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**POLICY ADVICE**

**ON THE IMPROVEMENT OF EXTERNAL AUDIT**

**OF LOCAL BUDGETS IN UKRAINE**

The present paper was prepared by the Directorate of Democratic Institutions, Directorate General of Democracy and Political Affairs, in co-operation with Prof. Paul Bernd Spahn, emeritus Professor of Public Finance, Goethe University, Frankfurt am Main, Germany, Prof. Gérard Marcou, University Paris 1 Panthéon-Sorbonne, Director of GRALE (Research Group on Local Administration in Europe), France, and Mr. Jon Barber, Audit Commission, UK.

## **Introduction**

The present policy advice was requested by the Working Group „Regional Development and Reform of Inter-Budgetary Relations“ of the Committee of Economic Reforms under the President of Ukraine, and the Ministry of Finance within the framework of the Council of Europe (CoE) Programme to Strengthen Local Democracy in Ukraine (2010-2013, funded by the Swedish International Development Cooperation Agency Sida). The Action plan of the above Working Group on Regional Development includes adoption of the new legislation on external audit of local budgets, in particular drafting of the Law amending Article 98 of the Constitution of Ukraine regarding the entitlement of the Accounting Chamber to control the implementation of local budgets.

The new Budget Code expanded powers of the Accounting Chamber to include control over revenues of the State Budget, formation of public debt, efficient use of state budget funds, use of local budget funds and transfers from the State budget, and collecting reports on the implementation of the State Budget of Ukraine (Articles 26, 53, 59, 60, 62, 109 and 110). However, following the adoption of the Law of 7 October 2010 “On Amendments to Legal Acts of Ukraine and Bringing them in Compliance with the Constitution of Ukraine”, articles 26, 53, 59, 60, 109 and 110 of the new Budget Code were amended, and with that the powers of the Accounting Chamber of Ukraine were reduced compared to the previous version of the Code.

The present paper is a CoE policy advice paper which was requested in order to help solve the inconsistency described above and to provide recommendations for improving the external audit of local budgets. In addition, the members of the CoE European Committee on Local and Regional Democracy (CDLR) provided information on the organisation of external audit in their countries (upon request from the Ukrainian CDLR Member, CDLR Chair Mr Huk). This information can be found in the Appendix to this paper.

The paper also takes into account the results of the Workshop co-organised by the CoE Programme, the Ministry of Finance, and the Working Group on Regional Development in order to discuss how could external audit of local budgets be improved in Ukraine. The discussion took place in Kyiv on 22 February 2011.

## **Definitions and general considerations**

Audit is often confused with control or supervision. Moreover, there are different definitions of audit, broader or narrower, depending on their purpose. In a broader sense, an audit is the evaluation of an organisation, a system, a project or a product, or event of a person with regard to given standards. The audit may be legal, financial or technical when it refers respectively to legal, financial or technical standards. In a narrower sense, audit refers to financial statements or accounts or, more extensively, to financial management.

The purpose of audit is to check the reliability of financial information on the basis of which a decision will be taken, and hence the reliability of the process of establishing this information. By contrast with supervision, the purpose of audit is not to set aside unlawful decisions and restore the legality; it is rather to serve directly the decision-making process. It is obvious that in reality the difference is not so clear, in particular because the same institution may serve various purposes, such as pure supervision, inspection and audit at the same time. For similar reasons, the institutions can be more similar in their functions than is suggested by their official names (for example Court of Accounts or Audit Office). The convergence is illustrated by the commonly accepted audit standards and the participation of all State audit institutions in the worldwide organisation, INTOSAI, with EUROSAI for Europe and EURORAI for regional audit institutions. State audit institutions are nowadays called in INTOSAI documentation "superior audit institutions"; this universal terminology reflects also the functional convergence.

In the management literature, another distinction is made between internal and external audit. This distinction is however not univocal: sometimes it is based on an institutional criterion (whether the auditors are staff/employees of the local authority under audit or not), some other times such distinction is based on a functional criterion (whether the results of the audit are intended to feed into the decision-making process of the local authority or of another, external entity such as a supervisory body, the government or the parliament). Yet in other cases, both criteria are used. According to this approach, internal audit will only be called so if it is both accomplished by employees of the local authority and its results are used by the authority itself, while external audit is accomplished by

an external entity and for the main benefit of other authority than the one under audit. Cases in between (in particular when the audit is performed by an external body but its results are used by the local authority) are dealt with separately. In a 2007 report<sup>1</sup>, the CDLR chooses to use the first (i.e. functional) distinction (in fact, to avoid misunderstandings, it systematically speaks about "internal audit *function*").

The current document will make use of the third distinction, including both the institutional and the functional criteria. This definition is indeed the less likely to provoke confusion. In its terms, the internal audit is part of the organisation subject to auditing; its purpose is to make possible risk assessments for the decision-makers, whereas the function of external audit is to check accounts and to provide an assessment of the performance of the organisation or of the policies that are being implemented. Whereas the internal auditors are employees of the organisation, external auditors have to be independent of the organisation being audited.

The development of the external audit of local and regional government is a rather recent trend. For a very long time, it has been part of the central government supervision of local authorities. Only recently, the external audit has been devised for or adapted to the needs of local self-government (LSG). A number of requirements and objectives of audit are similar for central and local government, but some are specific to LSG and may depend on the nature of the audit institutions.

The scope of external financial audit always includes: 1) the budgetary and financial supervision, including an assessment of the financial management and the supervision of spending authorities; 2) the certification of individual accounts held by the bookkeepers.

## **Background**

External audit of public budgets, including local governments, is well established in Ukraine: it is in the hands of the Main Control and Revision Unit (CRU) of the Ministry of Finance, which looks into matters of finance, inspection, and

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<sup>1</sup> Internal Audit at Local and Regional Level, CDLR (2007)

procurement. It also exercises preventive control on efficiency as regards money flows, land, and property. In addition to the budget of the central government, it supervises roughly 12,000 local governments, which it covers on a rotating basis comprehensively. The CRU has some 400 staff at the central level, and overall 8,000 employees including its regional subdivisions.

In addition, there is a second institution, the Accounting Chamber of Ukraine (ACU) established by the Law "On the Accounting Chamber of the Parliament of Ukraine". Its main function is to provide information to the Parliament (its officials are elected by the Parliament), although its representatives appear also to aim at a comprehensive, all-inclusive mandate for financial auditing of public budgets, including local governments. Their main arguments run as follows:

1. The CRU is ill-prepared to carry out external auditing because it is part of the State administration and hence not sufficiently independent as a financial supervisor.
2. There is no internal auditing of LSG budgets, and hence the external auditing by the CRU is also "insufficient" from the point of view of effectiveness.
3. The 2009 GRECO Report (Annex 3) recommends enlarging the sphere of competences of an independent audit institution and includes the control of local governments in particular.
4. There are substantial monetary flows from the State to LSG budgets, which would warrant control by State authorities and by the Parliament. This would not only apply to "delegated State functions" of LSG (which are financed through excessively large subsidies), but also other types of funding (unconditional subsidies, for instance equalisation grants) on the grounds that they come from the State budget. Ukrainian taxpayers would have an interest in knowing whether they obtain "value for money" for public services in oblasts and municipalities.

Incidentally, the Budget Code extended the powers of the Accounting Chamber beyond mere control of the State budget by including all uses of funds derived from the central budget, even those appropriated by local governments. This legislation was however revoked in October 2010 as being unconstitutional, although the control of earmarked subsidies for delegated functions remains.

## **The Controversy**

The ACU's ambitious agenda conflicts with the existing auditing activities exercised by the CRU. However, there has been no attempt to evaluate efficiency of the CRU's auditing activities. Similarly, there has been no attempt to investigate whether duplicating an existing audit service with some 8000 staff would be public money well spent. There may well be a case for reforming the CRU and for improving external auditing more generally, but it is not a task for this paper.

