COSO principles and European Social Fund funded projects in Romania

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Abstract

European Social Fund (ESF), being one of the oldest Structural Instruments of the European Union (EU) has to be implemented through projects, by public and private entities all over EU, according to the principle of “sound financial management”. But, are the Romanian ESF financed projects ready to comply to the “sound financial management” principle? The answer at this question may be delivered by a descriptive research on COSO’s principles in ESF implementation context, followed by an explorative research on beneficiaries’ perception about how COSO’s principles are implemented in their projects. The conclusions lead to a number of easy-recognizable and applied principles but also to some less applied principles, generating risks in ESF projects and in ESF implementation as a whole.

Keywords: COSO, European Social Fund, projects, sound financial management;

1. Introduction

European Social Fund’s (ESF) actual purpose is to finance labor market inclusion, and development of labor market related services, for more and better jobs in Europe through individual grant contracts, awarded within calls for proposals organized by the program Managing Authority to public or private beneficiaries offering requested types of services on exchange of ESF and national money. Grant contracts contain provisions related to eligible financed activities or services and their duration, to the target groups as number and structure, and a breakdown of eligible expenditures as well. The financed activities are mostly labor market related services such as: informing and counseling, certified training for new qualifications, job mediation and financial support for the participants. ESF beneficiaries must implement their interventions according to the “sound financial management” principle, as it is defined in the EC Regulation no. 1605, 2002 – Financial Regulation, i.e. considering the economy, efficiency and effectiveness.

2. Research and methodology

Our study tends to explore how ESF regulatory context encourage internal control implementation in organizations as parts of the management and control system, roles of authorities in enforcing the sound financial management as part of COSO’s internal control definition and how COSO’s principles are recognized, and perceived as applied by ESF financed beneficiaries in Romania, in connection with accountability of sound financial management. ESF regulatory context is explored through a qualitative, descriptive research of COSO’s internal
control definition reported to the general legal framework. The ESF beneficiaries COSO’s internal control related behavior is explored through an inductive interpretation of on-line questionnaires applied to managers, accountants, financial responsible, auditors and other members of implementation teams. There were 100 answers from about 1% of the total ESF financed projects in Romania. Convergence of implementation reality to COSO principles was explored through indirect questions related to implementation facts, so that all above mentioned stakeholders were invited to value their perception on the actual situation of their ESF project implementation. Even if study’s results could be affected by the data collecting method, convergent answers given within each category of respondents, small and explicable differences among categories indicates a reasonably reflection of actual facts of ESF projects.

3. COSO and the sound financial management of ESF financed projects in Romania

The sound financial management has to be declared, but also monitorized and controlled. Performance has to identifiable, measurable and has to be also accountable in each ESF financed project. As long as performance identification and measurement should stay with the Authorities, the accountability remains a task for beneficiaries accounting systems. This is why; provisions referring to performance should equally involve the national program management authorities and the beneficiaries spending EU money in their projects. Performance accountability creates for beneficiary’s real opportunities in terms of in-time interventions on budgets, activities and results. Performance accountability in ESF implementation could mean in terms of efficiency a larger number of qualified workers or people receiving a large range of useful labor market related services and eventually, in terms of effectiveness more and better jobs, representing the most significant impact of an ESF financed project consistent to ESF and Romanian policy goals.

For a sound financial management, ESF implementation performance should be referred in the general legal framework and stakeholders internal procedures as well. Internal control, especially in beneficiary’s organizations may reasonably ensure management about ESF performance, and COSO, being the most widely known internal control referential, may provide common language and support for internal control implementation. Organizing internal control is not subject of specific ESF rules and regulations, but of national rules harmonized with the EU and international rules. Even so, program implementation rules should refer to and encourage commitment to internal control development measures among all beneficiaries. On the other hand, to achieve its goals, internal control has to be perceived as useful, and implemented by the beneficiaries according international best practices collected and systematized by COSO in the referential principles.

Sound financial management may thus become a natural result of implementing internal control system based both on external supportive regulatory framework and also on internal approaches embodied in practices, policies and procedures COSO complaints.

