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Chapter 9 - Local Government auditing in Italy

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Abstract

This article describes the audit of local government in Italy. In Italy, as elsewhere, local audit has been affected by the growth in new public management. There is an increasing trend towards collaboration and cooperation between the audited authority and the auditor. Audit has begun, as in other jurisdictions to widen its remit, so that it focusses on performance as much as financial and compliance issues. This change in role brings with it opportunities for the auditor to help public sector improvement but also challenges- as new skills are required for the new roles that the auditor takes on and audit independence is complicated by the cooperative nature of modern local government audit.

Keywords: Public sector auditing; performance auditing, local government; court of auditors; auditors' relationships, Italy

9.1 Introduction

The auditing system in Italian public administrations is quite heterogeneous. The State presides over this function applying various tools, differentiated depending on who effectively carries out the audit function and who the recipients of the results of these inspections and audits are (Monfardini, 2017). As for local public administrations, the system is implemented by both the central government and the Supreme Audit Institution, called Court of Accounts ("Corte dei Conti", hereafter Court). In general, the control and auditing function exercised by the central government is carried out through specific offices of the Ministry of the Interior and its local Prefectures, along with the Ministry of the Economy and Finance, which holds powers of inspection. The Court operates at the local level mainly via its Regional Departments. The Court, based on specific regulations, reports directly to the Parliament on the controls carried out on central and local administrations concerning public accounting and specific subjects of investigation that the Court includes in its annual audit plan to ensure an adequate understanding of phenomena entailing appropriations that could impact the sustainability of national public accounts (Cerulli, 2006; Corso, 2006).

In addition to the central government and the Court, each local public administration has a specific auditing body which serves as a qualified interlocutor in front of the central government and the Court due to its autonomy and independence guaranteed by the law and their selection and appointment procedures. In this chapter, all these bodies and their activities are presented but a particular focus is on the role played by the local auditing bodies.

9.2 The context to the local government system

The local government system in Italy has undergone radical changes over the last three decades, beginning in the 1990s with the advent of the New Public Management paradigm, which has more recently evolved towards models of governance that increasingly interconnect the public and private spheres in providing public services. These changes pushed local governments towards the simplification and rationalisation of their administrative activities and a profound shift in auditing activities from those related to the legal compliance to more flexible control models based on the

adoption of internal auditing systems (Mussari, 1995, 1997). This evolutionary process has been institutionalised by differently stating the role of the local government system in the Italian Constitution. With the modification of Title V of the Italian Constitution, local governments have obtained greater decisional autonomy from central government and their funding has changed from a system of indirect financing to a more autonomous and direct financing. In particular, the legislator has made great efforts to support autonomist principles during the past decades, promoting the adoption of a federal tax system at the regional level (law n. 42/2009). In 2011, a process of accounting harmonisation favoured the adoption of uniform accounting principles by central, regional and local administrations and a reorganisation of their financial accounting reports and budgets (Legislative Decree 118/2011). This reform process also involved Court controls, which were extended to cover bodies owned by, or subsidiaries of, local governments and the quality of public services provided (IFEL, 2014). These modifications significantly broadened the Court's sphere of investigation, drawing the attention of Court's judges to local governments' management aspects and its level of efficiency and effectiveness (Monfardini and Von Maravic, 2012).

To understand in detail the impact that these financial and accounting reforms have had in Italy, we must consider the administrative structure existing at the territorial level in Italy. There are 7,903 Municipalities, 107 territorial areas, 14 of which are metropolitan cities, 80 provinces, 2 autonomous provinces, 6 free municipal consortia of Sicily, and 5 suppressed provinces. There are 20 Regions, 5 of which have special statutes. Finally, it should be noted that small municipalities can join together in Unions to generate management synergies that would otherwise be difficult to achieve individually, including auditing, which is entrusted to a body of auditors that centrally handles the needs of the various municipalities within the Union.

Local governments' financial resources are guaranteed by a tax system based on three different types of revenues: from taxes directly imposed by a local government on its citizens; from the local government's share of taxes and fees raised by the central government; and finally, from direct State contributions ensured by the allocation of a share of the equalisation fund. The autonomy-building process began with fiscal federalism (enabling law n.42 of 2009), which sought to make local administrations increasingly autonomous from the State in terms of revenues and coverage of expenditures for basic services, but was partially interrupted. The law system had, in fact, postulated that the fund was to already be fully operational, with fund resources being allocated based on standard costing of public services and the quantification of the resources to transfer based on the full financing of the costs for performing the basic functions of local governments and to ensure minimum essential levels of services in line with the civil and social rights they must protect and fulfil (Giannola and Bianchi, 2019). On this point, many have noted that among the causes of the failed implementation of (tax) federalism, two had a significant impact on local finances. The first was the insertion into the Constitution of the balanced budget requirement (art. 28), which greatly limited budget planning capacities; the second concerns local governments' contribution, even if less significant than that of the central government, to the pursuing of public finance objectives set at the European level.