Considering the principles of the European Charter on Local Self-Government (ECLSG, Annex 4) the following points are important to keep in mind:

1. Independence and transparency are key concepts of external auditing. Yet "independence" is not a major point of Article 8 of the ECLSG; it is not mentioned in the CoE Recommendation R(98) (Annex 5). Full independence is not a general practice in many of the CoE Member States<sup>2</sup>. Moreover, LSGs carry out effective internal audits themselves, on which external audits are based. "Independence" can be secured through other means: the status of employees and their relationship to the audited authority (Germany); rotation of staff (United Kingdom); control by the media and the civil society; and judicial procedures for misdemeanour. It is sufficient if the auditing body is "at arm's length" from the supervised authority, which is likely to be the case of the Ministry of Finance.
2. Ukraine operates a Single Treasury Account, which includes the local government sector. This by itself should allow monitoring of financial transactions and authorisations as to their consistency with the approved budget proposal. This does not allow for detection of misappropriation of funds through criminal acts (e.g. through forging documents), but this is also difficult to identify through an external audit. Any control system will have to rely on a large number of factors: ethical norms and cultural tradition, peer control, sound procedural rules, the separation of payment and authorisation functions, and control by citizens and the media. This is why the CoE emphasises, in R(98) 12 (1), the important role of political

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<sup>2</sup> In Germany local governments are subject to external audit by the Ministry of Interior of their respective Land, which is of course part of the administration.

supervision by citizens (e.g. direct democracy) and the provision of procedures “that local bodies can themselves initiate for solving their internal conflicts”. The **focus should thus be on developing grass-root local democracy rather than emphasising central control**, which would be clearly against the spirit of the ECLSG.

3. The Ukrainian officials argue that mandatory local functions are poorly exercised and that citizens do not get sufficient “value for money”, which would warrant extending central control through the ACU. It is true that performance budgeting and outcome-related monitoring have emerged in many countries in order to cope with “value for money” issues, but it is questionable whether this would suffice to make a case for a larger ACU. First of all, poor performance can result from a lack of resources, including human resources and training, which requires other means of addressing the problem. Second, appropriate performance criteria and benchmarks must be developed to render external auditing effective. These criteria cannot be established on the basis of financial indicators alone. They require cooperation with norm-setting line ministries (e.g. in education, health), contributions from independent research institutions, and pertinent surveys of citizens’ satisfaction. Performance criteria may also be developed independently by non-government institutions or international organisations (e.g. the OECD for Pisa Testing). Neither the Ministry of Finance nor an extended ACU would be able to develop such criteria without relying on non-financial expertise. Moreover, performance measuring requires staff with a highly diversified range of qualifications, which the ACU does not possess at present.
4. The CDLR report<sup>3</sup> recommends not to strengthen the external audit, but rather to promote “the establishment of internal audit functions in local government authorities, regard being had to the budgetary and human resources available”. The CDLR also makes specific recommendations for the ways in which such internal audit should be organised and conducted.
5. Finally, and most importantly, there is a danger that an overly bureaucratic approach to “controlling” – a word too often used during the Workshop – through a double-edged external auditing machinery will

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<sup>3</sup> Internal Audit at Local and Regional Level, CDLR (2007)

interfere with the constitutionally guaranteed rights of LSG in Ukraine. This risk is all the more prominent as the ACU aims at a comprehensive supervision based on the argument that the use of *all* funds derived from the national budget (apparently some 85 percent of local budgets) would have to be put under its scrutiny. Since money is fungible, it would be hard to distinguish own funding from State funding, so total local budgets could easily become subject to external auditing – and perhaps interference – by the State. Depending on the exact content and extent of the audit, this could run against the principles of the ECLSG.

Article 8 of the Charter stresses the principle of commensurability by saying that “administrative supervision of local authorities shall be exercised in such a way as to ensure that the intervention of the controlling authority is kept in proportion to the importance of the interests which it is intended protect”. This could be questioned if the proposal to extend the functions of the ACU were to go through. Finally, there is a risk of a serious conflict between the ACU and the CRU, which would undoubtedly be fought at the expense of local government authorities.

## **Recommendations**

To summarise the above, the CoE experts would not recommend extending the external auditing function of the ACU into the realm of LSG. Institutional reforms can provide a solution, but they must emerge from an internal discussion process of the interested Ukrainian parties themselves, and it is likely to be a long-term process. In order to guide this internal discussion, the following recommendations based on three implementation phases could be provided:

### **Phase I**

This phase is a “no change to existing arrangements for external auditing” with some additions. The CRU would continue to serve as the backbone of external auditing of LSG in Ukraine. The additions would be the following:

- *Strengthening of local democracy.* The CoE principles and recommendations emphasise LSG and “the essential role of political supervision by citizens”,

while securing the “transparency of local authorities’ actions” (R(98) 12 (2)). LSG in Ukraine is weak and needs to be strengthened, which is the main objective of the ongoing CoE assistance Programme in Ukraine. With regard to external auditing, it would mean the development of guidelines, statutory provisions and procedures, and a clear definition of which acts are subject to supervision. Strengthening of local democracy includes the strengthening of advising and assessing the LSG through certain (also independent) bodies, the development of internal mechanisms for financial and management supervision, reporting and publishing requirements, citizen participation, the creation of intermediary institutions such as ombudspersons, etc.

- *Building up and strengthening internal audit at local level.* It is of prime importance that there is a functioning internal audit at local level, which is currently lacking. External audit will have to build on it. The development of internal audit requires qualified staffing, standard procedures (e.g. dissemination of handbooks), and training of local officials (through regional training centres). It is also important to generate administrative capacity in financial management and procurement procedures. All this would be the main responsibility of the Ministry of Finance. Measures could also be adopted for procedures that local authorities can themselves initiate for solving internal conflicts, which would confine external interventions to deadlock-breaking for unresolved disputes.
- *Development of performance criteria at the local level.* Performance criteria are likely to be best developed by line-ministries, especially for their delegated functions, but also by the Ministry of Finance, research institutes, non-government institutions and, perhaps, international agencies. Performance measuring should be introduced with care and with the participation of local government officials and the local civil society<sup>4</sup>.

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<sup>4</sup> Performance Management and Local Finance Benchmarking are both included into the new CoE Programme to Strengthen Institutional Capacities of Local Authorities in Ukraine, which will begin in April 2011. The Programme is funded by the Danish and Swiss governments. Its performance management component will involve 20 pilot local authorities and will help them develop and make use of performance indicators in three public services (to be selected by them). The results of this pilot project could subsequently be a useful model for and feed into an extended programme of establishing more general performance standards and criteria for local government.

- *Reduction of earmarked funding for "delegated functions"*. The European Charter limits the scope of administrative supervision of local governments to "ensuring compliance with the law and with constitutional principles", but makes an exception for the so-called "delegated functions". In Ukraine, this could become a "Trojan Horse" for substantial intrusions into LSG given the large share of such functions. The Recommendation R(98) 12 (2) favour the attribution of "own" competencies over delegated functions, which would reduce the scope for potential meddling in local affairs. A thorough review of the "delegated functions" and their reduction could therefore strengthen LSG, improve the quality and the level of local public services, and contribute to stronger local democracy.
- *Confining budget control by the ACU to the State budget*. It would help to clearly limit the role of the ACU to controlling the State budget only. The fact that State budget resources flow to other entities (local governments, but also private firms, for instance), does not warrant controlling the internal use of such funds by the recipient institution. Private and public institutions should be treated similarly.

