

LEGAL ASPECTS OF THE EXTERNAL CONTROL SYSTEM OF MUNICIPAL FINANCES

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Abstract in original language

The control of expenditure of municipal budgets is the essential regulatory element. The municipal budget is the financial basis for the institutional functioning; therefore, local residents, i. e. taxpayers, and local authorities need to know if the budgetary appropriations are implemented lawfully and appropriately, how the budgetary funds are used and their accounts kept, if the targets have been met.

The article analyses the external control system of municipal finances and its legal regulation in Lithuania; defines the concepts of municipality, financial control and financial control system; reveals the content of the internal and external control of municipal budgets. The paper provides a thorough analysis of the work carried out by the external control entities of municipal finances (municipal controllers (municipal control and audit services), the National Audit Office, and independent auditors) as well as their interrelationships.

Key words in original language

Municipality, municipal finances, public finance, internal control, external control, external control entities.

The purpose of each municipality is to develop, improve and transform the economic, social, cultural and ecological structure of the governed territory, combining the interests of both the local community and the state. The competency of local authorities can be perceived as the reflection of economic, cultural, legal functions performed by these bodies within the structural framework of the state.¹

In the view of K. Ehrhart, S. R. Schwarz-Jung, H. Welge, the budget and finances are the main issues for political discussions taking place in municipalities; these discussions lead to establishment of the framework for the municipal financial performance, the decision-making on whether it is worth for the municipalities to invest and how this should be done; and all this considerably determines the autonomy of actions taken by municipalities².

¹ Stačiokas, R., Rimas, J. Lithuanian municipal development and financing. Monograph. Kaunas: Technology, 2002.

² Ehrhart, K., Schwarz-Jung, S. R., Welge, H. (1996). Budget and finance. Vilnius: Pradai, p.32.

The Republic of Lithuania Law on the Local Self-Government (hereinafter – LLSG) defines the municipality as “an administrative unit of the territory of the state, defined by law, the community of which has the right to self-government guaranteed by the Constitution and implemented through a municipal council elected by the permanent residents of that administrative unit of the territory of the state and through an executive institution as well as other institutions and establishments of a municipality, which are formed by the latter and accountable to it”³. A municipality is a public legal person, and this presupposes its definition as that of an autonomous public authority. The economic policy of the state gives local authorities a right to possess their own financial resources, which may be freely used within their legislative powers at their own discretion⁴. Financial resources are needed for municipalities to carry out their functions. The financial resources of municipalities consist of tax revenues, the municipal property, the income received from the leased-out state land, the state budget and other subsidies. The funds received by the municipalities from the state budget or the national monetary funds are used to perform their public (relegated to the municipalities by the state) functions.

The Republic of Lithuania Law on the Budget Structure⁵ lays down that the municipal budget means a plan of a municipality’s revenue and appropriations for a budgetary year as approved by a municipal council. The appropriations of municipal budgets are used for implementation of the Law on Local Self-Government and other laws in carrying out the programmes approved by the managers of municipal budget appropriations.

To ensure rational implementation of municipal budget funds, a control mechanism for optimum implementation of funds must be defined by legislative acts.

The theoretical part distinguishes between three functions of finance, i.e. the functions of finance formation, use and control. Control in public administration plays a distinct role, as control is an integral and inseparable part of the public authority and administration mechanism.⁶

³ Law of local municipal government of the Republic of Lithuania // Valstybes zinios. 1994, No. 55-1049.

⁴European Charter of Local Self-Government // Valstybės žinios (State Gazette), - 1999, No. 82-2418.

⁵ Law on Budget formation of the Republic of Lithuania // Valstybes zinios. 2004, No. 4-47; 2005, No. 144-5237.

⁶ Katkus A. State economic control. Vilnius: Thought, 1997. psl. 91.

Different authors approach the concept of financial control differently. According to K. Leviškauskaitė and G. Rūškys⁷, *financial control* means the overall operations and activities of inspection of the financial and related performance of economic and management entities by applying specific forms and methods of control organization.

We believe that the most accurate content of financial control can be disclosed by the following concept (covering both the institutional and the state levels)⁸: financial control is the control of lawfulness and appropriateness of formation, allocation and use of monetary funds of the state and public authorities for the effective social and economic development of the whole country as well as its separate regions.

