

THE SUPREME AUDIT INSTITUTION IN THE ROLE OF IMPROVING THE OPERATION OF THE MINISTRY OF DEFENSE

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ABSTRACT

The most important institution that regulates the national defense system in the Republic of North Macedonia is the Ministry of Defense, which in accordance with the Law on Defense creates the defense policy, determines the directions for the development of long-term and medium-term plans, and manages human, material and financial resources. It is of great importance for providing support to the Army of the Republic of North Macedonia, which is the guardian of territorial integrity and sovereignty. Realizing its mission, the Army of the Republic of North Macedonia, achieves the maintenance of peace and security outside the country through joint action or as part of collective security and defense systems. This paper explores the role of the supreme audit institution (in our country the State Audit Office) in improving the legal and purposeful work of the Ministry of Defense, since the existence of the State Audit Office until today. A detailed analysis of the audit reports issued by the State Audit Office for the Ministry of Defense in the last ten years, the total number of audits performed from 2010 to date has determined and identified the significant conditions regarding the financial operations of the Ministry, compliance with regulations and laws, as well other systemic weaknesses. The analysis used all published annual reports on the performed audits and the operation of the State Audit Office, as well as the last published final audit report for the Ministry of Defense. In addition to analyzing those reports, the paper covers other literature and scientific papers on how state audit affects the performance of key institution in terms of defense and security.

Keywords: Ministry of Defense, Supreme Audit Institution, State Audit Office, Audit.

JEL Classification: M42, H56

1. INTRODUCTION

Financial regulation of the security sector is essential because it keeps security and defense service providers responsible for their use of public funds. Properly enacted, it guarantees that: 1) services are allocated according to the security need of the citizens, 2) security and defense investments are rendered consistently and effectively, 3) key security and justice providers do not function as a state-within-a-state and remain financially accountable to their oversight institutions and affordable for society, and 4) public funds allocated for security and defense do not infringe on programs aiming at reducing poverty and promoting sustainable social and economic development (Masson, Andersson, & Salah, 2011).

The defense sector is made up of the main security and justice providers and their management and supervisory agencies. The legislative and policy system controls their roles, authorities, and frameworks. Defense, security, and justice providers in one country are the security forces, such as armed forces, police, intelligence, and security services, and there are justice and law enforcement institutions, such as courts, prisons, and traditional justice systems. On the other hand, the countries also have management and supervisory bodies/institutions. The executive management and supervisory bodies may encompass the following: the Ministry of Defense, the Ministry of Interior, the Ministry of Justice, the Ministry of Finance, the Presidency, etc. Last, but not least, we have legislative management, such as the Parliament and its committees, and the Ombudsman. Moreover, there are also informal supervisory institutions, such as civil society organizations, media, research, and advocacy organizations.

The financial accountability of the security sector in one country is of great importance. The laws that regulate financial accountability provide a framework for the management of public money and public property. These laws mainly include the state's constitution, which defines the separation of powers and the oversight role of parliament; financial administration laws, which provide rules to govern the financial transactions of public funds; financial accountability laws, aimed at increasing the transparency of governmental spending mechanisms; laws establishing ministries with specific financial oversight functions, such as the Ministry of Finance; laws establishing the supreme audit institution or auditor-general; anti-corruption laws; and the state budget, which is enacted by the parliament and has, therefore, the value of a law (Masson, Andersson, & Salah, 2011).

The paper covers the financial control of the Ministry of Defense, as a key institution in the security sector of the country, by the State Audit Office as the supreme audit institution and the most important institution in controlling the spending of public money.

2. THE MINISTRY OF DEFENSE AS A KEY INSTITUTION FOR THE DEFENSE OF TERRITORIAL INTEGRITY, PEACE AND SECURITY IN THE REPUBLIC OF NORTH MACEDONIA

Talking about the concept of national security, many experts have discussed the essence of national security, concluding that national security is a general concept of defense and that national security is a very complex problem of every nation, i.e. independent state (Yusa, Margynata, & Haris, 2018).

National security can be simply understood as freedom from foreign orders or colonization. This means that the national security is also free from threats, which can be similar to what was stated by Wolfers as quoted by Paleri (2009), namely, "National security objectively

means the absence of threats to acquired values and subjectively, the absence of fear that values will be attacked” (Paleri, 2009).