Where there are unconditional grants to local governments (e.g. equalisation subsidies), the ACU's role should be confined to supervising whether the criteria for grant allocation were observed, but it should not monitor the use of funds by local governments. Where the grants are earmarked (e.g. subsidies for delegated functions, which are hopefully significantly reduced in volume), there are two options:

- (i) Where a constitutional State function is delegated to LSG (as an agent) by law or statute, the funding should ideally go through the local budget. The local authority would then manage the funds on behalf of the State (the principal). For these functions, the level of funding must be adequate according to Article 9 of the ECLSG.<sup>5</sup> Adequacy could be assessed through comparative studies usually under the responsibility of a line ministry or the Ministry of Finance,

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<sup>5</sup> "Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law."

but also derived from independent external studies. It can, but should not, involve the ACU.

- (ii) Where the implementation of a particular project is conveyed to a local government, the funding does not have to go through the local budget. Payments are preferably made directly from the State budget on the basis of relevant documentation and certification by local government officials. The corresponding line in the State budget would of course be under control of the ACU.

However in both instances there is a need to monitor outcomes on the basis of performance indicators. This could involve the ACU, but is likely to be better confined to the respective line ministries. The latter appear to be more appropriate for project financing in particular.

- *Changing the role of the ACU.* Consideration could be given to converting the ACU over time into something akin to a Congressional Budget Office<sup>6</sup>. This would be appropriate given the fact that the ACU now mainly acts as an independent body set up by Parliament. Its future role would be reporting on the economic and budgetary outlook, including estimates of spending and revenue levels, analysing the budget proposal of the President, analysing the spending or revenue effects of specific legislative proposals, preparing cost estimates of pending legislation and tracking the progress of such legislation in a scorekeeping system, discussing a range of options that address changes in spending and taxes, presenting illustrative scenarios for State spending and revenues and describing the implications of those scenarios for the economy in a longer-term budgetary outlook, identifying legislation which imposes unfunded mandates on lower tiers of government or the private sector, spotting unauthorised budget appropriations and expiring authorisations, and finally monitoring the financial position of the public sector as a whole, including local governments, in particular as to public borrowing and debt, macro stability and the sustainability of the budget. However the ACU would have no powers in external auditing.

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<sup>6</sup> See the 1974 Congressional Budget and Impoundment Control Act of the United States

## **Phase II**

This phase is "*rendering the existing arrangements for external audit more effective and independent*". This is also a process rather than an act. It includes the modernisation of procedural rules of public financial management, the systematic use of information technologies, the training of staff, etc, which should take place within the Ministry of Finance initially. The process could be accompanied by discussions on how to render the CRU more independent, mainly vis-à-vis the State budget (since the CRU is part of the State administration), but also vis-à-vis local governments.

At the end of this process the CRU could be transformed into an independent body for external auditing with some pre-judicial powers. The National Audit Office of the United Kingdom could serve as a model here. The Control and Revision Unit could become a Control and Revision Agency (CRA). The Audit and inspection rights would be vested in the Head of the CRA, the Auditor General, who is an officer of Parliament, appointed by the President on a proposal from the Prime Minister. The CRA's professional staff would not have the status of civil servants and would therefore be independent from government. The officers and staff of this new body, which could of course be formed from the officers and staff of the CRU, would have to have comprehensive statutory rights of access to the bodies they audit. The budget of the new institution would be set by Parliament, not the Government, and would be partly financed from income generated, including audit fees paid. Oversight of the CRA could be confined to the ACU.

The CRA would have regional outlets whose obligation is to audit the accounts of regional bodies of the central administration, but also of regional authorities (oblasts) and local governments.

## **Phase III**

This phase is "*outsourcing and incorporating local government participation in external auditing*". Already phase II could be used to outsource external auditing of local governments, on a pilot basis, to third-party professional companies (accounting firms) and/or quasi-public consortia set up by local governments for

providing auditing services. This is only possible once there are clear and standardised procedural rules and evaluation benchmarks, which the new CRA would have to develop and render mandatory for auditing. The outsourcing of external auditing would be rolled out more extensively during Phase III, where auditing is provided on a fee-for-service basis. The CRA would have to accredit the auditing bodies and assure a quality control of their services.

Encouraging local governments to set up auditing consortia on a (sub)regional basis whose services are provided in accordance with national standards and transparency requirements would certainly strengthen local democracies and render LSG more accountable through informational links to be established with the civil society at large and at the micro level<sup>7</sup>. Of course outsourced auditing service providers would not have the direct authority of local governments, so their reports would remain subject to a final evaluation by the CRA, which is also responsible for initiating judiciary action where necessary.

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<sup>7</sup> The German experience of supra-municipal auditing demonstrates that regional auditing consortia could also contribute to establishing informative benchmarks for assessing value for money by making inter-jurisdictional comparisons.

## **Models of Audit Systems for Local Government**

There are five models of audit systems for local government:

1. The model of the superior audit institutions, extended to local government, and vested with judicial powers;
2. The model of the superior audit institutions, extended to local government, without judicial powers;
3. The model of auditing by central administrative authorities;
4. The model of external audit established by local governments;
5. The model of external audit contracted out to the private sector (audit companies).

It is important to be aware that several models may be combined in a particular case. For example, external audit by the private sector may be combined with the model of auditing by central administrative authorities. In federal governments, the external LSG audit may be organised at the regional level by federative governments through institutions quite similar to superior audit institutions established at the central level. As a consequence, this makes no difference from the viewpoint of local authorities subject to external audit, all the more so that procedures are usually similar.

Reforms have been implemented in this field for several years; they may affect significantly the present or previous organisation of the external LSG audit. This is in particular the case of the external audit reform in the UK.

### **1. Superior audit institutions, extended to local government, and vested with judicial powers**

Court of accounts, in various forms, have been the original and most common form of financial audit of central government during the process of State building in Europe, and they have to be considered as an essential part of this process for the financial organisation of the State. They date back to the medieval times in France, Spain, Portugal, the former *Grand Duché* of Burgundy, but also, and this is less well known in England, where the Court of the Exchequer was removed

only in 1880, although the audit function passed to the Parliament in 1866, before the creation of the National Audit Office in 1983. Sweden and, during the 19<sup>th</sup> century Finland had also a court of accounts, before the audit of accounts passed to an audit board deprived from judicial powers. In fact, only in German speaking countries the control of accounts was first exercised by an audit committee subordinated to the king, first of all in Prussia and in Austria, but without judicial powers.

Nowadays, only some of these countries have maintained a court of accounts with judicial powers: Belgium, France, Italy, Spain, Portugal. In Belgium, however, the court of accounts has no competence on municipal governments; in France and Italy this system was adjusted to decentralisation reforms with the establishments of regional courts or offices of audit.

In **France**, regional chamber of accounts (*chambers régionales des comptes*) were established after the first decentralisation reform, in 1984, to monitor the financial management of local governments. Members of these chambers are recruited through the ENA ( National School of Public Administration) or among experienced civil servants from various administrations; they are independent magistrates. Regional chambers are subject to inspection by the Court of Accounts (*Cour des Comptes*: art. 47-2 of the Constitution), but they are fully independent in their judicial as well as supervisory functions from the Court of Accounts. They judge the accounts submitted by all local governments and, by extension, local government bodies. They review the budget of a local government in case there is a deficit in order to propose savings or additional revenues; if not adopted accordingly by the council the budget is settled by the prefect, who is not bound by the proposals of the regional chamber of accounts. They supervise the financial management from the view point of efficiency, they submit their reports to local authorities that have the right to let publish their comments or objections with the report; they may undertake thematic reviews of local government spending and policies on their own initiative in their own constituencies.

According to a reform draft law on financial courts, still pending before the Parliament, the judicial powers of the Court of Accounts would be enlarged to the liability of spending authorities, with the power to impose fines, instead of the

existing Chamber of budgetary and financial discipline that does not meet its purpose. Additionally, the reform would integrate the regional chambers of accounts and the Court of Accounts in a unified entity with a joint programme of activities, more adequate for the development of the evaluation of public policies throughout central and local governments. However, the regional chambers of accounts would continue to supervise the financial management of local government, but they would cover interregional constituencies. The function of the new integrated institution would extend to the certification of the accounts of the various local self-government bodies. Members of the Court of Accounts would become full financial magistrates and form with members of the present regional chambers a unified body; beside the recruitment through the ENA, other sources would ensure a diversified professional membership. Lastly a financial court of appeal would be established in order to open the possibility of an appeal to all those who are subject to a judgment by a financial court.