To sum up, the public financial control is understood as the overall measures, by analysing, examining and assessing the financial and related performance of economic entities of the authority, management and public sector, by applying specific control methods in order to ensure the efficiency of financial performance in the public sector and to avoid negative processes in the future.

The formation of a controlling mechanism in a particular country is objectively predetermined by the goals and objectives specifically set for that particular state. The interests and rights of all the participants of financial relations must be protected. This is the financial performance control of all economic entities, carried out by the institutions as laid down by the laws.

The content of municipal financial control includes the verification of compliance with the financial discipline, the examination of lawfulness, economy and transparency of the use of funds allocated for local authorities, the prevention of financial discipline violation.

The municipal financial control system is disclosed in the context of control objects and entities as well as their relationships. The control objects and entities enjoy a close mutual relationship. *The municipal financial control object* means the financial economic relationships as a result of the formation, allocation and use processes of the local authority monetary funds. *The municipal financial control entity* means the financial control institutions (state or municipal institution, legal person) responsible for the lawfulness and appropriateness of formation, allocation and use of the local authority monetary funds as well as the compliance with the principles of financial management (economy, efficiency, effectiveness and transparency), and exercising the legislative powers to operate in the field of financial control.

⁷ Leviškauskaitė K. ir Rūškys G. Public finance. Kaunas, VDU, 2003.

⁸ Финансовое Право, Москва, 1995m. psl. 83-84.

The municipal financial control system is not and shall not be static. The realisation of public administration leads to new goals, the changes in the forms of activity and legal regulation of their realisation, etc., i.e. to the quantitative and qualitative change of the control objects. Thus, the municipal financial control system also changes.

The circle of the entities of the municipal financial control system as well as the objectives raised to them modify the volume and structure of the control objects, and consequently, the changing financial control objects influence the objectives raised to the financial control entities as well as the institutional financial control system of the state and municipalities.

Therefore, the municipal financial control system means the overall measures, methods, performed functions applied by financial control institutions, ensuring the lawfulness and appropriateness of formation, allocation and use of the monetary funds of the state and local authorities as well as the compliance with the principles of financial management (economy, efficiency, effectiveness and transparency).

The literature review leads to the conclusion that authors approach the public financial control system differently by providing different classifications. For example, based on the time of performance: a) *ex-ante financial control*, which includes the control of collection, allocation and use of funds – the budget formation and approval, the approval of other financial acts; b) *on-going control*, which is implemented during the process of other respective financial transactions; c) *ex-post financial control*, including the control of already performed financial transactions as well as of the use of financial resources; based on the content of control: a) *budgetary*; b) *tax*; c) *banks*; d) *currencies*; e) *insurance business*; f) *customs*. E. Buškevičiūtė⁹ distinguishes between the forms of financial control based on the entities implementing control: external audit, National Audit Office, internal control, internal audit.

Analysing the municipal financial external control system, it is appropriate to analyse not only the content of the external control, but also to define the concept of internal control. All this will help to reveal the essence and context of external control.

The internal control is a dynamic complex process, continuously adapting to the changes taking place in an organization. All levels of managers and employees have to participate in this process, considering the risks and ensuring the implementation of the organization's mission and objectives.

⁹ Buškevičiūtė E. Public finance. - Kaunas: Technology, 2006, p. 372.

A. Katkus applies the following features to the internal control:¹⁰ 1) it is based on the relationship of subordination between the control entity and the control object, i.e. the controller and the controlee are the employees of the same institution or organization; 2) the apparatus performing this type of control is an integral part of an administrative apparatus of a particular institution (organization); 3) this type of control is performed by the managing bodies themselves within their system; 4) this type of control covers the overall activity of the controlled object: from the implementation of separate legislative acts and objectives to the implementation of separate economic activity; 5) operational nature is typical to this type of control (i.e. it is frequently short-term); 6) implementing this control, the factual control is dominant in the lower levels, meanwhile in the upper levels – the examination of documents prevails; 7) this type of control is usually implemented through specialized autonomous internal control units.

