The EU Legal Audit Framework - The Case of Kosovo

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Abstract: This paper will analyze the legal framework and the development of the audit according to the *acquis* and the role of the general auditor in preserving public money in Kosovo. Like any other country in Europe that claims EU membership, Kosovo should continue the process of harmonizing its legislation with EU directives that require the so-called "hard" transposition of the acquis. One of the major segments of EU membership is the development of a system of internal financial control in the public sector. This paper will address the issue of Audit in the development phases, which has passed since 1800 to date, modern times. It is evident the role of the general auditor in ensuring the credibility of the financial system and in promoting the independence of the auditor, in the functional, financial and operative aspect, which always consists of a dynamic and never static process. The purpose of this paper is to review the regulations - EU directives through normative and comparative methods, in particular the provisions that foresee protection of the public interest and ensure the quality of the audit in the EU. Therefore, in this paper, the crucial audit role is concluded in the qualified examining of financial accountability in managing public finances in general.

Keywords: History of auditing; audit objectives; auditing EU regulation

1. Introduction

Regardless of the different forms of regulatory state that have distinguished in essence the mode of operation, it can be said that from the middle of the 1800 and early 1900, the practice of auditing was considered to be a kind of *"traditional conformation of the role of audit"* (Heang & Ali, 2008, pp. 1-3).

The word *audit* derives from Latin, which means *to hear*.

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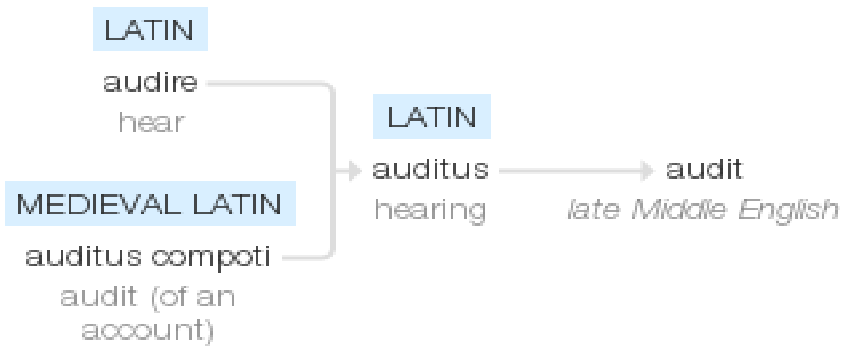

Figure 1. **Origin of the word audit**

Source: website https://www.google.com/search

According to some authors, audit is a social phenomenon which serves only for practical use and the existence of auditing is totally utilitarian (Flint, 1988).

According to *Brown* (1962) the audit objectives and techniques have changed over the years along with changes in societies influenced by economic, political, sociological factors in some cases also environmental factors. Today, auditors are required to provide a framework for understanding the role and the process of auditing and far from memorizing techniques (Pratt & Peursem, 2006, pp. 11-32).

There are eight recognized principles in the field of audit which express the overall audit characteristics, at *Mautz and Sharaf*:

- The primary condition for an audit is that there is a relationship of accountability;

- The subject matter accountability is too much remote, too complex, and/or too great significance for the discharge of the duty to be demonstrated without the process of audit;

- Essential distinguishing characteristics of audit are the independence of its status and its freedom from investigatory and reporting constraints;

- The subject matter of audit, for example conduct, performance or achievement or record of events or state of affairs, or a statement or facts relating to any of these, is susceptible to verification by evidence;

- Standards of accountability, for example of conduct, performance, achievement and quality of information, can be set for those who are accountable; actual conduct, performance, achievement, quality and so on can be measured and compared with these standards by reference to known criteria; and the process of measurement and comparison requires skill and the exercise of judgement;

- The meaning, significance and intention of financial and other statements and data which are audited are sufficiently clear that the credibility which is given thereto as a result of audit can be clearly expressed and communicated;

- An audit produces an economic of social benefit;

- There is no necessary conflict of interest between the auditor and the management of the enterprise under audit;

- When examining financial data for the purpose of expressing an opinion thereon, the auditor acts exclusively in the capacity of an auditor;

- The professional status of the independent auditor imposes commensurate professional obligations.