Despite a stronger regionalisation, **Italy** has kept a more centralised audit system (royal decree of 12<sup>th</sup> July 1934, as amended later on). The Court of Accounts of Italy (*Corte dei Conti*) is a judicial body, although only part of its function is of a judicial nature, as in France, and its members are magistrates. They are recruited through a competitive procedure, among civil servants or professionals outside of the public administration. The Court of Accounts is in charge of the general supervision of the financial management by State authorities and entities, regional governments and local governments, and of the judgments of accounts of all those who manage public money and properties. The supervision of the financial management includes the supervision of the legality of management acts, whereas in France this remains a prerogative of administrative courts. Since 1994, the Court of Accounts establishes regional sections: in each region, a section in charge of the general supervision on financial management, and a judicial section with a prosecution office. Regional supervisory sections contribute to the general coordination of public finance through verifications of compliance with the budget balance rule by all regional and local governments, in relation with the domestic stability pact and with EU commitments of Italy. For judicial sections, there is a central judicial section of the Court of Accounts where appeals against decisions of regional sections may be lodged. Regional sections are competent for all State bodies having their seat

in their jurisdiction, for the regional government, for provinces and municipalities as well as other local government entities. At the central level, the “united sections of the Court of Accounts” is competent to decide on competence issues and issues of major relevance.

In **Spain**, the Court of Accounts (*Tribunal de Cuentas*) is also a judicial body although only part of its activity is of a judicial nature. It is based on the organic law 2/1982 and the law 7/1988. Members are elected by each house of the Parliament among those who fulfil the requirements set out by the law; they are independent and may not be displaced without their agreement. Several civil service bodies forming the personnel of the Court support them. The Court has two main functions: 1) the supervision of the financial management of all public bodies (including the social security) and of the use of public money involved in public policies; 2) the judicial scrutiny of accounts submitted to the Court by all public bodies. Regional and local governments are included in the competence of the Court of Accounts. The Court is organised in sectoral and territorial departments for the performance of its tasks. The sectoral departments are organised according to the main areas of the public sector. The territorial departments should be in charge of the supervision of economic and financial activities of regional and local governments. However, the territorial have never been established. Since regional government have created their own external audit institution, the supervisory functions of the Court of Accounts have been exercised through these institutions. As provided by the law 7/1988, the Court of Accounts may utilise the results of any financial inspection, internal audit as well as the results of the external audit performed by regional audit institutions. The latter have to coordinate their activity with the Court of Accounts and have to transmit within legal deadlines the results of the scrutiny of the accounts and the results of the general supervisory function they have to perform. Conversely, the Court of Accounts may delegate some tasks to the regional external audit institutions (see articles 27 to 29 of the law 7/1988). However, according to the Constitutional Court, whereas regional governments may establish their own external audit institutions, article 136 of the Constitution does not allow these institutions to judge the accounts of the public sector bodies within their jurisdiction (STC 1988/187). In the same sentence, the Constitutional Court states that the general financial supervisory function of the Court of Accounts is

targeted on the scrutiny and the verification of the economic and financial activity of the public sector from the view point of the principles of legality, efficiency and economy. Only four regional governments did not establish their own external audit institution, until now, but those that were created are very similar with each other.

Lastly, the Court of Accounts of **Portugal** (*Tribunal de contas*) has been reorganised on the basis of the constitutional reform of 1989, but still within the traditional conception of a superior audit institution vested with judicial powers. Members are recruited through open competition among judges, civil servants, academics, professionals that are at least 35 years old. The Court of Accounts is in charge of the general supervision of the financial management of all public entities, as well as all entities or corporations under their control, and this includes local governments and the regional governments of Madeira and Azores; as the judge of accounts, the Court has to judge the liability of all those who deal with public money through the accounts they hold. With the amendments of 2006 to the law 98/97 on the organisation of the Court of Accounts, the new formulation of the judicial function of the Court makes possible to judge not only bookkeepers, but also those who exercise the spending authorities, among which local officials. Furthermore, the Court of Accounts of Portugal has an extensive competence to supervise all public contracts involving an increase of public spending. The law makes possible a deconcentration of the organisation of the court, but this possibility has not been used until now, but in both autonomous insular regions.

To summarise, all these courts of accounts have nowadays a constitutional basis. Whereas they were established in the history of the State building to serve the king, they passed all to a closer relationship with the Parliament with the development of parliamentary democracy, and they report to parliaments. In all these countries, the judicial function of the courts of accounts has been confirmed by recent reforms or reform projects, and there is a tendency to enlarge this judicial function to spending authorities. Lastly, with the only exception of Belgium, the competence of the courts of accounts embraces the external audit of local government bodies.

## **2. The model of the superior audit institutions, extended to local government, without judicial powers**

The second main variant of external audit institutions of local government are superior audit institutions without judicial powers. There are historically two branches of this variant: countries that have abandoned the judicial of the courts of accounts and turned to an audit office closely linked to the parliament (case of the UK, and of Sweden, for example), and the tradition of the non judicial courts of accounts established as an independent administrative authority (Austria, Germany, Poland). In the latter branch, the external audit of local government remains in the hands of State authorities. In the former branch, the external audit tends to be released to local governments themselves.

### a) National audit offices and local authorities

Until 1983, local government accountants were appointed by the ministry for Environment and accountable to the **UK National Audit Commission**, which reported to the Parliament. In 1983, the Audit Commission for local authorities was established (Local Government Act 1982); auditors to the respective local public bodies are appointed by the Audit Commission. Its competence was extended to the National Health Service and the Audit Commission was vested in 2000 with the power to carry out "best value inspections", which were in turn extended to social housing in 2003. The Audit Commission has extensive investigation powers, may refer local government decisions to the court when considered as unlawful, and the results of inspections may result in more or, on the contrary, less, discretion in decision-making. The Audit Commission for local authorities worked out a Code of audit practice for the performance of audit in local governments. The Audit Commission reports to the National Audit Office. The inquiries of the Audit Commission are aimed at increasing efficiency in financial management and in the execution of local policies. There is no specific procedure for ascertaining the accounts, but unlawful practices may give rise to prosecutions if there is a criminal offence.

However, the Secretary of State announced on the 13<sup>th</sup> of august 2010 that the Audit Commission will be disbanded. New arrangements for the external audit of local government will be in place for auditing local public bodies in England by

2012-2013. In the framework of the drastic savings plan of the conservative government, the main purpose of the reform is to cut public expenditure. The external audit of local authorities will pass to the private sector. This will be an obligation for local authorities, and the cost will be on local budgets. A smaller public body should be left at the central level to monitor and regulate the performance of auditors, in order to preserve the independence and the reliability of auditing. The fraud survey would pass to the National Fraud Authority (an authority of the Attorney general, the main law officer of the Crown) (Audit Commission, "The future of local audit: issues for consideration", *Issues Paper*, September 2010).

In **Sweden**, after the judicial function of the Court of Accounts (*Statskontoret*) was abandoned, the external audit has been focused on regularity, then on efficiency in recent times. But, with the increasing responsibilities of local government, the national audit institutions have kept only the general overview of the audit system, whereas, the organisation of the external audit passed to municipal and county councils.

b) The courts of accounts without judicial powers

In **Germany**, because of the federal structure of the State, it was decided that the Federal Court of Accounts is in charge of the verification of accounts of federal public bodies and of the supervision and assessment of the financial and economic management of these federal public bodies. It has no power in the jurisdiction of the *Länder*, but on the use of federal money granted to them. The Federal Court of Accounts (*Bundesrechnungshof*) has no judicial powers, but its members have the judicial independence guaranteed by the Basic Law (see: art.114.2). It is a higher federal body, not a constitutional body, according to German constitutional law.

