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Integrated Analysis of the Use of Non-Reimbursable Funds. Financial Audit of Non-Reimbursable Funds

Aurelian Constantin¹, Carmen Gabriela Sirbu²

Abstract: The Community funds absorption constitutes itself an objective of the post-accession strategy. Their main role is to close the variances in the economic development level of the EU state members. What has been the significance of 12 years EU membership for Romania? Have we succeeded to increase the absorption degree of the European funds? In what fields? In 2017, was the termination of the cooperation Protocol, regarding the setting up and the conduct of financial audit for European and other non-reimbursable funds, a beneficial measure? What is the actual role of the financial audit?

Keywords: European funds; financial audit; European Union; market audit; public interest

JEL Classification: M42; R11; M48

1. Introduction

The accession of Romania to the European Union has opened new horizons for our country from the perspective of closing the economic gaps existing between us and the member states. Those past 12 years meant a huge amount of work effort for both governors and direct beneficiaries. The absorption capacity of the European funds gradually increased from one year to another during 2007 – 2015. For instance, considering the total amounts received from the EU budget, their annual variations were significant: €1.6 billion in 2007; €2.6 billion in 2008; €2.9 billion in 2009; €12.29 billion in 2010, reaching €5.56 billion in 2013, €5.93 billion in 2014 and €5.49 billion in 2015 (Gherghina, p. 6).

Until 2017, the financial audit activity was compulsory for the European projects with non-reimbursable financing. Starting with 2017, the financial audit activity has become optional, depending on the beneficiaries' wish, in the context where the applicants' guidance ceased the obligation of an independent financial audit, following the termination of the cooperation Protocol regarding the setting up and the conduct of financial audit for European and other non-reimbursable funds.

In this publication we will be focusing on the importance of the financial audit within the framework of the European projects with non-reimbursable financing, its implications for the direct beneficiaries and its impact on future absorption of the European funds as well.

In support of those affirmations, we will underline the precise activities performed in relation to the projects where the financial auditors determined an inherent risk of error which consequently either lead to expenses settlement failures or worse, to fraud accusations following the subsequent post implementation controls.

2. Theoretical Background

This publication is based on existent national statistical data regarding the absorption degree of the European funds (Gherghina, *Absorbția fondurilor europene în România/ Absorption of European funds in Romania*).

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I have analysed the Romanian Academy Society studies with a view to the European funds absorption's impact on Romania, the directions taken by them and the issues risen during their implementation.

Furthermore, critical documentary sources that I used, were the Audit Report regarding the performance in using the government budget allocated to programmes or projects financed through external funding during the interim period during 2007 – 2012, issued by the Court of Auditors and the annual reports of the Auditing Authority within the Court of Auditors.

3. Methodology

To perform the research, I employed a deductive and inductive method with a view to identify opinions, critics and opportunities. In the first stage, I presented the financial auditor's position and role in the European financed projects for a correct performance along with the mission of the auditing activity within those projects.

In the second stage, I presented the amendments which occurred in the financing guidance of 2017, in relation to the financing period of 2014 – 2020 and the implications of those decisions in the European projects performance and completion of financial audit activities by professionals.

As for the third stage, I presented the frauds/errors which might occur during the projects based on non-reimbursable finance and the methods that could be used by auditors in identifying them.

4. Findings

A. The Financial Auditor's Position and Role in the Correct Performance of European Funded Projects

To clearly identify the auditor's role within a project with non-reimbursable finance, we should start with the defining sentence of the standard report drafted in line with applicable ISRS 4400: "As our procedures are not an audit or review conducted in accordance with International Standards on Auditing or the International Standards on Review Engagements, we do not express any assurance as to the claim for reimbursement attached. If we had any additional procedures or if we had audited or reviewed the Beneficiary's financial statements in accordance with the International Auditing Standards, other elements could have been subject to our attention, which would have been reported to you".