3.1. COSO and EC Regulation 1083/2006, the general regulatory framework

Sound financial management is perhaps the most important financial concept of European Union and is mentioned in the 274th article of the consolidated text of the Treaty establishing the European Community stating that the EC implements the budget on its own responsibility in accordance with the principle of sound financial management and Member States shall cooperate with the Commission so that budgetary appropriations are used in accordance with the principle of sound financial management. According to the 27th article of the Financial Regulation (EC Regulation no.1605, 2002), the concept of sound financial management include as principles economy, efficiency and effectiveness.

If we are associating to the sound financial management the legality and regularity of the financed operations we may have an image on the entire scope of the ESF management and control system, as it is stipulated in the relevant European regulations. Empowered national authorities and how they interact, including with project beneficiaries as a whole creates the image of the way in each every Member State of the European Union acts to achieve the purpose of the ESF.

Thus, in terms of implementation internal control over the ESF implementation system, we may agree that elements of internal control COSO’s definition can be found in the description of management and control systems
as stated in table 1, containing a selection from the general regulatory framework (the 58th article of EC Regulation 1083/2006). This may create support for national further developments of the internal control systems especially for European funding beneficiaries, including here ESF beneficiaries as prior condition in performance measurement and accountability of the financed operations.

**Table 1. COSO and the management and control system (art. 58 of EC Regulation 1083/2006)**

<table>
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<tr>
<th>Internal Control defined by COSO</th>
<th>Management and control system, role to ensure:</th>
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| effectiveness and efficiency of operations | • rule for auditing the functioning of systems,  
   • compliance with the principle of separation of duties among public institutions involved and in each of them as well; |
| reliability of financial information | • reliable accounting, monitoring and financial information systems in computerized form,  
   • a reporting and monitoring system where the responsible public institution uses the delegations of powers, |
| degree of compliance with applicable laws and regulations. | • definition of the functions of institutions that have responsibility for management, control and allocation of functions within each public institution,  
   • reporting and monitoring procedures for irregularities and recovering amounts unduly paid,  
   • Systems and procedures to ensure a proper audit process. |

From performance perspective the audit of functioning systems may use available guidelines of the European Court of Accounts (2011) as well as some of Romanian Court of Accounts (2005). These guidelines are a ready to use part of a methodological effort that have not been completed yet with a legal obligation for Audit Authority in conducting operational audit missions for the Structural Instruments, so that achievement of performance audit missions of ESF funds stayed up. In terms of compliance with the principle of separation of duties among bodies and within each of them, the regulation (CE Regulation no.1083, 2006) defines the necessary framework for a proper functioning of institutional management and control system: the establishment of the Managing,

Further on (articles 59 - 62), the Managing Authority seemed to have efficiency and effectiveness related responsibilities. It has to ensure itself that all financed operations are compliant with EU relevant rules, so sound financial management is not an option. The Managing Authority may realize this by means of management verifications or periodical evaluations. Evaluation doesn’t mean that fund recovery can be applied for sums spent outside the sound financial management; the only financial impact of the program evaluations ordered by the Managing Authority could reside on future program modification, after the approval of EC. Management verifications, conducted according Authorities internal procedures should be considered for measuring performance of ESF financed projects.

The role of Certifying Authority resides only to the certification of sums spent, according to the EU relevant rules, including so the sound financial management. Apparently, the Audit Authority has only to plan and execute audit missions, including here sampling verifications on declared expenditures. But, according to the general regulatory framework, it has also to establish its audit strategy, including here the future methodology in use. Including in this strategy performance audit missions is a choice but not a must for Audit Authority and such a decision can be assumed without other constraints within the actual European and national legal framework. Performance audit reports issued by the Audit Authority could and should be used by the Managing Authority, apart from management verifications, for unjustified expenditures recovery.

### 3.2. COSO and ESF financed projects in Romania

ESF is financing projects to organizations or partnerships delivering integrated services related to facilitation of the access to labor market dedicated to a total of 1650000 persons living in Romania. As long as the beneficiaries could be a large range of public or private legal persons, or even partnerships of these, national rules applicable for organizing internal control are different. If public legal persons have to organize it against the provisions of Ministries of Finance Order 946/2005, the private ones don’t have a compulsory framework. They have, in their best
case scenario, to adjust according world-wide recognized referential such as COSO, putting so in practice mechanisms that could offer a reasonable assurance for sound financial management of their projects.