All *länder* have established similar courts of accounts in their own constitution on this model. These regional courts of accounts are also higher administrative authorities, vested with judicial independence, but without judicial powers. Their powers are similar to those of the federal court, but for the public bodies of the Land. However, they are not always involved in the financial supervision of local government. Only some courts of accounts are responsible for the verification of

accounts and the financial supervision of local governments: Berlin, Bremen, Hamburg, Mecklemburg-Vorpommern, Rheinland-Pfalz, Sachsen, Sachsen-Anhalt, Schleswig-Holstein. In several other *länder*, the external audit of local governments belong to the president of the court of accounts: Hessen, Thüringen. In Baden-Württemberg, Bayern, Niedersachsen, specific autonomous bodies were established to scrutinise local government accounts (Gemeindeprüfungsanstalt). Lastly, in other *länder*, the supervision is in the hands of the ministry of the Interior of the Land.

In **Austria**, on the contrary the Court of Accounts established by the federal constitution (art.121 and following) is competent also for the accounts and for the general supervision of the financial management of all public bodies of the Land and of all municipalities over 20.000 inhabitants (art.127 and 127a). Other municipalities are subject to accounts scrutiny and financial supervision by a supervisory body of the government of the Land that is a higher administrative authority. For several years, there is a discussion in Austria to enlarge the competence of the federal court of accounts to all municipal bodies.

The **Polish** system of external audit of local governments is a kind of synthesis between the French and the German model. Whereas the Higher Control Chamber (*Najwyższa Izba Kontroli* – NIK) has authority to check the regularity, reliability and economy of the financial management of local governments through its regional offices, regional chambers of accounts (*regionalne izby obrachunkowe* - RIO) were established on the French model to supervise local government finance. Already provided by the first local self-government law of 1990, they find nowadays a constitutional basis in article 171 of the Constitution of 1997. NIK as well as the RIO have no power ascertain accounts through judicial decisions; however, from a law of 17<sup>th</sup> December 2004, they are the first instance in case of disciplinary procedures in case of unlawful practices by local officials, and a financial discipline committee is established in RIO to deal with such cases. An appeal is possible to a second instance body in the ministry of finance.

In Russia, most subjects of the federation have established their own external audit institution, on the basis of article 265 of the Budget Code. The law distinguishes between previous, current and ex post supervision; the latter one

includes the verification of accounts. The control on treasuries is organised separately (art.267) and is performed under the authority of the Federal Treasury.

### **3. Auditing by central administrative authorities**

This system can be met in various federal countries when the federal entities are in charge of the financial supervision of municipal authorities. This is the case in several German *Länder* and in Austria for smaller municipalities.

In Russia, this is still the case as regards the role of the traditional financial revision under the authority of the ministry of finance.

### **4. External audit established by local governments**

This option has been developed in Sweden, in the Netherlands and more recently in Russia in a number of big cities.

In **Sweden**, an audit commission elected by the council is in charge to review the accounts of all local public bodies and to report to the council. This commission may hire experts to perform its task.

This system has developed in the **Netherlands** once the national Court of Accounts has concentrated its supervisory activity on State bodies. For a long period, the external audit of local authorities has been performed on contracts by private auditing firms. Bigger cities have established own verifications offices in the city administration. However, since 1997, independent external audit institutions have been established by municipal councils, and this has been generalised by the reforms of the laws on municipal (2002) and provincial self-government. As a consequence of this reform, all municipal councils and provincial councils had to establish until 2005 (provinces) or 2006 (municipalities) either an audit commission of the council (in which members of the council may be elected) or a local court of accounts (only with professional members).

In **Russia**, this move has developed recently and 68 cities of different regions had already established independent external audit institutions in 2008.

## **5. External audit contracted out to the private sector**

There is a few cases of pure private auditing of local governments by private companies. The last significant example, the Netherlands has shifted to local, but independent and public audit bodies. The recent British reform project will probably not be fully private, since there will be a kind of public regulating body. On the other hand, this does not rule out the possibility for public bodies to contract the private firms, especially when public bodies of external audit are established by local regulations.

## Audit Arrangements

### (responses provided by the members of the CDLR – the Council of Europe Committee on Local and Regional Democracy)

On behalf of the Ukrainian government, the CDLR Committee members were requested to answer to the following questions:

1. What body performs external auditing of local budgets ?
2. What is the status of this body? State body, autonomous administrative authority, private institution...?
3. Does this auditing concern only legality or also expediency of expenditure and budgetary acts ? Can it take sanctions against local authorities or representatives and/or redress wrongdoings?
4. How are staff of this body recruited? How can they be fired?

The following countries kindly provided replies:

- |                   |              |
|-------------------|--------------|
| 1. Finland        | 10. Malta    |
| 2. Germany        | 11. Austria  |
| 3. Norway         | 12. Italy    |
| 4. Denmark        | 13. Poland   |
| 5. Czechoslovakia | 14. Romania  |
| 6. Sweden         | 15. Hungary  |
| 7. Switzerland    | 16. Ireland  |
| 8. Iceland        | 17. Portugal |
| 9. Netherlands    |              |

#### 1. Finland

- Central Chamber of Commerce inspects private sector
- National Audit Office inspects public bodies but not self governing bodies, which have their own appointed external auditors.

- One tier system of local self government for health, educations and social welfare

Auditors for these bodies are appointed by the municipal council

- Auditing committee is statutory body in each municipality which conducts its own performance audits and preparing the appointment of external auditors
- Auditors accredited/ examined/ registered by Finnish Board of Chartered Public Finance Auditing (CPFA Board). The CPFA Board operates under the auspices of the Ministry of Finance.
- The general public are not involved though the report is made publicly available

The CPFA Board performs quality checks and has the following duties:

- Provide general guidance and supervision
- Confirm arrangements for applicants applications, adjudicate and mark examinations
- to decide on the approval of an auditing corporation;
- maintain register of approved auditors and arrange training for auditors
- to submit motions and proposals to improve public finance auditing.

## **2. Germany**

- Courts of Audit- independent financial bodies for public administration.
- There are separate audits for Federal/ municipal economic and budget management. These are conducted by the Federal Court of Audit and the courts of audit or Municipal Auditing Offices (local auditing offices or local auditing houses)
- External auditors of local authorities are appointed by the relevant local parliaments Audit Offices
- Municipal companies have to employ double entry book keepers which are then audited by independent auditors appointed by local parliaments Audit offices and audit commissions are given basic and advanced training in quality management by independent institutes. The results are discussed afterwards by the local parliaments

- The public is informed in the framework of the annual reports of the individual courts of audit

### **3. Norway**

The NAO does not cover municipalities

- The municipal council or county elects a control committee which continually supervises municipal/county management on their behalf.
- The municipal/county council decides whether a local authority shall appoint its own auditors or contract an auditor. The resolution is passed through committee. Municipal County councils appoint their own auditors again passed through a council resolution
- Certain people are exempt from the control committee. These include chairman/ vice chairman of municipal or county council, members of the boards of aldermen, anyone with the powers to make decisions for councils, any members of council executive boards, employees of the council
- Quality checks performed by the state but also subject to random quality checks by the committee of The Norwegian Association of Municipal Auditor. There is good local government auditing practice (*though unclear if this is statutory*)
- Meetings held on camera unless otherwise decided by the committee itself. The auditor has a duty to preserve secrecy where appropriate but documents sent to or from the control committee or auditor are made publically available.
- Municipal/county councils exercise highest Levels of supervision. They are able to reverse decisions made by any other elected body. Both councils elect their own control committees which has no fewer than 3 members meetings are open to the public and filmed

### **4. Denmark**

- National Audit Office may directly require the accounts of the regions, but not accounts of the municipalities. The Regions are primarily funded by grants from the state, while municipalities are primarily financed from own revenues.