The legal basis of internal control is ensured by the Republic of Lithuania Law on Internal Control and Internal Audit¹¹. The aforementioned Law defines internal control as: “the entire set of controls established by the management of a public legal entity in order to provide reasonable assurance that the operations of the public legal entity are legal, economic, efficient, effective and transparent, that the strategic and other plans are implemented, that assets are safeguarded, that financial information and reporting are reliable and exhaustive, that contractual liabilities to third persons are satisfied and that all identified risks are managed.” One of the objectives of the internal control is the aim to ensure economy, efficiency, effectiveness of a public legal entity’s performance. This is the so-called 3E concept.

The internal control system in a public legal entity can be perceived as a process designed to achieve the goals of the public legal entity. The internal control, acting as the organizational part of a public legal entity, has to ensure the lawfulness and appropriateness of the economic activity of the public legal entity and to comply with the principles of reliable financial management (economy, effectiveness, efficiency and transparency). In addition, this control has a goal to safeguard the assets of the state and municipalities as well as liabilities to the third persons against illegal acts, and to guarantee the reliability of financial information about the public legal entity’s performance.

Having analysed the definitions of internal control we can assume that both the scientific literature and the internal control regulating documentation approach the internal control in a different way, with

¹⁰ Katkus A. State economic control. Vilnius: Thought, 1997. p. 114.

¹¹ Law of internal control and internal audit of the Republic of Lithuania // Valstybes ziniuos. 2002, No. 123-5540.

the emphasis placed on one or another aspect of control; nevertheless, the authors agree on the essential elements of the internal audit concept, i.e. the internal control has a clearly defined scope of performance – it is carried out at the level of a public legal entity. The specific procedures of internal control are determined by the head of a public legal entity, and this leads to a certain degree of dependence of this type of control, i.e. the subordination between the control entity and the control object, because the internal control employees are subordinate to the head of a public legal entity. The Lima declaration provides, therefore, that the internal control has to be functionally and organizationally independent from a respective structure as much as possible.

The analysis of the internal control concept enables us to assume that the control implementation only at a certain level of a public legal entity is insufficient; there is a need for a “higher-level” control, which is performed by the entity which is independent from the controlee. In the opinion of A. Katkus, the internal control, irrespective of its forms of manifestation, is based on the direct subordination relationship; meanwhile, the external control is implemented by the cross-sectoral (special) institutions with respect to the institutions and organizations which are not dependent on them¹². Thus, the external control is such a type of control, which is performed by a control entity and is independent from the controlled object. This control is manifested by the financial, administrative, legal independence of the control entity from the controlled object. One of the main objectives of external control is to determine whether the organization management and control systems are in compliance with the principles of internal financial control.

The municipal financial external control is performed by the municipal controllers (municipal control and audit services), National Audit Office, independent audit firms.¹³

Municipal Controllers (Municipal Control and Audit Service)

Collection and use of financial resources of municipal budgets cannot be dissociated from the implementation of the systematic control principles.

Article 37¹⁴ of the Republic of Lithuania Law on the Budget Structure establishes the budget implementation control. The implementation of municipal budgets, estimates of programmes of managers of

¹² Katkus A. State economic control. - Vilnius: Mintis, 1997, p. 115.

¹³ The authors do not analyze the local budget revenue control objects and entities.

¹⁴ Law on Budget formation of the Republic of Lithuania // Valstybes zinios. 2004, No. 4-47; 2005, No. 144-5237.

municipal budget appropriations, accounting of municipal budget funds and sets of consolidated reports of municipalities are audited by the municipal control and audit services.

A more detailed presentation of the municipality control and audit system is provided in the Republic of Lithuania Law on Local Self-Government¹⁵. Under the aforementioned Law, the municipal controller (municipal control and audit service) means an entity who supervises whether the municipal property and by the right of trust managed state property is managed and used in a legal, effective, economical and efficient manner, as well as the implementation of a municipal budget and the use of other monetary resources.

For the implementation of the municipal control and audit functions, the municipal council, based on its own decision, establishes a municipal control and audit service. However, if the number of residents of a municipality is less than 30 000, the council may be established but it is not a requirement. The Municipal Controller, who is accountable to the municipal council, directs this service and is responsible for its activities.