Therefore, the role of auditing has changed throughout history, by overcoming the historical paradigm, it is essential that auditing to be understood as a proactive and logical approach towards auditing - a qualified examination of legal and financial compliance. After the industrial revolution, with the growth of businesses the need for auditing of their economic activity is also highlighted. Upon reaching the contractual agreement between the contracting parties an audit engagement usually continues with the risk assessment and the formulation of an audit plan that defines the scope and objectives of the audit, and thereafter auditors collect and analyze audit evidence and form the opinions that deal with the internal control, as well as the credibility of the information provided by management and at the completion of the engagement auditors present a formal report expressing their opinion (Aicpa, 2012, pp. 1-4).

In order to have a more accurate overview of the historical development of the audit, the audit analysis can be divided into several chronological periods, such as: before the 1800s, during the years 1800-1920; 1920-1960; 1960-1990 and 1990 onwards (Heang & Ali, 2008, pp. 1-3).

The early historical development of the audit is not well documented, but in the period of ancient civilization in China, Greece, Egypt, and in England, it has been found that some of the activities of the then states that have to do with the revenues and public expenditures were audited - controlled by special persons appointed by that state organization. During the years 1800 - 1920, the auditing practice was not formalized until the occurrence of the Industrial Revolution in England. With the increase of the number of companies in form of corporates, the amount of invested capital increased automatically and in this way the stock market was unregulated and had high levels of informality and financial loss.

Therefore, in 1844 the so-called *Joint Stock Companies Act* was approved, which stipulated that company directors should keep accounting books that need to be balanced, complete and with accurate data. During the years 1920 - 1960, the historical development of the audit moved from England to the United States. During this time, the world economy suffered the great economic crisis from 1929 to 1933, when the Wall Sreet crisis affected in the growth of economic depression. The economic recovery of the stock market made the division of ownership from the corporate manager and thus increased the interest of the investors to invest the capital in the companies that had financial statements that presented their position and performance. The role and function of the audit influence the increase of the credibility of the financial statements by identifying the frauds and mistakes of the companies in question.

In this period, the role of the audit consisted of: internal control of the companies involved the sampling technique; audit evidence was collected from internal and external sources; the financial statements had to be prepared by accurate data; During the audit process should be reconsidered the evidence from external physical observation and other sources outside the accounting book (Heang & Ali, 2008, pp. 1-3).

During the period 1960-1990, the audit process was advanced along with the novelties and the technological changes that affected the period in question and the increase in the number and complexity of the companies. The role of auditing grew to the extent that it was facilitated equally by developing the whole audit procedure relying on computer methods. In the 90's, the role of auditing grew day by day and the creation of specialized companies offering audit services including the creation of independently audited audit reports, increasing the level of trust and accountability for fraud detection, avoidance or concealment of taxes. At this time, was undertaken some reforms that are considered radical in some countries of the world, such as in the USA was approved Securities and Exchange Act of 1934 that created the *Securities and Exchange Commission (SEC)* committee, which had a duty to state authority to issue audit rules and oblige the US company to periodically submit audit reports to this commission drafted on the basis of GAAP (Accounting Principles). In 1939 *the Statement on Auditing Procedure* (SAP) entered into force, this regulates the method of inventory inspection and income receivable by the auditor. In 2002, the *Sarbanes-Oxley Act (SOX*) was adopted, which imposes a significant change in public companies and in the accounting profession. Then in the Australian state after the collapse of HIH Insurance Ltd, the Australian government engaged professor Ian Ramasay to investigate the issue of the auditor independence, the draft report is known as the *Ramasay Report.*

At present, AICPA[1] has listed some of the necessary conditions for a future advanced audit and is required by the *audit* to be: audit evidence provided by automated procedures; High degree of auditor capacity in information technology and audited cases; Availability and control of audit reports; Credible means for obtaining the results of the audit procedures in a timely manner; Reliability of systems that provide the subject.

2. Audit Regulatory Framework in the European Union

The Council of the European Union has taken some legal steps to regulate auditing in the European Community area. EU legislation in the area of audit is comprised of directives and regulations. The EU Council has adopted a directive on company auditing in April 2006, while last amended in April 2016 2016 (2006/43/EC)[2] this foresees expanding the scope of application of the EU legislation, specifying the duties of legal auditing, independence and ethics.

The regulation contains a series of additional requests that have received much attention, but only concern statutory audits of public interest entities (PIE).