Statutory duties for Supreme Audit office to audit the management of state property and financial resources – however not resources collected by municipalities or regions under their independent jurisdiction.

There is a Supreme Audit Office (SAO) entitled to ad hoc control of municipalities/ regions within certain limits.

- Municipalities and regions appoints their own auditor, approved by state administration in charge of supervision of municipalities and regions. Dismissal of the auditor requires also approval of state administration in charge of supervision
- Auditors for municipalities/ regions must be experts in local and regional conditions. From 2012 auditors will need to be state licensed. To have a state licence one must pass a special examination. Auditors are also independent
- Quality is not checked. It happens indirectly through requirements for the competence of the auditors of the municipalities and the regions
- public not involved

## **5. Czech Republic**

- There are annual audits of municipalities/ regions conducted either by a regional authority which is free of charge or an independent auditor for a fee. The Ministry of Finance audits regions and the Capital City of Prague
- The legal option of municipalities appointing their own auditors is rarely chosen due to cost, most opt for the regional office. Regions are obligatorily audited by the Ministry of Finance
- Public audits fall under the jurisdiction of SAO, qualified by the Act of Supreme Audit Office and an Audit Procedure code
- there is no one body however there are 'senates' of the SAO which review audits, decide on objections. : Local and regional authorities perform both state admin and their own independent activities – called a joint model of public administration

- Quality checking- There are also the Collegium of the SAO who decides on appellants against decisions, approving conclusions and annual reports. The Disciplinary Chamber of the SAO deal with poor quality, misconduct, breach of duty.
- There is no one body however there are 'senates' of the SAO which review audits, decide on objections. (see additional notes)

## **6. Sweden**

- The Swedish Supreme Audit Institution - *Riksrevisionen* - covers the national authorities , not the municipalities or counties. In some extent their remit covers how the local
- The Swedish local and regional authorities appoint their own auditors.
- The auditors for municipalities and counties are elected representatives (laymans), but they are assisted by experts. Those experts can be employed by the authority or be appointed by public procurement. The competence of the experts are written in the law
- The audit reports are presented for the local assembly.
- There elected representatives are responsible for the process.

## **7. Switzerland**

- Communities at local level levy their own taxes and form their own budget. The audit is conducted by an elected commission either by local people or the local parliament. Small communities have a people's assembly, larger ones a parliament
- Elected by local people or local parliament
- The quality-control is supposed to be achieved by the hope that only capable men and women may be elected.

## **8. Iceland**

Municipal councils engage chartered accountants or an accounting firm, though they may decide to use their own audit office which should be under the management of a chartered accountant.

Appointed by the council and answerable to the council but independent of municipal committees

## **9 . Netherlands**

- Each municipality is obliged to establish an independent local audit office and each province has an independent regional audit office. They may all cooperate with each other and frequently do.
- Members of the council, municipal staff can also be members of the audit office along with external personnel. Most cooperate with each other. However certain people are prohibited such as Government Ministers, members of the National Court of Audit.
- An annual report is submitted to the council and these are also made publicly available.
- The Audit function conducts structural audits around efficiency, effectiveness and regularity of policies made by each municipality/province. There are also annual audits of accounts.

## **10. Malta**

- Supreme Audit Institution has two main roles: an administrative role to appoint and remunerate local auditors; and to lend support to Local Government Auditors, to ensure that their observations and recommendations are given serious consideration. It does not appoint local auditors or undertake audit. The Ministry of Health also covers the role undertaken by local health bodies overseas. The Ministry falls under the responsibility of Central Government, therefore subject to audit by SAI.
- Only those qualified by Accountancy Profession Act are eligible to audit
- The Quality Assurance Oversight Committee (QAOC) is the policy-making body and regulator of the quality assurance function- it oversee, support and \appraise work of Quality Assurance Unit (QAU). Also to follow up on recommendations made by audit firms.
- The public is not directly involved, but may influence through the local media. Also a local NAO website has a facility to comment on published Audit Reports.

## **11. Austria**

- The municipality of the “Land” (autonomous state) has a right to examine the management of thrift, economy and expedience. Each Land has its own audit court which checks financial administration
- Appointing body is composed of civil servants appointed by local ‘land’ government. The head and deputy of the audit court are appointed by land parliament.
- Regulated by public law
- Audits courts held in public

## **12. Italy**

- The Constitution of the republic appoints a *Corte di Conti* to control use of state’s budget, checks if admin functions are compliant with law and a financial audit of public funds
- Organised through regional offices – members are magistrates who are recruited through public selection. Each local region has to establish an internal audit office but have autonomy on how they do so. Auditors are appointed by Govt from registered professionals
- Local auditors are registered as a legal auditor, registered maintained by Min of Justice. Appointed by public bodies
- Quality assurance is a recent development and recent bills have incorporated evaluation and assessment of quality within them
- Poor public involvement though public ‘satisfaction’; surveys are conducted.

## **13. Poland**

- Regional chambers of audit conduct the audit regulated by the Supreme Audit Institution
- By regional chambers and the Supreme Audit Institution
- Regional chambers of audit and Supreme Audit Institution.
- Quality not checked though there are standards set in law
- Results made publicly available (website)

## **14. Romania**

- Romanian Court of Account- supreme auditing body both at local and central levels, established by the law.
- Romanian Courts of Accounts appointed and supervised by Parliament
- Court of Accounts is eligible to audit the public bodies. Since this institution's role to audit is set by the law, there is no qualifying process involved
- There are procedures in place derived from international standards
- No public involvement

## **15. Hungary**

- Audit Office with broad powers of audit. Controls use of public revenue and expenditure, monitors management of state assets.
- Complex system of external and internal financial control. Localities/districts are obliged to hire independent auditor. Internal control for self government can be carried out by a civil servant appointed by LA., an internal controller employed by Local Authorities
- Professional qualification required and in some cases, fixed period of experience also. Regulations to prevent conflict of interests. Appointment is procurement-based.
- Indirectly checked by State Audit Office and Treasury
- Reports are made public, all financial reports are published by local authorities, the mayor sets out a public annual report on the results of the control activity. Details of paid local subsidies and contracts exceeding a certain value are published.

## **16. Ireland**

- Local Government Audit Service and Comptroller & Auditor General for central funding and Government Departments
- Appointed as staff of the Local Government Audit Service, they are professionally qualified accountants. The Director of Audit assigns auditors to local authorities. External firms are not used.

- Commercial auditing firms are appointed to audit subsidiary companies and all commercial state bodies eg. *ESB, CIE, Bord na Mona, An Bord Gas, Coillte* etc.
- Conducted by internal file review, training and development and new audit software used by both the Comptroller & Auditor General and the Local Government Audit Service (called TeamMate - originally developed by PwC)
- Audits carried out by Comptroller & Auditor General are the subject of public hearings. Audit reports issued by the Local Govt Auditors are presented to the full elected council for discussion. They are also subject to review by the audit committees within local authorities. Notice of the commencement of audit has to be published in the press and the public has the right to make objections in relation to the annual accounts to the appointed local government auditor.

## **17. Portugal**

- External control is committed to the Court of Auditors. For Internal control (bodies within central government) there are inspection bodies, one general (General Inspection of Finance) and several sectoral (General Inspect of Local Administration) that exert audit functions.
- Appointed by the Court of Auditors
- Local authorities themselves must have an internal control system and a legal certification of their accounts (mandatory from 2007 onwards). Civil servants can also be nominated.
- Audit is assured within the Court itself, for inspection bodies there is a co-ordination of the inspection activities by the IGF which settles certain quality criteria that must be met.
- Public are involved when there is publication of audit results. In particular most of the audits made by the Court of Auditors are published on their website. Citizens can also complain direct to inspection bodies if there is any misconduct.