The institution of municipal controller (municipal control and audit service) has been expanding and developing for over twenty-one years, i.e. since the Restoration of Independence of Lithuania. On 24 December 2000, the ruling of the Constitutional Court laid down that the municipal controllers' institutions formed in municipalities are legal and in compliance with the Constitution.¹⁶ The Law amending the Law on Local Self-Government as of 2002, fully consolidated the institution of municipal controllers, who are elected for the period of five years and do not depend on the term of office of the municipal council. By that time the aforementioned Law established a control institution – a municipal controller, appointed by the municipal council only for the term of office of the municipal council. The provisions of the Law on Local Self-Government as of 1994 established the basis for the municipal controller's institution. On 20 November 1990, the Law supplementing the Law on the Fundamentals of Local Self-Government established the Council Control Service to ensure the lawfulness and appropriateness of the use of financial resources. Meanwhile, in February 1990, the Law on the Fundamentals of Local Self-Government regulated the establishment of the Revision Commission. Thus, the development of the control system in municipalities only confirms that financial control in the local municipal institutions was constantly strengthened and developed in order to seek for the best solutions and assurance of their functions' performance.

¹⁵ Law of local municipal government of the Republic of Lithuania // Valstybes zinios. 1994, No. 55-1049.

¹⁶ The resolution by the Constitutional Court of the Republic of Lithuania "On the municipal representative and executive institutions competence" // Valstybes zinios. 2003-02-25, No. 19-828.

Under Article 27 of the Law on Local Self-Government, the Municipal Controller carries out the external financial and performance audits in the municipal administration, the entities administrated by the municipality and the undertakings controlled by the municipality.

The activity of the municipal controller, as the activity of the National Audit Office, is based on the principles of independence, legality, openness, objectivity and professionalism. In its activities the municipal controller, has to observe not only the Law on Local Self-Government and other laws, but also the state audit requirements¹⁷, methodologies prepared by the National Audit Offices, and other legislation.

The municipal controller¹⁸ annually prepares and submits to the municipal council an opinion concerning a report on the property belonging to the municipality by the right of ownership and the state property managed by the right of trust, and an opinion on a set of reports on budget implementation, submitted for approval. In addition, the municipal controller makes decisions pursuant to financial and performance audit reports, indicates to the director of the municipal administration and the heads of the audited entities the shortcomings in their activity, and fixes a time limit for the elimination of the determined violations of legislative acts, as well as presents to the mayor, the municipal executive institution, the heads of the audited entities opinions, reports and decisions made on the violations of legislative acts determined during the financial and performance audit, which have not been eliminated.

Thus, the institution of municipal controller directly performs the independent external control and audit of the management of municipal budget appropriations; the activities and functions performed by this institution are significant in ensuring the budget implementation and transparent use of funds.

This local authority has to be guaranteed the autonomy of actions and independence. Only upon the legal foundation of performance of functions and independence, the institution of a municipal controller is able to perform all the objectives and functions imperative under legislation, i.e. to perform the financial and performance audits of the controlled objects as provided in the action plan and audit programme. To perform the control of accounting, management, use and disposal of municipal assets, to assess the quality of administrative activity of public administration entities, the reliability of the internal control

¹⁷ "Public Auditing Requirements" mean a set of rules, principles and procedures in all material cases conforming to international and national auditing standards and setting the way how the audit should be carried out. (Law on National Audit Office of the Republic of Lithuania).

¹⁸Law of local municipal government of the Republic of Lithuania // Valstybes ziniuos. 1994, No. 55-1049.

system, and to submit recommendations on its improvement, to perform preventive measures so as to eliminate and avoid recurring violations revealed during the audit.

It should be noted that the benevolent cooperation of the heads of the audited municipal administration units – managers of appropriations – is essential in this process. It is necessary to ensure a constructive handling of the uncertainties and adequate reaction to the opinion provided by the municipal control and audit service over the found discrepancies and recommendations on the internal control improvement and accounts keeping. Only mutual cooperation between the executive and control institutions can lead to an effective budget implementation, transparent allocation and use of appropriations. All the municipal authorities have to strictly comply with their mandate and act within their competency, without hindering the performance and restricting each other's functions.