These additional requirements include mandatory firm rotation (MFR) and non-auditory prohibited services (NAS). In Chapter 32 of the *acquis*, it is foreseen: Public Internal Financial Control (PIFC), External Audit and Protection of EU Financial Interests. (Gjinopulli, 2013, pp. 1-4) Within the framework of the International Organization of Supreme Audit Institutions (INTOSAI), there are three permanent commissions: Professional Standards Commission (PSC), Exchange of Knowledge service (KSC) and Capacity Building Commission (CBC) (Cocolli, 2014, p. 87).

[1] AICPA Assurance Services Executive Committee's Emerging Assurance Technologies Task Force.
[2] Directive 2014/56/Eu Of The European Parliament And Of The Council of 16 April 2014 amending Directive 2006/43/EC on statutory audits of annual accounts and consolidated accounts.

So there are a whole range of bodies of an administrative and executive nature that deal with the audit process. As a judicial body which is considered the highest authority for audit matters, is the European Court of Auditors (ECA) which carries out the function of an external auditor focusing on financial reporting within the EU. The ECA deals with three types of audit: financial, compliance auditing and performance.

With the amendment of the directive on auditing, the provisions provide protection of the public interest in order to increase the quality of the audit, as follows:

- Independent audit committees are required to monitor the financial reporting process and the statutory audit;

- Independence must be clearly defined. Auditor/firm cannot be involved in any way in decision-making of the audited entity;

- All statutory auditors and audit firms are subject to a system of quality assurance and subject to public oversight;

- Statutory audits must be carried out in accordance with international standards on auditing;

- Member states must organize effective systems of investigation and sanctions, which may be civil, administrative, or criminal;

- Member states must designate competent authorities responsible for approval, registration, quality assurance, inspection, and discipline for the purposes stipulated by the directive. They must cooperate with each other;

- Statutory auditor or audit firm can only be dismissed if there is a significant reason why the statutory auditor cannot finalize the audit. The reasons for dismissal or resignation must be disclosed;

- Key audit partner(s) responsible for carrying out a statutory audit rotate(s) from the audit engagement within a maximum period of seven years from the date of appointment and is/are allowed to participate in the audit of the audited entity again after a period of at least two years;

- Audited companies must disclose total fees paid to the statutory auditor or audit firm, broken down by fees for audit services, other assurance services, tax services and other non-audit services.

Statutory auditors and audit firms that carry out statutory audit(s) of public-interest entities publish on their websites, within three months of the end of each financial year, annual transparency reports that includes a description of the legal structure and ownership, a description of the governance structure of the audit firm; a description of the internal quality control system of the audit firm and a statement by the administrative or management body on the effectiveness of its functioning, etc. (Jankovic, Ivankovic & Jerman, 2015, pp. 1-14)

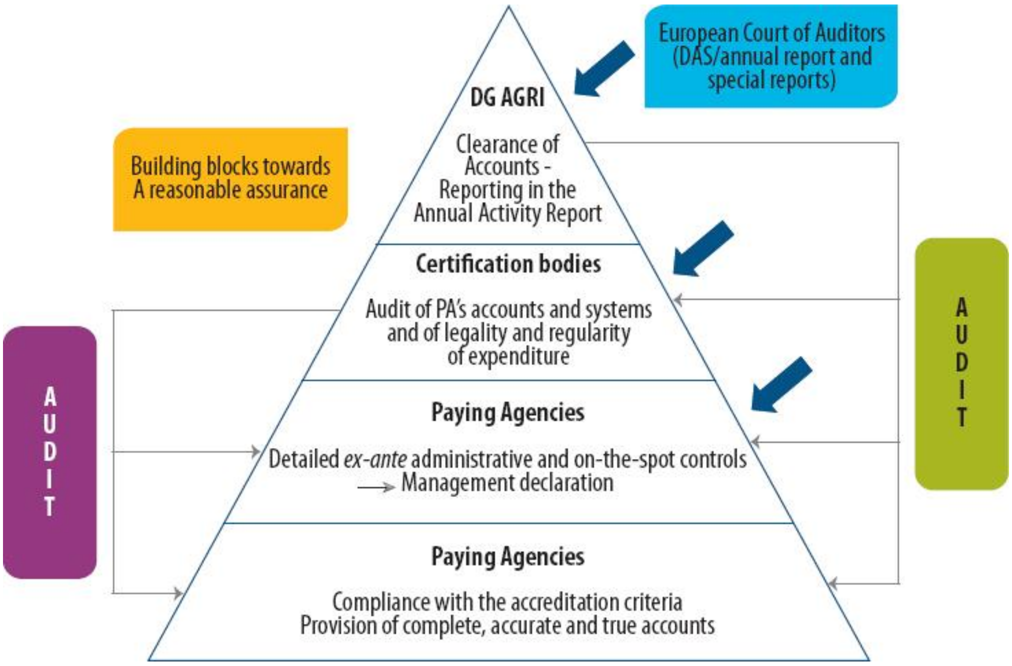

Figure 2. Diagram of audit system in EU

Source:https://www.google.com/search?client=safari&rls=en&biw=1343&bih=769&tbm=diagram +of+audit+system+in+EU