**Extract from the Joint First and Second Rounds Evaluation Compliance  
Report on Ukraine**

(Greco RC-I/II (2009) 1E, adopted by GRECO at its 42nd Plenary Meeting

(Strasbourg, 11-15 May 2009)

**Recommendation xiii.**

56. *GRECO recommended to establish an overall strategy with clear objectives for future reforms of the public administration in Ukraine in order to provide a common understanding for the necessity of change and to make this known to the wider public through awareness campaigns.*

**Recommendation xvii.**

71. GRECO recommended to enhance the competencies of the staff of the Accounting Chamber to be better prepared to detect instances of corruption in the course of their ordinary work.
72. The authorities of Ukraine report that in accordance with the Decree of the Cabinet of Ministers of 14 July 1999 (№1262) on Provisioning Finance for the Preparation and Increase of Professional Skills of Employees of the Bodies of Executive Power, Local Government and Bodies of Military Management of the Armed Forces, the Accounting Chamber is obliged to ensure that its staff develops their professional skills. In accordance with this Decree, a group of employees of the Chamber attended a seminar on the prevention of corruption on 23-27 June 2008. In addition, the Accounting Chamber has signed a Memorandum of cooperation with the Ministry of Justice in order to increase the professional skills of employees of the Chamber and the Ministry by holding joint meetings, conferences and seminars, including training, exchange of international experience in the field of prevention and detection of corruption and fraud in respect of state resources.

73. GRECO takes note of the actions taken. It welcomes the fact that some training on corruption prevention has taken place and welcomes the efforts undertaken to strengthen the cooperation between the Accounting Chamber and the Ministry of Justice, which appear to be a longer term project.

**Recommendation xviii.**

*75. GRECO recommended that the external independent audit of local authorities be extended to cover all their activities and that such an audit is built on the same principles of independence, transparency and control which apply to the Accounting Chamber.*

76. The authorities of Ukraine report that as the mandate of the Accounting Chamber is defined in the Constitution, the extension of its powers would accordingly require changes in the Constitution. Therefore, amendments to Article 98 of the Constitution enabling the Accounting Chamber to exercise control over the budget of local authorities were foreseen in the Government's Plan of Action for the implementation of the Concept Paper of the President ("On the Way to Integrity") for the period until 2010. However, taking into account the complicated procedure of enacting amendments to the Constitution, the Government resorted to a number of other actions, such as various legislative initiatives on budget discipline. The authorities report that, on 4 April 2008, the Parliament registered the draft law On Amendments to the Law on the State Control and Revision Service of Ukraine and some other legislative acts of Ukraine (Reg. No. 2359 of 10 April 2008). This draft law, which reportedly envisages the strengthening of the powers of the control and auditing service, including the authority to control the financial discipline of local government, was approved in a first reading by Parliament on 17 March 2009.

77. GRECO takes note of the information provided. It welcomes the fact that some changes to widen the audit of local authorities appear to be underway. However, the initiatives taken have not as yet produced tangible results in line with the recommendation.

**Extract from the European Charter of Local Self-Government**

(Strasbourg, 15 October 1985)

**Article 8 – Administrative supervision of local authorities' activities**

- 1 Any administrative supervision of local authorities may only be exercised according to such procedures and in such cases as are provided for by the constitution or by statute.
- 2 Any administrative supervision of the activities of the local authorities shall normally aim only at ensuring compliance with the law and with constitutional principles. Administrative supervision may however be exercised with regard to expediency by higher-level authorities in respect of tasks the execution of which is delegated to local authorities.
- 3 Administrative supervision of local authorities shall be exercised in such a way as to ensure that the intervention of the controlling authority is kept in proportion to the importance of the interests which it is intended to protect.

**Article 9 – Financial resources of local authorities**

- 1 Local authorities shall be entitled, within national economic policy, to adequate financial resources of their own, of which they may dispose freely within the framework of their powers.
- 2 Local authorities' financial resources shall be commensurate with the responsibilities provided for by the constitution and the law.
- 3 Part at least of the financial resources of local authorities shall derive from local taxes and charges of which, within the limits of statute, they have the power to determine the rate.

- 4 The financial systems on which resources available to local authorities are based shall be of a sufficiently diversified and buoyant nature to enable them to keep pace as far as practically possible with the real evolution of the cost of carrying out their tasks.
- 5 The protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility.
- 6 Local authorities shall be consulted, in an appropriate manner, on the way in which redistributed resources are to be allocated to them.
- 7 As far as possible, grants to local authorities shall not be earmarked for the financing of specific projects. The provision of grants shall not remove the basic freedom of local authorities to exercise policy discretion within their own jurisdiction.
- 8 For the purpose of borrowing for capital investment, local authorities shall have access to the national capital market within the limits of the law.

## **Explanatory Report**

### **Article 8**

This article deals with supervision of local authorities' activities by other levels of government. It is not concerned with enabling individuals to bring court actions against local authorities nor is it concerned with the appointment and activities of an ombudsman or other official body having an investigatory role. The provisions are above all relevant to the philosophy of supervision normally associated with the *contrôle de tutelle* which have long been the tradition in a number of countries. They thus concern such practices as requirements of prior authorisation to act or of confirmation for acts to take effect, power to annul a local authority's decisions, accounting controls, etc.

### *Paragraph 1*

Paragraph 1 provides that there should be an adequate legislative basis for supervision and thus rules out *ad hoc* supervisory procedures.

### *Paragraph 2*

Administrative supervision should normally be confined to the question of the legality of local authority action and not its expediency. One particular but not the sole exception is made in the case of delegated tasks, where the authority delegating its powers may wish to exercise some supervision over the way in which the task is carried out. This should not, however, result in preventing the local authority from exercising a certain discretion as provided for in Article 4, paragraph 5.

### *Paragraph 3*

The text draws its inspiration from the principle of "proportionality", whereby the controlling authority, in exercising its prerogatives, is obliged to use the method which affects local autonomy the least whilst at the same time achieving the desired result.

Since access to judicial remedies against the improper exercise of supervision and control is covered by Article 11, precise provisions on the conditions and manner of intervention in specific situations have not been felt to be essential.

## **Article 9**

The legal authority to perform certain functions is meaningless if local authorities are deprived of the financial resources to carry them out.

### *Paragraph 1*

This paragraph seeks to ensure that local authorities shall not be deprived of their freedom to determine expenditure priorities.

### *Paragraph 2*

The principle in question is that there should be an adequate relationship between the financial resources available to a local authority and the tasks it performs. This relationship is particularly strong for functions which have been specifically assigned to it.

*Paragraph 3*

The exercise of a political choice in weighing the benefit of services provided against the cost to the local taxpayer or the user is a fundamental duty of local elected representatives. It is accepted that central or regional statutes may set overall limits to local authorities' powers of taxation; however, they must not prevent the effective functioning of the process of local accountability.

*Paragraph 4*

Certain taxes or sources of local authority finance are, by their nature or for practical reasons, relatively unresponsive to the effects of inflation and other economic factors. Excessive reliance on such taxes or sources can bring local authorities into difficulties since the costs of providing services are directly influenced by the evolution of economic factors. It is recognised, however, that even in the case of relatively dynamic sources of revenue there can be no automatic link between cost and resource movements.

*Paragraph 6*

Where redistributed resources are allocated according to specific criteria set out in legislation, the provisions of this paragraph will be met if the local authorities are consulted during the preparation of the relevant legislation.

*Paragraph 7*

Block grants or even sector-specific grants are preferable, from the point of view of local authority freedom of action, to grants earmarked for specific projects. It would be unrealistic to expect all specific project grants

to be replaced by general grants, particularly for major capital investments, but excessive recourse to such grants will severely restrict a local authority's freedom to exercise its discretion with regard to expenditure priorities. However, the part of total resources represented by grants varies considerably between countries, and a higher ratio of project-specific grants to more general grants may be considered reasonable where grants as a whole represent a relatively insignificant proportion of total revenue.