Oatley (2008) said that, theoretically, national security is defined not just as military defense. At the very least, it is a fundamental part of the survival of society. Thus, this definition relates to efforts to create a political, economic, social, and environmental condition in which society lives (Oatley, 2008).

Furthermore, Anais (2015) argues that the Ministry of Defense is a key institution for consolidating democratic civilian control over the military (Anaís, 2015). Not only are legal, financial, and human resources necessary for this control, but the Ministry of Defense also needs effectively to be part of the political system. In short: “The ideal situation, at least in a new democracy, is one in which the Ministry of Defense as institution and the minister as an individual are integrated into the structure of government power hold the personal confidence of the executive” (Bruneau & Tollefson, 2014)

The national defense policy and doctrine are defined and based on the primary goals of the security policy of the Republic of North Macedonia, namely: to protect the life and personal safety of citizens, to guarantee the independence and territorial integrity of the state, political freedoms, civil and human rights, including the rights of religious, ethnic and other minorities, to guarantee the material well-being and prosperity of the citizens.

The Ministry of Defense has a key role in the national defense system and following the Law on Defense (Official Gazette of the Republic of N.Macedonia, Law on Defense, 2001) creates the defense policy, determines the directions for the development of long-term and medium-term plans, human, material and financial resources management and also supports the Army of the Republic of North Macedonia.

National defense interests are values and conditions that directly arise from the fundamental values established in the Constitution of the Republic of North Macedonia: preservation of the independence, the sovereignty and territorial integrity and the unitary character of the state as an essential framework for preserving the state identity of the Republic of North Macedonia and free nurturing and expression of the ethnic and cultural identity of all citizens.

3. THE STATE AUDIT OFFICE AS A SUPREME AUDIT INSTITUTION IN THE REPUBLIC OF NORTH MACEDONIA

The role of state audit is to objectively acquire and assess evidence in order to determine if the information presented by state entities accurately corresponds to the established criteria. It is a procedure of objectively examining the financial statements of state entities to obtain reasonable assurance about the legal and intended use of public funds, as well as to evaluate the use of funds in terms of economy, efficiency, and effectiveness. The existence of a supreme audit institution (hereinafter refers to as SAI) is one of the instruments to control the spending of public funds. SAIs report to Parliament on the manner in which public funds are used, the degree of compliance with laws and regulations, and the reliability of the financial statements of public sector entities.

The European Court of Auditors has stated in their “Handbook on SAIs in the EU and its Member States” (2019) that SAIs independently investigate the efficient, effective, and economic use of public resources, as well as the compliance of public spending and revenue collection with the applicable rules. They support parliamentary control of governments with their fact-based, objective, and impartial audit reports, and thereby help to improve policies, programs, public administration, and the management of their state’s finances. This helps to build citizens’ trust in

our societies' checks and balances and further develop democracies that function properly (European Court of Auditors, 2019).

Jack and Rick argue that SAIs' role in curbing corruption is increasingly relevant and the audits are potent deterrents to waste and abuse of public funds. According to them, SAIs help reinforce the legal, financial, and institutional framework which, when weak, allows corruption to flourish, and they establish a predictable framework of government behaviour by reducing arbitrariness in the application of rules and laws (Titsworth & Stapenhurst). Furthermore, each SAI develops its own policies and procedures for performing the audit engagements (Mamic, Pavic, & Vukovic, 2017).

In the Republic of North Macedonia, according to the Law on State Audit, which was adopted in 1997 and has set the framework at the national level, the state audit in the Republic of North Macedonia is performed by the State Audit Office as an independent public authority managed by the Auditor General (State Audit Office, 2019). To increase the compliance of the legal regulations in the state audit with the requirements of the Lima Declaration and the Mexico Declaration on SAI Independence and to bring it closer to the EU standards and practice, this Law underwent several changes, and in 2010 the new Law on State Audit entered into force, being largely in line with the stated requirements of the declarations (Dionisijev, Malchev, Tocev, & Kamenjarska, 2020).

