X			
France	X					X
Germany	X					(*)
Greece	X	X	X		X	-
Hungary	X	X	X		X	-
Ireland	X	X				
Italy	X	X	X		X	
Latvia		X	X		X	
Lithuania	X				X	
Luxembourg	X	X				
Malta		X	X	X		
Netherlands	X	X	X			-
Poland	X	> 150,000 inhab.	> 150,000 inhab.		X	
Portugal	X	X	X		X	
Romania	X				X	
Slovakia	X	X	X		X	
Slovenia	X				X	
Spain	X				X	X
Sweden	X	X	X			

(*) There are differences among Länders.

(**) There are differences among Regions.

Table 2. Auditing of dependent entities of the local government

	Dependent and controlled enterprises (>50%)			Foundations			Consolidated Reporting		
	Private auditor	NAI	RAI	Private auditor	NAI	RAI	Private auditor	NAI	RAI
Austria	Legal thresholds	X		Legal thresholds	X				
Belgium	Legal thresholds		(**)						
Bulgaria	X								
Croatia	Legal thresholds	X		Legal thresholds	X			X	
Cyprus	Legal thresholds	X		Legal thresholds	X				
Czech Rep.	Legal thresholds			Legal thresholds					
Denmark	X			X			X		
Estonia	X	X		X			X		
Finland	X			X			X		
France	Legal thresholds	X	X	Legal thresholds	X	X		X	
Germany	Legal thresholds		(*)	Legal thresholds		(*)			X
Greece	Legal thresholds	X		Legal thresholds	X				
Hungary	Legal thresholds	X		Legal thresholds	X				
Ireland	Legal thresholds			Legal thresholds					
Italy	X	X		X	X		X	X	
Latvia	X	X		X	X		X	X	
Lithuania	Legal thresholds	X			X			X	
Malta	Legal thresholds	X		Legal thresholds					
Netherlands	Legal thresholds			Legal thresholds					
Poland	Legal thresholds	X			X			X	X
Portugal	X	X		X	X		X	X	
Romania	Legal thresholds	X		Legal thresholds	X				X
Slovakia	X	X		X	X			X	
Slovenia	Legal thresholds	X		Legal thresholds	X			X	
Spain	Legal thresholds	X	X	Legal thresholds	X	X		X (2022)	X (2022)
Sweden	Legal thresholds			X			X		

Table 3. Types of external audit applied

Country	Private auditor	NAI	RAI
Austria		PA	LA/FA/PA (*)
Belgium			LA/PA (*)
Croatia		LA/FA/PA	
Cyprus		LA/FA/PA	
Denmark	LA/FA/PA		
Estonia	LA/FA	LA/FA/PA	
Finland	LA/FA		
France		LA/FA/PA	LA/FA/PA
Germany			LA/FA/PA (*)
Greece	FA	LA	
Hungary	FA	LA/FA/PA	
Ireland		LA/FA/PA	
Italy	FA/LA/PA	LA	
Latvia	FA	LA/FA/PA	
Lithuania		LA/FA/PA	
Malta	LA/FA	LA/FA/PA	
Netherlands	LA/FA		
Poland	FA	LA/ PA	LA/ PA
Portugal	FA	LA/FA/PA	
Romania		LA/FA/PA	
Slovakia	FA	LA/FA/PA	
Slovenia		LA/FA/PA	
Spain		LA/FA/PA	LA/FA/PA (*)
Sweden	LA/FA/PA		

FA: Financial Audit; LA: Legal Audit; PA: Performance Audit. (*) Differences among Regions

Table 4. Auditing standards applied in the external audit of local governments

Country	Private Auditors	NAI	RAI
Austria		National standards based on ISAs and ISSAIs	National standards based on ISAs and ISSAIs
Belgium			ISSAIs
Cyprus		ISSAIs	
Croatia		ISSAIs	
Czech Rep.		ISAs and ISSAIs	
Denmark	National standards based on ISAs		
Estonia	National standards based on ISAs and ISSAIs	National standards based on ISAs based on ISAs and ISSAIs	
Finland	National standards based on ISAs		
France		ISAs and ISSAIs	ISAs y ISSAIs
Germany		National standards	National standards
Greece	ISAs	National standards based on ISAs ISSAIs	
Hungary		National standards based on ISAs and ISSAIs	
Ireland			National standards
Italy	National standards based on ISAs	National standards based on ISAs	
Latvia	ISAs and ISSAIs	ISAs and ISSAIs	
Malta	ISAs and ISSAIs	ISAs and ISSAIs	
Netherlands	National standards		
Poland		National standards based on ISAs	National standards based on ISAs
Portugal	ISAs	ISAs and ISSAIs	
Romania	National standards	National standards	
Slovenia		ISAs y ISSAIs	
Spain		National standards based on ISAs and ISSAIs	National standards based on ISAs and ISSAIs
Sweden	National standards		

AUDITORES

INSTITUTO DE CENSORES JURADOS
DE CUENTAS DE ESPAÑA

Paseo de la Habana, 1 • 28036 - Madrid

Tel.: 91 446 03 54 • Fax: 91 447 11 62

E-mail: comunicacion@icjce.es

Web: www.icjce.es