

The relation between auditor and the auditee who is subjected to audit is not only guided by the standards – for instance INTOSAI standards - auditors apply, but also by general principles of good audit which give shape to auditors' professional judgement and which can limit his discretion. In what kind of cases do those principles apply and what is their relevance for the audit practice? Those general principles are well known in the administration of justice and in public administration. In audit their existence and recognition are to a certain extent overshadowed by the implications of audit standards. This article analyses on the basis of concrete issues the relationship between general principles of good audit and internationally adopted audit standards. And the implication of general principles of good audit for the audit practice.



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1. Introduction

Research institute X is beneficiary of European funding "EU funding" is not only controlled by their own auditors, but as well by external auditors hired by the European Commission. From year to year they get some comments, but there are no serious problems with their financial administration. During the fourth year of the programme a private audit firm hired by the EU commission raises serious objections against the calculation of overhead costs. The beneficiary asked the auditor what rules he applies to know the basis of which these objections are raised. The answer is: "These rules are secret." Such audit practice does not only result in frustration but creates also a serious threat to legal certainty for the auditee. In the beneficiary's view compliance is an important issue, but one should know on beforehand what the rules are you have to comply with. Moreover, the question is how legal certainty as general principle of law is protected in this case.

A large industry Y is beneficiary of EU research grants (so-called Seventh Research Framework Programme¹). The controlling auditor asks for detailed financial information, which cannot be provided by the administrative system which the industry has in place. Their answer to the auditor is that, although their system is highly sophisticated, delivering the required information will cost too much in relation to the amount of the EU funding involved. This case raises the question to what extent the claim for more detailed information is proportionate, and maybe what the relevance is for good audit at all.

Another entrepreneur receives 152.000 euro of EU subsidies. After the audit this amount is corrected by 40 euro or 0,01% of the payable amount. This case raises the question to what extend a 'reasonable' correction is justifiable.

During an audit of some public procurement files, the auditor applies a checklist with concrete requirements for proper procurement procedures. The lawyer who deals with these cases feels quite uncomfortable about some of the requirements and asks the auditor for clarification on bases of the case law of the Court of Justice. The auditor is not willing to do so and simply applies the rules he has put on paper. This lawyer observes on the basis of contacts with colleagues that in audit rules are applied which cannot or can hardly be deducted from the relevant case law. Notwithstanding this fact auditees comply with these rules because there is no feasible remedy² to contest their application.

¹ Seventh Framework Programme for Research and Technical Development 2007-2013 (the 'Seventh Research Framework Programme')

² Starting a case for the Court of Justice might be an option but a beneficiary might not want this in view of future prospects for EU grants etc.

Only four examples out of a long list provided by different groups of auditees show what items come up in practice. It is not only the question to what extent the issues at stake are covered by the audit standards, but also the question who answers this question and what the consequences are in daily practice. It goes without saying that the risks are high. The European Commission (Commission) is firm in recovering money which is not spend in an eligible way or with other compliance errors. After years Institutions, (small and medium) enterprises can be confronted with financial claims, which are not foreseen. Recoveries can be subjected to legal scrutiny by the Court of Justice, but the time lap between the decision of the Commission and the decision of the court might be considerable.

In some policy fields one can observe that the risks of unexpected outcomes of financial control and subsequent recoveries are that high that potential beneficiaries refrain from making use of EU moneys. For a beneficiary the risks mainly accumulate around three topics:

- the setting of rules (not directly available or complete, extensiveness, available capacity);
- the interpretation and application of rules (guidelines available and to what extent agreed with by parties, updates on changes in interpretation, administrative burden);
- auditing of rules (different auditors, different opinion when project evolves, timeliness of audit and reporting, focus of audit on details or big picture, fair treatment compared with other beneficiaries, possibility to be heard).

An area were several of these risks materialised was the Seventh Research Framework Programme, leading to less applications from potential beneficiaries The EU Commission has introduced considerable changes in their schemes in Horizon 2020 in order to be less unattractive for beneficiaries.

The question remains, however, whether the audit practice is adjusted to the obligations which derive from the general principles of good administration. Moreover the question is whether the norms auditors apply do comply with those principles.

Another important question is to what extent the professional norms auditors apply, such as norms of the *International Institute of Internal Auditors (IIA)* and the *International Organisation of Supreme Audit Institutions (INTOSAI)* already do incorporate principles of good administration or not. In order to answer these questions we start with a description of the principles of good administration. The following step will be a comparison between those principles and the general principles applied by auditors.