9.3 Auditing and the control framework

To provide an accurate picture of auditing systems in Italian local governments, it is helpful to clarify that auditing activities concerns both fiscal and financial aspects.

Concerning local governments' financial controls, the system involves different subjects: local governments' offices, organs of political representation (e.g. the Council), as well as the auditing bodies (Monfardini, 2017).

The level and quality of supervision of a local government's internal control office contributes positively on the activities of the auditing body, which can thus concentrate its activities on the risk-management system, the issuing of opinions and, in general, on all of the activities that are assigned directly to the auditors by the Court. As in the case of the assessment of the local government financial statements through the questionnaire issued by the Court, the auditing body makes a relevant contribution to the activity of the Court as it is composed by people which have specific skills and analytical capacities which are fundamental to provide an accurate financial and accounting picture of the local government under observation.

Auditing bodies can be monocratic, i.e. consisting of a single auditor (for local governments with a population below 15 thousand) or collegial (for all other municipalities). The same functions can also be carried out for a union of municipalities, although in such cases, it is the responsibility of the auditor to ascertain the consequent workload and to decline any further appointments considered excessively burdensome. The auditors of local governments are listed in a specific registry kept by the Ministry of the Interior, and must also be listed in the registry of the order of chartered accountants or that of legal accounting auditors managed by the Ministry of Economics and Finance. The sole auditor, along with the members of collegial auditing bodies (excluding the President) are appointed by the local governments' Councils through a drawing in the registry held by the Ministry of Interior, while the President of the auditing body is chosen directly by the Council. The tasks assigned to auditors include the issuing of obligatory opinions on budgets, accounts and financial statements and the most relevant and related measures and decisions such as those regarding the personnel, the borrowing, etc.

Additional auditing activities are carried out by the Court, which executes them through its Regional Departments. These are directed and coordinated by the Central Department of Autonomous Authorities ("Sezione delle autonomie") of the Court, a collective body chaired by the President of the Court and mostly composed of judges from its Regional Departments.

The Court's auditing function concerning local governments is exercised by its Regional Departments which verify - possibly during current reporting periods - the regularity of financial management, the adequacy of programming procedures and documents and the proper functioning of local governments' internal control offices and systems.

Focusing on the fiscal dimension, the Public Finance Inspection Service of the Ministry of Finance, using cash management data recorded in the Italian Central Bank, verifies any local governments' deviation from public finance objectives. The Public Finance Inspection Service audits can also be directly ordered by the Court if, during the auditing of a local government, relevant flaws able to compromising its contribution to public finance are discovered.

Finally, other auditing activities are performed by the Ministry of the Interior, with the aim of ensuring the proper functioning of the organs of local governments in order to avoid cases of legal misconduct, and in particular cases of mafia infiltration and influence. Furthermore, the Ministry of the Interior intervenes in cases of dysfunctions and organisational problems impacting the financial balance of a local government, including the failure to approve budgets and financial reports on time, or in the most critical cases, the failure to adopt acts declaring the financial insolvency of the government and the related acts to recover.

9.4 Scope

The scope and range of controls on local governments mainly comprise auditing of their budgets and financial reports, including 'treasurers' cash accounts, compliance with norms regarding indebtedness and expenditures, and in general, public finance objectives with which all State bodies must comply with (Galeotti, 1997).

The Court also uses local governments' auditing bodies, which provides, according to the Law 266/2005, the Court with specific reports on local governments' current-year budgets and accounts. To this end, the Central Department of Autonomous Authorities draws up annual guidelines on balance sheets and other financial statements accompanied by a questionnaire to electronically gather, through standard reporting, accounting and management data for all local public authorities. The aim is to ensure that the Court can extensively monitor local governments and facilitate the effective coordination of public finance measures adopted at the national level. The auditing activities are not limited to local governments' budgets and balance sheets – although this is their main focus, but extend to internal control systems. Local governments with more than 15 thousand inhabitants and regional governments must provide a report regarding the adequacy of their internal control systems functioning. This is an obligatory annual fulfilment through which the Court receives reports drawn up based on guidelines issued by the Central Department of Autonomous Authorities. This specific activity is also done by local governments' auditing bodies which are required to do so regardless of the size of the government, reporting in their written opinions any critical issues they may find regarding the functioning of local governments' internal control systems.

Further audits are carried out by both the Court and the auditing body on start-of-term and end-of-term reports by Mayors and Presidents of Provincial and Regional governments. This is a new requirement that is part of a shift towards assigning increased responsibility to public administrators, who must evaluate the financial soundness of the local authority which they are elected to lead at the beginning and end of their term in office, providing an overview of what has been done during the course of their tenure and the effects their actions have produced on the economic and financial management of the authority.