The second sentence of Article 9, paragraph 7, seeks to ensure that a grant for a specific purpose does not undermine a local authority's freedom to exercise discretion within its own sphere of competence.

#### *Paragraph 8*

It is important for local authorities that they have access to loan finance for capital investment. The possible sources of such finance will, however, inevitably depend on the structure of each country's capital markets; procedures and conditions for access to these sources may be laid down by legislation.

**COUNCIL OF EUROPE**  
**COMMITTEE OF MINISTERS**

**RECOMMENDATION No. R (98) 12**

**OF THE COMMITTEE OF MINISTERS TO MEMBER STATES**

**ON SUPERVISION OF LOCAL AUTHORITIES' ACTION**

(Adopted by the Committee of Ministers on 18 September 1998

at the 641st meeting of the Ministers' Deputies)

The Committee of Ministers, having regard to Article 15.b of the Statute of the Council of Europe,

Considering that the aim of the Council of Europe is to achieve a greater unity between its members for the purpose of safeguarding and realising the ideals and principles which are their common heritage, and to foster their economic and social progress;

Considering that, as provided for by Article 4, paragraph 3, of the European Charter of Local Self- Government (hereinafter referred to as "the Charter"), "public responsibilities shall generally be exercised, in preference, by those authorities which are closest to the citizen";

Considering that, when local authorities have, as provided for by Article 3 of the Charter, the right "within the limits of the law, to regulate and manage a substantial share of public affairs", these authorities become accountable to the citizens - electors and taxpayers - and the state;

Considering that compliance with the principles of the rule of law and with the defined roles of various public authorities, as well as the protection of citizens' rights and the effective management of public property, justify the existence of appropriate controls;

Considering that the nature and scope of controls over local authorities' acts must normally be differentiated depending on whether they are tasks implemented on behalf of superior authorities or acts carried out within their "own" competencies;

Considering that a possible lack of clarity in local self-government statutes, and in particular in the definition of competencies, constitutes one of the main threats to self-government and can result in exorbitant control over local authorities' acts;

Considering that the principles enshrined in Article 8 of the Charter on the administrative supervision of local authorities' activities also apply to administrative sanctions concerning local authorities' elected representatives;

Considering that, under Article 11 of the Charter, "local authorities shall have the right of recourse to a judicial remedy in order to secure free exercise of their powers", which implies the possibility of recourse against improper exercise of supervisory powers;

Considering that transparency is the best guarantee that public authorities carry out their acts in the interests of the community, that it is an essential prerequisite for effective political supervision by citizens and that, therefore, strengthening it allows the reduction of other forms of supervision;

Considering that the experience of many member states shows that it is possible to make the systems of supervision evolve in a way favourable to local self-government without endangering their effectiveness;

Having regard to Recommendation 20 (1996) of the Congress of Local and Regional Authorities of Europe on monitoring the implementation of the European Charter of Local Self-Government;

Having regard to the report of the Steering Committee on Local and Regional Democracy on supervision and auditing of local authorities' action,<sup>8</sup>

Recommends to the governments of member states that they:

1. adopt the appropriate measures:

- to extend the application of the principles enshrined in Article 8 of the Charter to all forms of supervision of local authorities' action;

- to recognise the essential role of political supervision by citizens and to foster the implementation of this supervision, through, inter alia, the use of the instruments of direct democracy considered appropriate;

- to strengthen the transparency of local authorities' action and to ensure, in general, the public nature of decisions which engender financial costs to be borne by the community, as well as the real possibility for citizens and legal persons concerned to have access to these decisions in conformity with the procedures established according to the law;

- in accordance with Article 7, paragraph 1, of the Charter, to allow administrative sanctions concerning local authorities' representatives (suspension or dismissal of local elected representatives and dissolution of local bodies) only exceptionally, to accompany their use with the appropriate guarantees, in order to ensure their compatibility with the free exercise of local electoral mandates, and to give preference to procedures where the supervisory authority, or a named ad hoc authority, intervenes in the place of the authority at fault, thus reducing cases where administrative sanctions could be adopted against the latter;

- to provide procedures that local bodies can themselves initiate for solving their internal conflicts, and envisage the intervention of the supervisory administrative authorities only when these procedures achieve no result;

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<sup>8</sup> Study series on "Local and regional authorities in Europe", No. 66.

2. Undertake, if necessary, the appropriate legislative reforms in order to improve consistency between the systems of supervision and the principle of subsidiarity, and the effectiveness of these systems, taking into account the guidelines appearing in the appendix to this recommendation.

## **Appendix to Recommendation No. R (98) 12**

### **Guidelines on the improvement of the systems of supervision of local authorities' action**

#### **I. Guidelines on the scope of administrative supervision**

- To provide that, unless the contrary is provided for by law, local authorities exercise their own competencies.

- To favour the attribution of "own" competencies over the delegation of competencies, resulting in a reduction of expediency supervision.<sup>9</sup>

- To enumerate clearly, in statutory provisions, the acts subject to supervision.

- To limit compulsory ex officio administrative supervision to acts of a certain significance.

- To reduce a priori administrative controls (those where the involvement of a government authority is necessary for a local decision to take effect or be valid).

#### **II. Guidelines on the development of alternative mechanisms to administrative supervision**

- To strengthen the dialogue between central and local authorities.

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<sup>9</sup> The Netherlands delegation recalls that the Government of the Netherlands, when ratifying the European Charter of Local Self-Government, indicated that it did not consider itself bound by Article 8, paragraph 2, of the Charter. Likewise, this particular guideline could only be followed by the Netherlands Government where it does not bring into question the extent of the supervisory power given to the Crown in the legal system of this country.

- To strengthen the function of advising and assessing, which some bodies (whether independent of central administration or part of this administration) may have, in particular in the financial and management fields.

- To strengthen the role of independent bodies such as ombudsmen and mediators.

- To strengthen internal mechanisms of supervision, in particular in the financial and management fields.

### **III. Guidelines concerning the supervisory procedures**

#### *i. Judicial procedures*

- To deny courts the power to replace the local authority in evaluating the expediency of an act: where such evaluation is necessary, this should be a task for administrative supervisory authorities.

- To give the courts the power to adopt interim measures, when these measures are justified by their urgency and/or the risk of irreparable damage.

- To provide for appropriate measures in order to ensure the full and immediate execution of courts' decisions concerning the legality of the act subject to supervision, including the procedures for substituting the authorities at fault.

- To provide for appropriate measures in order to reduce the time taken to examine cases brought before the court, as the length of judicial procedures runs counter to legal security and may prejudice the usefulness of the supervision.

#### *ii. Supervisory procedures before the administrative authorities*

- To provide, if possible, that there is only one first instance supervisory authority; where the intervention is required of specialised supervisory authorities (depending on the content of the act subject to supervision), to define precisely the respective spheres of competence of these bodies, in order to avoid uncertainty over which authority actually has to carry out the supervision.

- To set, in statutory texts, the time limit granted to the supervisory authority in order to perform the a priori supervision and to provide that the absence of any decision within the given time limit signifies agreement.

### *iii. Financial supervision and supervision of management*

- Minimise the effects of financial supervision and supervision of management in so far as these can bring into question the expediency of choices made by local elected representatives.

- To organise these two kinds of supervision in order to foster good accounting practices and the effectiveness of management, prevent financial imbalances, monitor financial rehabilitation of local authorities which encounter financial difficulties and enlighten citizens with complete and objective information.

## **IV. Guidelines on the prevention of the risk of informal supervision**

- To prevent, as a general rule, local authority staff members being dependent on authorities other than the ones that employ them, when taking decisions as part of their duties.

- To avoid relations between local authorities and central government departments working with them which lead to the replacement, by unofficial "technical" control, of official supervision, the level of which is lowered.