2. General principles of good administration

General principles of good administration are developed in the legal systems of member states as well as on the level of the European Union. They partly derive from case law, partly from confirmation of it in legal texts. In this respect article 41 from the Charter on Fundamental Rights – as a part of the Lisbon treaty - marks an important moment in the development of general principles of good administration in EU law. Article 41 introduces since 2009 the right to good administration, which encompasses the right to have his or hers affairs handled impartially, fairly and within a reasonable time by the institutions and bodies of the Union. According to the Charter this right includes among other things the right of every person to be heard, before any individual measure which would affect him or her adversely is taken, the right of every person to have access to his or her file, while respecting the legitimate interests of confidentiality and of professional and business secrecy and the obligation of the administration to give reasons for its decisions. The rights in Article 41 of the Charter hold a confirmation of previous case law of the Court of Justice.

On basis of this case law other principles of good administration do apply. In the first place the principle of proportionality, on bases of which there should be a balance between the objectives to be reached and the efforts it takes³. Secondly the principle of legal certainty and legitimate expectations is important. Individuals should know on beforehand the rules which are applicable in

³ The proportionality principle has a much broader scope, as it is laid down in Article 5 of the TEU. The criteria for applying this Article is set out in the Protocol (No 2) on the application of the principles of subsidiarity and proportionality annexed to the Treaties.

order to determine their legal position. Another important general principle of good administration concerns the right of defence, which encompasses the right to be heard. A principle of good administration related to all the principles just mentioned is fair time delays and application of proper and reasonable deadlines.

Those general principles are applicable on any action of European Institutions, agencies and other bodies and they are applicable as an auxiliary to the laws and rules which are formulated for specific subjects. Individuals (including companies, institutes or other entities) have the right to be treated in accordance with those principles in the preparation or execution of any action of EU institutions and agents acting in their name. This implies that internal auditors and external (private) auditors hired by the Commission and the European Court of Auditors have to respect these principles when doing their work. The complexity of EU's organisation and management implies that less obvious entities are subjected to those general principles of EU law. For instance many EU programmes are executed in shared management by management authorities in member states. Those management authorities and related administrative bodies should also apply those general principles of administrative law.

3. Audit principles

Before describing audit principles it is important to note that these principles stem from a different discipline as the legal discipline governing the general principles of law. For that reason there is a risk of introducing confusion, in the sense that even the wording 'general principle' does not mean the same in those different disciplines. General principles of administrative law can be considered as the commonly accepted legal foundations of EU law, and more generally of law. General principles that auditors apply often derive from international standards developed as informal law on the basis of (inter)national co-operation in (inter)national NGO-like organisations and organisations of audit professionals. For internal audit in the public sphere the *International Institute of Internal Auditors (IIA)* has enacted *Standards for the Professional Practice of Internal Auditing* which belongs to the wider scope of the *International Professional Practices Framework (IPPF)*. For external audit by supreme audit institutions (SAIs) INTOSAI has enacted

ISSAIs⁴, inspired by the private sector's *International Standards on Auditing (ISA)*. National supreme audit institutes and the European Court of Auditors (ECA) have adopted these standards by transforming them into soft law instruments for their own organisation. For this purpose the ECA has adopted the Court's Audit Policies and Standards (CAPS). On bases of this policy document important internal instructions have been developed for the different audit tasks, such as financial and compliance audit and performance audit.

As noted before, general principles of administrative law and general audit principles stem from different disciplines – the legal discipline and the audit discipline - and have a different normative basis. For example, audit standards are important for auditors' professionalism as such. If they violate those professional norms they may be held responsible under disciplinary law of their professional organisations. Audit principles are to a large extent a reflection of good audit practices which have been developed over the years. However some audit principles have a more fundamental nature. INTOSA's Lima declaration and Mexico declaration are considered by the profession as the 'bible' for audit. These Lima and Mexico declarations provide for definitions of auditor's work and for instance institutional arrangements like independence from the executive and basic rights of auditors such as access to documents. For the ECA fundamental principles (i.e. independence among others) are confirmed in articles 285 to 287 TFEU as legally binding rights and obligations. It is by this way that those fundamental principles are incorporated in the work of ECA's auditors.

4. General principles of good administration and audit principles

Audit principles provide for conscious fact finding procedures which are based on the 'no surprise' principle and two rounds of consultation. Subsection 61 of the Common Provisions to EU's Financial Regulation⁵ stipulates:

⁴ International Standards of Supreme Audit Institutions, issued by the International Organisation of Supreme Audit Institutions (INTOSAI).

⁵ Regulation (EU, Euratom) No 966/2012 of the European Parliament and of the Council of 25 October 2012 on the financial rules applicable to the general budget of the Union and repealing Council Regulation (EC, Euratom) No 1605/2002.