Building on those aspects, we ask ourselves whether the audit is necessary or not for the projects with non-reimbursable financing. Certainly, it is, in our opinion. The auditor has the possibility, even if optionally, to undertake any measure for ensuring the expenditure's reality, which makes the object of the funding application. In that respect, the auditor has the possibility to request both internal (provided by the organization) and external evidence (provided by other entities).

Thus, the financial auditor can, via the activities performed, to detect errors or frauds in the beneficiaries' statements of expenditure.

The condition is that the financial auditor should be independent, requirement which is not compulsory under the ISRS 4400 standard. Also, the auditor should pre-emptively perform all the investigations generally undertaken by the financer via the Management Authorities or other inspection bodies.

In that way, the financial auditor could, through the activities performed, to detect errors or frauds in the beneficiaries' expenditure statements.

The "irregularity" is represented by "any infringement of a provision of Community law resulting from an act or omission by an economic operator, which has, or would have, the effect of prejudicing the general budget of the European Union or budgets managed by the Communities, either by

reducing or losing revenue accruing from own resources collected directly on behalf of the Communities, or by an unjustified item of expenditure” (Regulation (EC) No 2988/18.12.1995 of the European Council).

In the Romanian legislation, the irregularity is defined as “any infringement of legality, regularity and conformity in accordance with both national/European legal provisions and contracts or other legal agreements provisions concluded based on those provisions, which prejudice the general budget of the European Union and/or budgets managed by the European Union or on its behalf, along with budgets sourcing the relating co-financing, through an unjustified expenditure” (Government Emergency Order No 79/2003 referring to the control and recovery of the European funds). If we analyze attentively this first definition from the Romanian legislation, we can easily notice that it is mentioned only the “prejudice of the budget”. The definition offered by the European legislation is wider, where the irregularity “has, or would have, the effect of prejudicing the budget” in case that it might not be discovered. In other words, the European legislation considers as being irregularity even the inclusion of an amount of money in the financial statements, amount originating from an irregularity although that irregularity had been spotted in time and the payment wasn’t made by the Beneficiary.

In the national legislation, that type of omission is adjusted through the Government Emergency Order No 66/2011 substituting the Government Emergency Order No 79/2003. At article 2 paragraph 1 of the Government Emergency Order No 66/2011, the irregularity is defined as being “any infringement of legality, regularity and conformity in accordance with both national/European legal provisions and provisions of contracts or other legal agreements concluded based on those provisions, which result from an action or lack of action of the beneficiary or of the competent authority managing the European funds , which prejudiced or could prejudice the European Union budgets/the budgets of the international public donors and/or national public funds”.

Therefore, both European and national legislations place a great emphasis on preventing measures, in that way where the irregularities should be revealed and penalized before they would effectively prejudice the European budget.

There are two main categories of irregularities which the auditor could identify: errors and frauds.

Error is any infringement from legality which occurs following an action or lack of action of the beneficiary which led or could lead to the European budget’s prejudice by an unjustified amount paid. The fraud represents the error committed intentionally. Mihailescu et. al (2008) captures the role and the importance of the financial auditor and, consequently, their responsibility: “From the auditors” practice it resulted the fact that often it is more difficult to detect frauds as the managers or employees committing a fraud, are trying to disguise it. However, that fact does not change the auditor’s responsibility towards the planning and the appropriate conduct of the audit”.

There are three elements which underpin the frauds, and can be summarized under a “fraud triangle”: opportunity, justification and financial pressure (Cressey et. alli, p. 41).

We shall analyze only the opportunity element of that “fraud triangle”. The opportunity resides in the weakness of the investigating systems. Despite the justification and the financial pressure, if the Beneficiary of a project with non-reimbursable funding would not have the opportunity, then that fraud would not be committed. Right here intercedes the auditor’s role: the Beneficiary has to be conscious that the auditor will detect any fraud attempt since the project’s implementation stage.

We take into consideration that the auditor is the first person able to identify the error or fraud and they might report it to the competent bodies as they have got the skills and possibly the necessary independent status.