Community can help the municipal controller to carry out its functions. The residents, having faced the abuse of powers of municipal officers, the failure to carry out their duties, being aware of the improper management of funds, or violations, have to immediately inform the municipal controller about certain violations, and to request to examine the complaint. "All citizens and civil servants able to inform about non-transparent activities of municipal authorities, officials and civil servants should be guaranteed anonymity and protection. It is necessary to establish anonymous reporting facilities, such as reliance telephone, e-mail account or mail box, etc."¹⁹ Only cooperation and mutual understanding lead to the achievement of goals, enable the development of local self-government and management of its appropriations.

The Association of Municipal Controllers, established in 1998, which joins the controllers from all the 60 municipalities of Lithuania, is also worth mentioning. It is an independent and voluntary, non-profit public organization dealing with the general problems of municipal controllers (municipal control and audit services), coordinating the main functions, objectives and the goal-oriented activity, representing the general interests of its members in the public authorities and public institutions as well as in foreign countries and other international organizations. The main goal of the Association is to unite municipal controllers and the municipal control and audit services, to properly represent their members and defend their interests, to strive for the autonomy and independence of municipal controllers, as laid down by the legislative acts, to enable the members of the Association to upgrade their qualification, to develop their knowledge and practical skills, to implement the external audit functions of municipal budgets.

The analysis of the concept of the municipal controller (municipal control and audit service) enables to assume that the main objective of this control entity is to supervise whether the municipal property is

¹⁹ Gutauskas A., Ragauskas P., Stračinskienė L, Čilinskas K. Slide toward local municipal government. Vilnius: Firidas, 2005m. 19-20 psl.

managed and used efficiently, economically and effectively, whether the municipal budget is implemented and other monetary resources are used appropriately, and to submit recommendations on the improvement of financial management of municipalities.

National Audit Office – the External Control Entity of Municipal Finances

The external review of the audit performed by the municipal controller is carried out by the National Audit Office. The aim of external review is to assess the policy and procedures of audit quality assurance of the audit institution, related to the overall audit function as well as their efficiency in order to disseminate the best audit practices, to determine the fields of auditors training, to provide reliable information on the quality of the audit performed.²⁰

The National Audit Office of the Republic of Lithuania is the supreme financial control public authority accountable to the Seimas, which carries out its duties in compliance with the procedures defined in the Constitution of the Republic of Lithuania, legislation, international treaties, public audit standards and other legislative acts.

It should be noted that the performance of the National Audit Office is based on the Constitution. Although, the Constitution of the Republic of Lithuania devotes one section for the National Audit Office, which includes only two articles – Article 133 and Article 134, the provisions enshrined thereof define the main and most important purpose of this institution – to supervise whether the state assets is lawfully managed and used and how the state budget is implemented, as well as to establish the basis for the appointment of the state controller, the submission of the report on the annual execution of the budget to the Seimas. The legal status of the National Audit Office in the state, the activity of this institution and the legal relations of the National Audit Office are regulated by a specific law – the Law on National Audit Office. The main goals of the institution include: ²¹ 1) to supervise the lawfulness and effectiveness of the management and use of the state property and execution of the state budget; 2) to promote positive and effective public audit impact on public finance management and control system and on public management oriented towards results and public needs.

The supreme public audit institution performs financial (lawfulness) ²² and performance audit, following the principles of independence,

²⁰ National Audit Office of the Republic of Lithuania 2009 – 2011 year strategic activities plan. http://vkontrole.lt/veikla_planas.shtml. [Last accessed on 03 08 2011].

²¹ Law on National Audit Office of the Republic of Lithuania // Valstybes zinios. 1995, No. 51-1243.