4. ANALYSIS OF THE STATE AUDIT OFFICE ROLE IN CONTROLLING THE OPERATION OF THE MINISTRY OF DEFENSE

According to the Law on State Audit, state audit is obligatorily performed once a year of the Budget of the Republic of North Macedonia and the budgets of the funds, and other audits are performed within deadlines determined by the Annual Work Program of the State Audit Office (Official Gazette of the Republic of N.Macedonia, Law on State Audit, 2010). Thus, following the methodology of the State Audit Office and certain criteria in selecting the entities to be audited during the year, so far the State Audit Office has performed 8 regularity audits (financial audits and compliance audits) at the Ministry of Defense, of which the last audit was conducted in 2018, and the final audit report was released in 2019. Our research refers to the period from 2010 until today, all audits that have been performed since then, particularly 3 regularity audits for the years 2011, 2013, and 2017, and the final audit reports being released in 2012, 2014, and 2019.

The research is based on a detailed analysis of the irregularities determined by the state auditors in the conducted audits, the number of determined irregularities by year, as well as the identification of significant groups of identified conditions. Analogously, this research continues with determining the given types of opinions on the work of the Ministry of Defense in the years covered, and finally, how many of the recommendations given have been implemented by the Ministry of Defense. We conclude the research with a regression between the number of identified irregularities and the number of recommendations given per year.

Figure 1 shows the number of determined irregularities by certain sections/groups of audit reports by year. As can be concluded from Figure 1, the largest volume of irregularities found by state auditors belongs to the group of use of funds in accordance with legal regulations, i.e. public procurement, and for 2017 as many as 13 irregularities related to public procurement in the Ministry of Defense were determined.

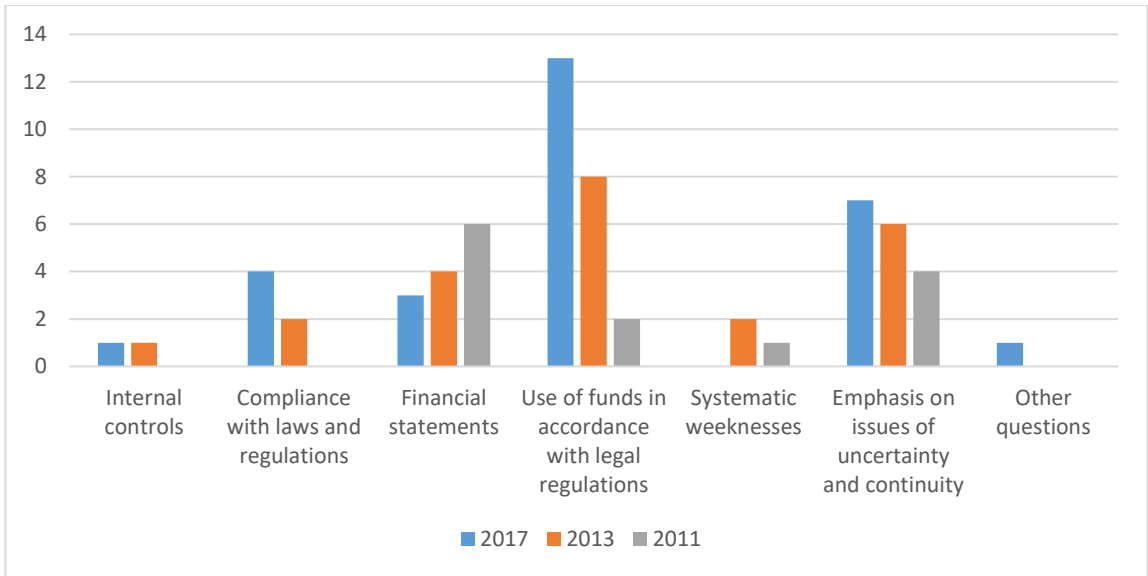


Figure 1: Irregularities determined by State Auditors at the Ministry of Defense (Source: Authors' own elaboration)