B. Legislative Changes for Auditing Obligation for the Projects with European Funding

Within the framework of current regulations regarding the performance of operational programmes during 2014 – 2020, respectively the applicant’s guidance, it has been considered that the financial audit activities within the projects had to become an optional activity. Those provisions led to the

termination of the cooperation protocol regarding the setting up and the conduct of financial audit for European and other non-reimbursable funds between the Regional Development Ministry, the Public Administration, the European Funds and the Romanian Chamber of the Financial Auditors.

Even if eligible in theory, the financial audit activity is mentioned as eligible within the indirect expenditure, category capped to a specific percentage of the indirect expenditure, thus being subject to inherent budgetary constraints, fact which will lead to the impossibility of any objection to be contracted at a reasonable level. In practice, that activity will be omitted by the beneficiaries most of the time.

The implications of that unilateral decision of the authorities are multiple and significant, having a direct impact specifically on a sound financial management of the projects, respectively that of funds absorption in general, being a great opportunity for potential errors, irregularities and frauds. In that way, the beneficiaries of the financed projects will not be able to correct any possible implementing errors during the project's performance, being subject to an ex-post inspection carried by the Audit Authority within the Romanian Court of Auditors.

C. Which are the Frauds/Errors that Might Arise during the Projects with Non-Reimbursable Financing and how the Auditors Could Identify Them?

Some of the most common frauds/errors are:

- Frauds/errors in human resources area;
- Frauds/errors in purchases area;
- Frauds/errors in travelling expenditure area;
- *Frauds/errors in human resources area.*

One of the most common frauds, especially in the programmes relating to human capital development, are those relating to staff costs.

In the Romanian legislation and not only, has always been a limited number of hours for someone employed by an employment agreement. Thus, someone employed by one or more employers can work a maximum number of 12 hours per day.

The employment law, through that restriction, is supporting the employee who would need at least 12 hours break to recover for the next working day.

Starting with that restriction, the employers running projects with non-reimbursable financing turn to all kind of ploys with a view to arrange illegal settlements for as many hours as possible for their employees.

A particular case is that of Universities which employ teaching staff on a full-time basis. Thus, the teaching staff of universities have individual employment contracts for 8 hours/day even if they are working only 2-4 hours/day when teaching during the courses/seminars. According to Law 1/2001, the rest of hours up to 8 hours/day are allocated to the teaching staff for preparing the courses and seminars, research etc.

Also, those teaching staff work, besides the agreed norm, when there is a shortage in teaching staff, overtime at a specific "hourly rate". In that way, the teaching staff would work 2-4 hours extra per day, teaching either during courses or seminars.

When a teaching staff is involved with a project having non-reimbursable financing, they have to justify through timesheets their working hours for that specific project. Also, they have to declare, on their own responsibility, the number of hours worked on a daily basis for any other projects or activities for which they were paid.

Here, the fraud occurs. As I have specified above, the difference between fraud and error is associated to intention. Hence, intentionally, being aware that they cannot declare a higher number of 12

hours/day, the teaching staff does not declare the actual number of working hours, that of 2-4 hours per day (out of 8 hours/day). In addition, they deliberately omit to declare the hours paid at an overtime "hourly rate".

How could the auditor, as the first investigating link, to determine that fraud?

In order to avoid the finding of those frauds happening within the European projects, usually the Universities do not declare the amounts settled as hours worked but as amounts of money. In that way, even if the pay slips are done distinctively for each project, there are pay slips where are mentioned both the number of hours and their gross value (the payment for the projects with non-reimbursable financing being made upon the number of hours worked); individual timesheets are prepared showing the number of hours when tax declarations are made (the so called declaration no. 112), when the financial officers declare only the basic number of hours. The number of hours paid at an overtime hourly rate and for activities within the projects with non-reimbursable financing appear only as amounts of money.

The financial auditor will verify, even if is not currently compulsory, those declarations as well and will notice that a staff who worked just 8 hours /day was paid with an amount of money consisting of relating basic amount, relating overtime hourly rate and the amount relating to the project with non-reimbursable financing. Dividing that sum of amounts by the number of hours declared for taxes, it will result that the staff was paid with an hourly rate higher than specified in their individual employment contract for the basic norm and in their employment contract for the project having non-reimbursable financing.