²² „Financial (regularity) audit" means the evaluation of the data of sets of financial statements and reports on implementation of the budget, sets of

lawfulness, publicity, neutrality, and professionalism. Implementing its main goals, the National Audit Office audits the following: the implementation of the state budget, the use of financial resources, the management, use and disposal of the state property, the implementation of the budgets of the State Social Insurance and Compulsory Health Insurance Funds, as well as the respective fund management institutions and beneficiaries, the funds of the European Union allocated to the Republic of Lithuania and the implementation of the programmes wherein Lithuania participates, the use of the state budget funds allocated to municipal budgets, the use and implementation of the municipal budgets and the management, use and disposal of municipal property in accordance with the scope of public audit.²³

The Article 14 of the Law on National Audit Office lays down that the *entities* of public audit are state institutions and establishments, municipalities, undertakings of all types, in which the shares owned by the state or municipality grant at least 1/2 of votes, undertakings and other legal entities, to which a state or municipal institution has allocated or transferred property. In the view of the authors, the definition of institutions, establishments, state institutions, etc. as entities, as laid down by the Law, is incorrect, because these are the objects audited by the National Audit Offices. Thus, the entity in this case is the National Audit Office as a specialized institution²⁴ performing the external financial control oriented towards the objects: state institutions and establishments, etc.

A proper use of concepts leads to the identification of the essence of the issues or processes in question, enables their characterization, identification of their inter-relations and the mechanisms of interaction. Therefore, it would be more appropriate to identify the institutions mentioned in Article 14 of the National Audit Offices as objects, but not entities.

Under the Republic of Lithuania Law on National Audit Office, as amended on 25 November 2003, the National Audit Office is authorised to audit the use of the state budget funds, allocated to the

annual consolidated statements, a national set of statements and reports and (or) other statements of an audited entity, the assessment of legality of the management, use, and disposal of the State funds and property and the assessment of their use for the purposes set by the law, as well as the giving of an independent opinion.

"Performance audit" means evaluation of the economy, efficiency, and effectiveness of the public and internal administration activities of the audited entity.

²³ Law on National Audit Office of the Republic of Lithuania // Valstybes ziniuos. 1995, No. 51-1243.

²⁴ „A specialized institution - basic aim are public financial control.

municipal budgets, to carry out *external review* of the audit performed by municipal controllers and to provide them with methodology. The audit of management, use and disposal of municipal property is performed in accordance with the scope of public audit. This institution annually establishes the scope of the public audit in the Public Audit Programmes. These programmes are approved by the Auditor General, upon having assessed the recommendations given by the Seimas Audit Committee.

The National Audit Office indicates in its annual opinion as submitted to the Seimas over the report on the state budget implementation whether the allocated appropriations (also allocated to the municipal budgets) have been used to achieve programme goals, whether the appropriations have been used in the most effective manner possible, whether there have been any violations of legislative acts in the use of the appropriations, also to what extent the programme goals have been achieved.

A question arises whether the external review performed by the National Audit Office concerning the audits performed by the municipal controllers is not a duplication of the audit which has already been carried out by the municipal controllers.

It should be noted that only the funds, which are allocated from the state budget, are audited in the National Audit Office municipality. The external review reveals the compliance with the public audit requirements when preparing the audit plan and programme, collecting the audit evidence, executing the audit report and submitting the auditor's report.²⁵

In addition, the Law on Local Self-Government establishes a municipal controller's duty to annually submit a plan of activities of the municipal controller (municipal control and audit service) to the National Audit Office within 10 days after its approval. The Auditor General may also have use of the results received from the audit of the municipal internal auditor, in such a way reducing the scope of the carried out work, but only having been convinced that the work methods used by the internal auditor are appropriate, and the auditor's report is based on sufficient, reliable and appropriate evidence.

It can be stated that the aforementioned provisions enshrined in the Law on Local Self-Government help to avoid the repetition of the audit performed by the municipal controllers and the National Audit Office and ensure a coordinated and effective audit performance in the municipal control objects.

An Audit Firm as the External Control Entity of Municipal Finances

The municipal external control system distinguishes one more entity – audit firms.

²⁵ Mackevičius J., Prankevičiūtė L. Public audit system and its improvement // Economic theory and practice: Monetary studies, 2007./1. http://www.lb.lt/lt/leidiniai/pinigu_studijos2007_1/mackevicius.pdf [last accessed on 01 08 2011].