‘The Court of Auditors should ensure that any of its findings that could have an impact on the final accounts of auditees or the legality or regularity of their underlying transactions, are transmitted to the institution or body concerned in good time in order to allow such auditees sufficient time to address those findings.’

The first consultation takes place after the fact finding during the audit in the form of a statement of preliminary findings (or a letter containing those findings) and the second one on bases of the draft report during the adversarial procedure. ECA’s audit is mainly aimed at activities of the European Commission, but many other parties may be involved. Those parties are referred to as ‘the beneficiaries’ of EU funds, for instance a University under Horizon 2020 subsidies or a farmer under the programme on agriculture and rural development. Those parties are often subjected to audits of the European Commission (eventually by external private auditors hired by the Commission) and the ECA. In those relations general principles of good administration do apply. An analysis of the audit instructions, for instance the Financial and Compliance Audit Manual shows that on the one hand the procedures and criteria for audits are described in detail. On the other hand, a manual like this is not written with the principles of good administration in mind. However, with these principles in mind one can identify the following ‘good administration’ elements, which apply to planning the audit, the audit process itself and the subsequent reporting.

- The auditor should prepare audit documentation on a timely basis (1.10);
- The audit process is submitted to systemic quality control (1.11);
- Professional judgment and scepticism should be exercised when planning, as well as performing and reporting on audits (2.1.3);
- Auditors should acquire an understanding of the entity so as to have a frame of reference within which to plan and perform the audit and to exercise sound professional judgment (2.3.2);

- Sufficient, relevant and reliable audit evidence is needed to substantiate audit conclusions in relation to the audit objectives (2.4.2-4);
- If necessary confidentiality of audit evidence should be safeguarded (2.4.10), and
- The rights of third parties get special protection, in case they are or could be identified in the report (4.1.5).

It is obvious that the consultation of beneficiaries and the commission during the audit process contributes to good administration, but it is important to discuss separately the implications of principles like proportionality and legal certainty for the audit process. The examples given in the Introduction raise two questions. Firstly, to what extent auditees or beneficiaries can rely on general principles of good administration during the audit process? Secondly, the question what remedy is in place for a beneficiary or other interested party.

The first question should be answered in the positive, in the sense that the general nature of principles of good administration imply that they are applicable to audit as well. Public or private auditors acting on behalf of the European commission or other European organisations like agencies are bound by those general principles of good administration. Auditors should apply them during the audit process as us them as a frame of reference in applying audit standards. This means that auditors, in order to form sound professional judgement on the audit issue at hand, need to look at:

- the text, i.e. the rules that should apply;
- the context in which these rules are used, taking into account specific circumstances where necessary and applicable;
- intention of the rules, i.e. whether the rules where used in line with their overarching purpose and principles, including principles of good audit/administration.

The answer to the second question is not an easy one. Reading all audit standards and applicable procedures there are no special procedures

available in which principles of good audit can be protected. Indeed a decision on recoveries by the EU commission is subjected to legal protection by the Court of Justice. However, many decisions during the audit process acts are not (yet) reviewable acts. Waiting until the Commission takes a recovery-decision may take too long and might be ineffective, for instance if the recovery will cause serious financial problems for the beneficiary. And not every 'error' will lead to a recovery, but may lead to a replacement of projects in the Member State. Many debates on the regularity of (elements of) projects take place in shared management where national management authorities are competent. What if there is a dispute on the regularity of some elements of a project?

5. Conclusion

Feedback from beneficiaries on audit practices concerning EU programmes raise the question which general principles of audit exist and where do they derive from. Principles of good audit need to encompass a number of general principles of good administration. Otherwise auditors would act against the Treaty, against certain provisions of the Charter of fundamental Rights. In order to be in line with that Charter also auditors have to respect, when forming their professional judgement, certain eminent principles like the one of proportionality, legal certainty and the right to be heard while respecting reasonable deadlines. While the latter one is specifically arranged for in audit standards the first two are not directly apparent in those standards. And there is no immediate need for that since the general nature of principles of good administration imply that they are applicable to audit as well. To see that in practice public auditors, at whatever level, need to realise the relevance of these general principles of good administration for their day-to-day audit work. So that these principles of good administration become part of the principles of good audit.

For beneficiaries of EU subsidies the application of these general principles of good administration is fundamental to perceive to be treated fairly and just when dealing with the EU and to develop a relation of trust between auditor and auditee. For the European Union in general, trust between European institutions and citizens or entrepreneurs is key in gaining their support to and involvement

in EU programmes. General principles of good audit need to be further developed, building upon general principles of good administration and general principles of law. Such a development should decrease the risk that detailed rules become a predominant factor when forming and auditor's opinion while general principles of good administration may indicate a different direction.