Therefore, we must not neglect to mention the auditing activities carried out by all those subjects listed as delegated to audit local authorities with regard to public finance objectives. These activities are an important focus of the Court and the Ministry of Economics and Finance, as they can negatively impact the overall financial sustainability of the State.

Another area of increasing importance is the control of the correct use of European resources. In this case, several control bodies may be involved, dealing with, on the one hand, the auditing of internal public authority offices called upon to manage these resources, and on the other, the auditing body tasked with overseeing their correct utilisation.

A separate discussion must be reserved for local governments in severe financial difficulty. Policymakers have established a new multi-year financial rebalancing tool that allows them to avoid insolvency and bankruptcy and to internally manage the crisis by adopting expense-containment measures and recover from deficits over the mid-to long-term. Numerous control bodies are involved in this procedure: the auditing body, which obligatorily provides an opinion on the sustainability of the rebalancing plan and the effective expectation of recovery; the Ministry of the Interior through the Commission for the financial stability of local authorities; and the Court through its Regional Departments for each given territory. The Court may become involved exclusively when there is a need to lodge a petition for denial, which transfers the entire matter to the jurisdictional level by appealing to a specifically constituted Whole Central Departments Body constituted at the central level.

9.5 Independence of the auditor

The figure of the auditor in local governments has always been present in the legal system of the Italian Republic. Over time, it has taken on increasingly important functions within the sphere of administrative and accounting controls of public authorities. Nowadays, auditors go beyond the mere

auditing of financial statements, serving also as an external evaluator of local governments' internal control systems. Notwithstanding this enlargement of auditing to internal dimensions, the auditing body has consistently maintained an independent, autonomous space outside the executive organs of local governments, albeit one of collaboration with their Council.

Concerning the principle of the auditor's independence, it should be noted that it is a requirement intended to safeguard the auditor's objectivity and must be verified based on a series of risks that could potentially undermine their integrity.

The past decade has seen the consolidation in the legal system of an impartial approach to the appointment of auditors in local governments. A random assignment procedure has been adopted in order to render auditors really independent and extraneous to the organisational dynamics of the local governments they will inspect. However, with the advent of the new decade, there has been a partial reversal, allowing municipalities with collective auditing bodies, unions of municipalities, metropolitan cities and provinces to directly appoint the President. In this case, the collective body of auditors is composed of three members: the President, chosen by the local government, and two auditors randomly drawn from the registry of auditors of local public authorities, no longer on a regional basis, as with the previous regulation, but on a provincial basis.

This step backwards has been justified by claiming that it served to ensure the highest level of discussion and dialogue among professionals from different spheres and circumstances. It also seems clear that allowing public authorities to choose and appoint the President of their auditing body constitutes an impediment to the autonomous execution of the task. We can presumably imagine that the President of the auditing body will be less independent as appointed on a fiduciary basis by the political body of a local government with potentially negative effects on the evaluation capacity of the auditing body.

Other conditions considered necessary to maintain auditors' independence include: 1) professional protections; 2) interlocution with the Court; 3) qualification as a public official; and 4) a suitable level of compensation.

1- The professional protections the auditor must adopt in order to be released from potential risks concerning professional responsibilities refer in particular to the adoption of guidance from the Court, and the implementation of appropriate auditing and sampling techniques in line with guidelines provided by the national Board of chartered accountants.

2 – As far as relations with the Court and specifically with Regional Departments are concerned, direct interlocution with court offices can be of great benefit and can be performed in part through the internet portal Con.Te. Through it, the Court receives official acts drawn up by auditing bodies.

3 – The auditors' qualification as public officials, as a subject appointed to carry out a public function, widens the scope of the jurisdictional assessments for which he/she is responsible.

4 – An appropriate level of compensation may be a crucial element given the aim of safeguarding the real independence of the auditor, who must carefully evaluate workloads and relative compensation before accepting an appointment. In any case, it should be noted that the Ministry of the Interior has recently adjusted – albeit only marginally – compensation to be paid to auditors by local governments. The initiative was well-received by those working in the sector, as it acknowledged the value of the professional contribution of auditors and the increase in control activities entrusted to auditing bodies.