Generally, audit can be defined as checking of enterprise financial accountability and presentation of opinion whereof. The most important structural elements of audit include: check (a certain form of control when certain objects are checked), independent auditing (conducted by independent auditors), checking of financial statements (checking balance sheets, profit & loss accounts, financial statements for a certain period), opinion on the financial statements (the auditor's report, having performed the aforementioned checks). According to J. Mackevičius, a compulsory audit is such an audit, which is compulsory for enterprises under the laws of the Republic of Lithuania.²⁶ The Law of the Republic of Lithuania on Audit defines audit as follows²⁷: "Audit of financial statements means an independent examination of the financial statements of the audited entity and provision of the auditor's report according to the requirements set by legal acts regulating the carrying out of audit of financial statements". The purpose of audit is to verify whether: "1) the financial statements in all material respects present fairly the entity's financial position of the audited entity, its performance and cash flows under the legislation regulating the accounting and drawing up of financial statements; 2) the financial data provided in the annual report (consolidated annual report) or the entity's activity report (if they are drawn up under the requirements of legislation) meet the data provided in the annual financial statements (annual consolidated financial statements)."²⁸

The objects of compulsory audit include the state and municipal enterprises, the Bank of Lithuania, commercial banks, insurance companies, financial institutions, limited liability companies as laid down in the following laws: the State and Municipal Enterprise Law of the Republic of Lithuania²⁹, the Republic of Lithuania Law on Banks³⁰, the Republic of Lithuania Law on the Bank of Lithuania³¹,

²⁶ Mackevičius J. Audit: theory and practice. Vilnius, Lithuanian Science, 1999, Kn.24, p. 49.

²⁷ Law of the Republic of Lithuania on Audit // Valstybes Zinios. 1999, No. [59-1916](#).

²⁸ Law of the Republic of Lithuania on Audit // Valstybes Zinios. 1999, No. [59-1916](#).

²⁹ The State and Municipal Enterprise Law of the Republic of Lithuania // Valstybes Zinios. 2004, No. 4-24.

³⁰ The Republic of Lithuania Law on Banks // Valstybes Zinios. 2004, No. 54-1832.

³¹ The Republic of Lithuania Law on the Bank of Lithuania // Valstybes Zinios. 2001, No. 28-890.

the Republic of Lithuania Law on Companies³², the Republic of Lithuania Law on Insurance.³³

The audit firms conduct audit in both private and public sector institutions, but we will focus exclusively on their activity in the field of municipal public finance. The need for independent audit in the context of public finance is presupposed by the attempt to check financial accountability, its accuracy, to verify the real financial situation of an enterprise, etc. In addition, the entities performing such audit are not bound by the relationship of subordination with the management of the enterprise; this is an absolutely independent entity.

Thus, independent auditors are attributed to the municipal external control entities, because: 1) the audit firms are not bound by the relationship of subordination with the audited institutions, and this determines that they are not internal control entities; 2) audit firms are both legally and financially independent from the audited institution; 3) the activity of audit firms is based on respective legislative acts; 4) the participation of independent audit firms, when performing the public sector institutional audit, is laid down by the laws.

The analysis of legislative acts suggests that participation of independent audit firms is important when performing external audit in the undertakings controlled by the local authorities; however, there is a lack of more detailed regulations on the relationship between the audit firms and other external control institutions, i.e. municipal controllers (municipal control and audit services), the National Audit Office.

The Republic of Lithuania Law on Local Self-Government and other legislative acts do not establish a right for the municipal controllers to receive information from the audit firms on the audits, which have already been previously performed in the local self-government objects, and this may result in the duplication of work performed by other auditors.

The municipal financial external control, carried out by the municipal controllers (municipal control and audit services), officers of the National Audit Office and independent audit firms, is necessary in order to ensure a reliable management of municipal finances, to assess the quality of administrative activities, to reveal the opportunities for performance improvement. We assume that a partnership of such auditors should be supported and promoted. Cooperation of the municipal external control entities may be beneficiary to the state and

³² The Republic of Lithuania Law on Companies // Valstybes Zinios 2003, No. 123-5574.

³³ The Republic of Lithuania Law on Insurance // Valstybes Zinios. 2003, No. 94-4246.

society in general. The experience of private audit firms enables a high quality performance of audit in a municipality.

In order to achieve the effective cooperation of external control entities and to avoid duplication of work with respect to the same audit objects, it is essential to determine possible forms of cooperation in terms of exchange of information, methods and means of sharing best practices, and lay down them in legislative acts.

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