As a consequence, the amounts of money paid for those projects will not be declared as eligible, the Beneficiary wouldn't be allowed to include them in their payment requests.

- ***Frauds/errors in the purchases area***

In most cases, the frauds in this area start since the project is being written, in association with the consultancy firm which is writing the project. In that stage, it is possible that the future beneficiary of non-reimbursable financing would have already decided from where and whom they will purchase the fixed assets/ inventory objects necessary for the project. Many beneficiaries have not understood, after so many years of implementation that the purchases should be strictly necessary to the project submitted and that they would need to be made as though as they were paid from the beneficiary's own budget. Besides, one of the most important principles of the non-reimbursable financing is that the expenditure should be made upon the same rules as if it would be supported by the own budget.

In this case, the auditor's role, who would have to be employed since the beginning of the project, is to pull the alarm signal when they would notice that the purchases are being prejudiced. There is a possibility that the purchases are being made through a long-term supplier of the beneficiary. An indication would be, in that case, the age of the business relationship between the beneficiary and the supplier used for a project having non-reimbursable financing. From our point of view, longer is the business relationship prior the project, greater the risk of the purchases made from that supplier to be prejudiced. The prejudice could be created by buying a product at a higher price than other competitors would offer.

- ***Frauds/errors in travelling expenditure area***

Considerable errors could intervene during projects implemented in partnerships with beneficiaries from other countries, and I refer here mainly to the cross-border projects: Basin of Black Sea, Interregional Romania-Bulgaria, Romania-Ukraine, Romania- Republic of Moldova, Romania-Hungary etc.

In projects of that type, there is allocated a large amount of money with a view to organising common events in a third country. Usually, the events are carried along more days, during which people from partner companies are invited.

An example of fraud is the declaration of expenses for more days than the actual event lasted, when those people were taking part to the event effectively. Usually, the people invited/guests are present on the day of the event and they return on the same day, however the settlement is made on the whole period of the event. An “aid” is coming to the Romanian legislation in accordance with the European legislation which does not require solid evidence to prove someone’s presence in a specific place (such as the bill for accommodation). In that way, that person receives a delegation compensation which includes a daily flat allowance for food and accommodation without requesting justifying documents.

How could the auditor detect the fraud in this case? Simple, we say. The auditor has the possibility to request the border authorities to confirm the exact leaving day and the return day for that person. We agree that it would be possible for a trip outside the European Union or for a flight within the Union. What does it happen in other cases, when someone is travelling by car from one country to another within the European Union?

Well, there is a possibility here too, by checking the fuel receipts which could show when and where that person passed through.

A useful hint in cases of fraud associated with travelling expenses is that the appointed person declares that they travelled by car or other mean of transport, but they do not request settlement for the travel expenses. There is a chance of over 95% for a potential fraud in that case. Nobody is offering gratuities in situations of settlement supported by non-reimbursable funds. It is obvious the fact that they preferred to bear costs themselves as they could recover the expenses from the flat allowance received for the trip!

5. Conclusions

The role of the financial audit is of paramount importance in correcting deviations from the national and European legal provisions. It is easier to prevent errors or any possible frauds than risking a refusal for having the expenditure approved by the intermediary bodies or worse, to receive penalties and request to return the money paid for that expenditure, following an ensuing investigation.

Any subsequent financing sourced by European Union may be affected by the correctness of current projects’ performance.

An efficient management of the European funds offers value to the investments undertaken based on those funds and the audit has the role to ensure the operations’ accuracy. Despite the guidance for applicants willing to access the European funds which states that the financial audit is optional, our recommendation is to reinstate the audit as a compulsory condition in projects’ budgeting, giving it great importance.

The above-mentioned situations determine us to reiterate that preventing is easier than correcting. Besides, the risks entail financial matters and business image, issues that cannot be disregarded.

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