Broadly, ESF financed projects may be seen as activities using program’s financial resources generating convergent results with the program’s indicators and impacts, as expected by national and EU policies. We may illustrate the components of sound financial management as follows:

![ESF Financed Project Diagram](image)

Figure 1. Performance of ESF financed projects

The economy may be achieved by daily reporting both personnel recruiting and use and assets procurement and usage against the transparency principle. Efficiency could be reported permanently, comparing each result to the extent of financial expenditure for that service delivered. Effectiveness should consider internal and external factors impact in influencing impacts. Demonstrated commitment to integrity, ethical values and competence, enforced accountability, identified risks and selected and developed control activities for risk mitigation are, in our opinion, the most important COSO principles regarding performance in general, and ESF implementation projects as well.

According to our study for a population of 49 persons involved working for about 1% of the total ESF financed projects in Romania; accountants and financial responsible perception of the above mentioned COSO principle is described below:

<table>
<thead>
<tr>
<th>COSO Principle</th>
<th>Accountants (15)</th>
<th>Financial responsible (34)</th>
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<tbody>
<tr>
<td>Demonstrates commitment to integrity and ethical values</td>
<td>73.34%</td>
<td>63.63%</td>
</tr>
<tr>
<td>Demonstrates commitment to competence</td>
<td>66.67%</td>
<td>87.88%</td>
</tr>
<tr>
<td>Enforces accountability</td>
<td>60.00%</td>
<td>76.76%</td>
</tr>
<tr>
<td>Identify, analyze and manage risks</td>
<td>60.00%</td>
<td>69.70%</td>
</tr>
<tr>
<td>Selects and develop control activities</td>
<td>40.00%</td>
<td>60.61%</td>
</tr>
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Reporting ESF project’s performance could be a difficult task if reliable financial information is not really connected with the services provided (activities). According to our study, less than 15% of the ESF projects are organizing management accounting. Even if more than 80% of the ESF project’s accountants connect “always” the invoices to the budget lines and activities, just about 60% accountants receive detailed explanations about meaning of the financial documents they have to register. About reliability of financial information, 60% of respondents claimed that financial documents are not “always” verified by someone else, before they receive them.
4. Conclusions

The Romanian nowadays realities are pushing national ESF financing environment rather to quantity, in an area where program indicators are to be achieved with the maximum of European financial support. Prior evaluation of financing program, made by the EC took into consideration the Romania’s year 2007 realities and program approval shouldn’t be considerate largely enough regarding sound financial management during all the implementation period 2007 – 2013. Realities are changing and Authorities should keep the track in creating and activating rules and mechanisms in so for. If there are no clear rules for performance implementation and measurement, internal control and management accountancy are still individual choices for organizations implementing ESF projects, so that the mix implementation degree of internal control and accounting management depends on level of interest and/or projects management proficiency. Even with a functional internal control system, implemented according COSO’s principles, if reliable financial information is missing, the management of ESF financed project cannot provide assurance about project’s sound financial management implementation. Timely delivered reliable financial data, processed by management accounting may be used for internal adjustments and management decision, protecting resources and assets from misusing or even fraud. If ESF financing will continue in 2014 – 2020 programming interval without use of cost standards, implementation of an appropriate management accounting model based on an accurate internal control system become essential from the sound financial management perspective.

Benchmarking may also be used to assess sound financial management of ESF projects and benchmarks can be obtained through econometric models. The budget as independent variable may be modeled according the deliverables of the ESF project as depending variables. Such depending variables may be considered: number of participants in projects – people receiving services, as a total, or people receiving only a type of services or a package of labor market related services. Such a model was designed in 2010 for the Human Resources Development component of PHARE pre-accession financial assistance granted to Romania. Benchmarks may be useful statically in ex-ante budgeting proposals and in on-going, flexible budgeting as well.

We may conclude that ESF financed projects in Romania readiness to comply with the sound financial management principle depends on improvements of national management and control system as well as beneficiaries internal controls. Sound financial management should be reported ex-ante firstly to project evaluation and contracting pursued by on-going management verifications (external and internal) and performance audit missions. Reliable, timely and personalized financial and non financial information is a must, so improvements of internal controls and management accounting should become usual facts in ESF project implementation.

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