3. The Role of the Auditor General in Preserving Public Money - The Case of Kosovo

States claiming membership in the EU must align their legislation with EU requirements. All of these countries, including Kosovo, should establish and develop their own internal financial control systems in the public sector known as the *Public Internal Financial Control* (PIFC) and apply this system to all government units (Ginopoulos, 2013, p. 111). PIFC requirements consist of two elements:

- Financial management and control;
- Internal audit.

However, in the requirements corpus of EU institutions for countries that aspire to EU membership except the main requirement that is *financial responsibility* considered as the main criterion for EU admission as it is about auditing or controlling of public money entrusted to the public sector, is requiring improving public accountability ratio.

There are also a number of conditions to be met to achieve full membership, including the establishment of effective financial control mechanisms that enable effective control of collection, spending and public money management.

The EU seeks a kind of comprehensive unification in terms of economic and political dimension within the European community, which is considered prerequisites for the EU functioning.

Through public money auditing, we evaluate how public institutions perform their duties (Kutyla, 2013, p. 1).

There are some EU Council regulations that deal with financial control, management and auditing of public money. According to the Law (No. 04/L-014) on Accounting, Financial Reporting and Auditing of Kosovo, within the scope of the powers of the Kosovo Financial Reporting Council (KFRC) as an independent professional body appointed by the Government, has the duty to: draft and approve *Kosovo Accounting Standards* in accordance with the provisions of the IAS/IFRS, and also oversee and implement audit standards in accordance with ISA and EU Directives as well as licensing auditors who, in addition to meeting the terms and conditions of professional education should be persons of high integrity and good reputation.

External Audit of Public Funds, Budget Execution, Use and Governance of Public Resources in Kosovo is the exclusive competence of the *Auditor General*, which is an independent body, operationally, financially and operationally. The independence of the *Auditor General* in preserving public money is ensured through the accountability mechanism constructed in that form that this body responds directly to the Assembly as a representative body of the people while being appointed upon the proposal of the President of Kosovo following voting in the Assembly with the majority of votes.

The Office of the Auditor General in Kosovo has a duty to conduct mandatory regularity audit on an annual basis of: Kosovo Government Budget Report and all budget organizations that have directly received a budget under the annual budget law and are obliged to draft Annual Financial Statements and carry out mandatory regularity audits in Public Enterprises, public-private partnerships, loans, credits or liabilities guaranteed by public sector entities as well as the treatment of all *public money*. The Auditor General has the task of drafting the audit report for the audited institution, these reports are submitted to the audited institutions and the Assembly not later than 90 days from the submission of the Annual Financial Statements.

Each public sector entity that deals with public money should systematically undergo internal audit aimed at assessing the appropriateness and effectiveness of financial management systems, control systems and asset retention.

4. Conclusion

The meaning, role and function of auditing is crucial in terms of public finance management in general. Depending on *public money* management, the level of economic and social development of the states is determined.

By harmonizing domestic legislation with EU regulations and directives in the field of auditing, a standardization approach is achieved - unification of European Community legislation and provides security for foreign investors in the public-private partnership sector, with regard to the accountability report. Kosovo's legislation in the field of audit is fully in line with the eighth EU Directive (84/253/EEC) regarding the qualification of persons responsible for carrying out statutory audits of accounting documentation.

Therefore, we can conclude that the Kosovo audit process and *public money* management relevant to legal infrastructure is in full harmony with the *acquis*, but from a practical point of view and the political readiness to manage - legitimately spent *public money* - remains to be deserved, taking into account the level of corruption and misuse of official duty by public sector officials. Alongside the improvement of the social situation in Kosovo's economy, the level of awareness of the accountability request by the officials entrusted to the collection, allocation and spending of *public money* will be increased.

Auditing or control of public money is indispensable in any state law system.

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