9.6 Performance Management

The process of corporatisation of the public administration, which began in Italy in the 1990s with an appeal to the cultural paradigm of new public management, reflected a real change in the mind-set of public decision-makers, which progressively adopted management models increasingly oriented towards results (Mussari, 1997). Local governments have thus had to radically change their systems of managing and evaluating staff, which were previously centred mainly around collecting data on time spent working and not on performance in terms of objectives achieved and results produced. The Legislative Decree n.150/2009 (known as the "Brunetta" reform) marked a shift in the conception of performance in the public sector, specifying the adoption and use of performance planning and reporting documents for contracted employees of all public administrations. Independent evaluation bodies were established (called "nucleo di valutazione" or "Organismo indipendente di valutazione") to monitor performance of, and performance systems implemented in, central and local governments (Ruggiero and Mussari, 2010). These bodies are monocratic or collegial and are appointed directly by a local government. The independent evaluation body is responsible for the transparency and integrity of the evaluations carried out, reporting on activities aimed at ensuring the functioning of local governments' performance system. The system of performance indicators and relative measurement methods was bolstered with regard to planning documents for local governments, which in municipalities with over 5,000 inhabitants are processed within the Executive Management Plan, gathering both objective-setting and performance data.

In addition to the above-mentioned independent evaluation body, local governments' performance management systems are overseen by their internal control offices, which carry out audits on its management. This function is usually delegated to the office of the municipal secretary, who, in the absence of a general director, is the executive officer in charge of evaluating managers and heads of the administration. In local governments', important roles are also played by the Mayor and the Council, which assign – in line with the planning documents and after dialoguing with the managers in charge – detailed objectives for each strategic and operational area, down to individual offices and their relative cost centres, as identified in the Executive Management Plan for municipalities with populations over 15,000, Provinces and metropolitan cities.

The auditing body, in this particular circumstance, merely controls the regularity of procedures adopted by the respective competent bodies, and in particular, monitors how these performance measurement systems impact on personnel expenditures with regard to the correct quantification of funds designated to finance the benefits component of the remuneration of public personnel (managerial and non-managerial).

It is not easy to draw conclusions regarding the effective improvement of local governments' performance following the adoption of the homonymous system, as controls on the effective achievement of objectives are carried out by the managers themselves, who may justify any gaps between planned objectives and results achieved using arguments the real importance of which is difficult to determine. The independence of the assessment body can, in fact, be impaired by numerous factors, from the most customary one, namely resistance to evaluation on the part of public sector employees, to the difficulty the evaluating body faces in fully discharging its task, conditioned as it is by the fact of having been appointed by the political organ itself, which often prefers not to risk upsetting the delicate organisational balance of its various offices.

The role of the Court in this particular context is strictly limited to verifying the adequacy of internal control systems (in accordance with art. 148 of the Consolidated Law on Local Authorities) and evaluating the measures to adopt for prudent and sound management of public authorities (art. 148 bis of the Consolidated Law on Local Authorities).

9.7 Auditing regulation and practice

As noted above, the regulatory system for financial and accounting controls on local governments in Italy assigns the task of overseeing public management and ensuring its proper administration to public institutions and independent auditing bodies.

As far as control by the public authority is concerned, there is a dual-track consisting of the magistrature of the Court, which exercises substantial control over all administrations, in particular about adherence to public finance and balanced budget requirements; and the Government, which exercises its administrative control via the responsible ministries. The ministries have specific powers to inspect and impose sanctions, which they exercise whenever clear signs of imbalance are perceived within the sphere of a local governments' financial management. In cases considered particularly critical, the same authorities call upon judicial authorities to carry out further checks to identify possible direct responsibility on the part of the local government and the personnel involved. The second body overseeing control of a local government is the auditing body, which can be monocratic or collective, made up of independent professionals from the registry of chartered accountants or the registry of legal auditors who are also listed in the registry of auditors of local governments. Auditors become privileged interlocutor of political organs in that they serve both the local governments' Council and citizens themselves. The auditing body, like the Independent evaluation bodies, can receive tips from citizens and order specific examinations/inspections of the controlled public authority to ascertain in detail their organisational dynamics and consequent possible financial effects. Finally, the legislator have also provided auditors of local governments the possibility of employing assistants, who can be paid directly by the auditors.

9.8 Conclusion

The overview provided in this chapter reveals two particular Italian trends regarding local governments' auditing. Firstly, controls of local governments by both auditing bodies and the Court have become increasingly collaborative in nature. The legislator's aim is to find a balance between the demands of external control and local governments' autonomy. Therefore – and this is the second current trend - the auditing body's role takes on special characteristics. The literature has already highlighted that, although in charge of the external control function, auditing bodies also serve to support local governments on performance management matters. Besides, they have the task of interfacing with the Court: for example, in the case of reports of severe management irregularities, where there is a hypothesis of responsibility, the auditing body must promptly notify the appropriate jurisdictional organs. Similarly, in the case of accounting and financial irregularities for which the local government has not adopted corrective measures, the auditing body must notify the competent regional control department of the Court. As a result, the role of the auditing body is progressively becoming hybridised, divided between the different functions assigned to it, which puts it in a position in which technical accounting and control competencies alone no longer seem sufficient.

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