With a detailed analysis of the State Audit Office annual reports, as well as the individual audit reports for the Ministry of Defense, we can conclude the following weaknesses: the Ministry of Defense has not taken any action to insure property and equipment available for protection against unforeseen situations (fires, floods, thefts), etc., due to unestablished financial records on their value, a situation that has been existing for years, creating a risk of additional expenditures for the budget and inability to compensate in the event of some unforeseen situation. Also, the established manner of public procurement planning is not in accordance with the Law on Public Internal Financial Control and does not cover the risk of incorrect determination of the procurements need, inadequate assessment of the funds provided for the procurement, and the inadequate definition of the technical characteristics of the goods, which contributes to the long duration of the procedures, the untimely conclusion of contracts and low realization of the annual public procurement plan, as well as negotiation of larger quantities than necessary, and other conditions that occur during the implementation of public procurement procedures, that are not in line with the Law on Public Procurement.

The irregularities determined by the state auditors result in audit opinions, so Figure 2 presents the types of audit opinions by years.

| Audited year | Financial statements (Financial Audit) | Compliance with laws (Compliance Audit) |
|--------------|---|---|
| 2017 | Adverse opinion | Adverse opinion |
| 2013 | Adverse opinion for the Balance sheet, and qualified opinion for Income Statement | Adverse opinion |
| 2011 | Adverse opinion for the Balance sheet, and qualified opinion for Income Statement | Adverse opinion |

Figure 2: Audit Opinions for the Ministry of Defense (Source: Authors' own elaboration)

The opinions expressed by the state auditors originate primarily from the unadopted strategic, long-term and medium-term documents that affect the annual and medium-term planning and achievement of the Ministry's goals, unfinished internal audits, incomplete inventory of assets and sources of funds, unrealistically presented liabilities supplies, unestablished accounting records of movable, immovable property and stocks of materials and small inventory, identified irregularities in the implementation of public procurement procedures and implementation of concluded contracts.

The purpose of the state audit is to provide reasonable assurance and to give clear, concise recommendations for overcoming the conditions found, and then to monitor the implementation of those recommendations. Thus, in Figure 3 we can see the total number of given recommendations and the degree of implementation of the recommendations by year.

| | 2017 | 2013 | 2011 |
|--|-----------|-----------|----------|
| Implemented recommendations | 2 | 5 | 1 |
| Partially implemented recommendations | 2 | 2 | 3 |
| Unimplemented recommendations | 3 | 4 | 3 |
| In progress | 3 | - | - |
| Total number of recommendations | 10 | 11 | 7 |

Figure 3: Recommendations given by the State Audit Office (Source: Authors' own elaboration)

It can be easily seen and concluded from Figure 3 that the number of recommendations increases from audit to audit, so in 2011 the number of recommendations given was 7, in 2013 – 11, and 2017 – 10. If we make a simple regression of the number of irregularities established in

the final audit reports by year, with the number of recommendations given by year, we will come to a conclusion that there is a linear correlation between these two variables. The R-squared in the model is 0.6597 which shows that 65.97 percent of the given recommendations can be predicted by the determined irregularities. This is a logical result because, with the increase of irregularities and the established conditions, the number of recommendations given by the state auditors also increases. Figure 4 provides the regression statistics.

Regression Statistics

| | |
|-------------------|----------|
| Multiple R | 0.81224 |
| R Square | 0.659733 |
| Adjusted R Square | 0.319466 |
| Standard Error | 1.717259 |

Figure 4: Regression Statistics (Source: Authors' calculations)

5. CONCLUSION

This paper contributes to the existing literature relevant to the matter, by providing a comprehensive understanding of the control over the financial operations of one of the key institutions in the country's security sector. From the analysis and the obtained results, we can conclude that within 10 years, the Ministry of Defense was subject to audit 3 times, and the number of identified irregularities and findings from audit to audit is higher, thus the number of recommendations given has increased. The audit opinions in 3 audits have not changed, i.e. they are the same.

Due to limited resources in the SAO, the scope of audit in the security sector, namely the Ministry of Defense, is limited and insufficient for full control of financial and material operations on an annual basis. Hence, the recommendation is to increase the number of audits at the Ministry of Defense, in order for that institution to use public funds more efficiently and effectively.

Taking into consideration the novelty and the insufficient research conducted in this area, a more diligent approach and focused analysis is required to prompt in-debt research.

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