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THE IMPACT OF STATE AUDIT ON THE EFFICIENCY OF GRANT MANAGEMENT IN THE PUBLIC SECTOR: THE CASE OF THE FEDERATION OF BOSNIA AND HERZEGOVINA

Sabina Selesković 

State Audit of the Institutions of the Federation of Bosnia and Herzegovina
Email: avdicsabina@hotmail.com

Amra Gadžo 

Corresponding Author: Faculty of Economics, University of Tuzla, Bosnia and Herzegovina
Email: amra.gadzo@untz.ba

Benina Veledar 

School of Economics and Business, University of Sarajevo, Bosnia and Herzegovina
Email: benina.veledar@efsa.unsa.ba

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Abstract

The paper aims to explore the impact of state audits of grants in the public sector on reducing non-compliance with legal regulations. The research was conducted over a ten-year period among federal and cantonal ministries in the Federation of Bosnia and Herzegovina (FBiH) responsible for planning and distributing grant funds as part of their regular duties. The research results show that the total number of recommendations given during the observed 10-year period was 1,666, including: 245 recommendations related to grant planning, 684 recommendations related to the distribution of grant funds, 554 recommendations concerning the oversight of the designated expenditure of allocated funds, 74 recommendations concerning grant implementation reporting, and 109 recommendations regarding the accuracy of accounting records. During the observed ten-year period, the number of recommendations decreased by 75%. The research results also indicate that the adoption of stricter guidelines for grant management has a strong impact on reducing the number of identified irregularities. The paper also presents an analysis of the most common causes of irregularities. The results of the conducted research will contribute to filling the literature gap on the importance of grant audits, the most common causes of identified irregularities, and the significance of stricter legal regulations and clearer rules related to grant management.

Keywords: State Audit, Public Sector, Grants, Financial Audit Report, Recommendations

1. Introduction

Public sector auditing is a fundamental mechanism for controlling the spending of public funds, organized by government bodies. Its primary goal is to improve the system of transparent financial management and to increase public accountability in managing public resources. Public sector auditing should act in a timely manner to detect illegal and inefficient spending of public funds and uneconomical management, so that corrective measures can be taken promptly to prevent negative consequences resulting from irresponsible behavior of the executive branch. Good government auditing has a distinct positive and statistically significant effect of the performance of the public sector (Gustavson, 2015).

The organization of audit institutions varies significantly across countries, as does the nature of their outputs, their relationships with stakeholders and the media, and their impact on organizations and society (Antipova, 2019). Public sector auditing in the Federation of Bosnia and Herzegovina (FBiH) is conducted by an independent audit institution called the Office for Auditing of Institutions in FBiH (hereinafter referred to as the Office). Within its jurisdiction, the Office conducts financial audits, performance audits, and other specific audits.

The goal of each audit carried out by the state audit office is to ensure that the planning and execution of budgetary funds are conducted in accordance with legal regulations, and that the expenditure of public funds is directed towards achieving the strategic goals of the parliament and the government. In the absence of such control, there is a high likelihood that decision-making will be based on inaccurate information, that decisions will not be implemented, that budgetary funds will be used irrationally, and that there will be abuses of authority by managers and other personnel. According to Allen and Tommasi (2004), "The role of public sector auditing is very important because it ensures that the bodies making final decisions (parliament, government, and/or citizens) are regularly assured of the quality of reports on the spending of taxpayers' money, as well as the management of assets and liabilities under public control."

Grants hold a significant share in the FBiH budget, which is why their management requires special attention. According to FBiH budget execution reports from the past five years, the share of current grants in total expenditures and outlays ranged from 41% to 45%. At all three existing levels of government in the Federation of Bosnia and Herzegovina (federal, cantonal, and municipal), both current and capital grants are continuously awarded. Grants represent financial incentives provided to carry out activities aimed at achieving strategic goals. They are specific sources of financing intended for companies, public institutions, universities, schools, municipalities, hospitals, as well as all other institutions, legal entities, and individuals, and are provided for specific purposes. Grants are a type of budgetary expenditure, and all principles of public expenditure established in financial theory apply to them, with a particular emphasis on the requirement for the rational use of public funds. Alkam *et al.* assert that effective audits contribute to reducing corruption levels, which is essential for ensuring that grants are used for their intended purposes (Alkam *et al.* 2023).

The competent institutions that manage budget funds for grants define the objectives for grant allocation, establish criteria for selecting recipients and the methods of their evaluation, propose expenditure programs, adopt regulations and procedures related to the selection of grant recipients, conduct the grant award processes, oversee the use of funds, evaluate the results achieved through fund allocation, and report to the relevant authorities on the usage of grant funds. Despite the fact that audits are conducted annually for certain recipients, with both current and capital grants being reviewed each year, and significant findings being identified along with adequate and actionable recommendations, irregularities in grant management continue to persist. These irregularities prevent the fulfillment of the strategic goals for which the grants were initially awarded. Therefore, the aim of this study is to determine the extent and nature of the impact that public sector auditing has on the achievement of the strategic goals for which funds were allocated, as well as the extent to which these funds are used rationally. Since there is insufficient scientific research on the issue of grant auditing as a significant component of budget expenditures, this study will significantly contribute to filling the literature gap.

2. Grants as a significant part of budget expenditures in Federation of Bosnia and Herzegovina

In the regulations of the Federation of Bosnia and Herzegovina, there is no specific definition of grants. Grants are represented as distinct items in the budget and are recorded under special positions in the financial reports of institutions. They are divided into current and capital grants and are most commonly awarded in monetary form. According to the Budget Accounting Regulations in FBiH (Official Gazette of FBiH, no. 60/14), all non-refundable funds not allocated for the purchase of capital assets are recorded under the position of current grants and other current expenses. Non-refundable funds provided for the purchase of capital assets are recorded under the position of capital grants. Account categories in the Chart of Accounts are detailed according to the recipients to whom the grants are awarded.

Grants constitute a significant part of the Federation of Bosnia and Herzegovina's budget expenditures and are directed towards various sectors of society. According to FBiH budget execution reports, over the past seven years (2013-2019), the share of grants in the FBiH budget ranged between 40% and 50%. This calculation does not include the current reserve allocated through decisions of the FBiH Government as well as resolutions from the Prime Minister and Deputy Prime Ministers of FBiH, a significant portion of which pertains to the disbursement of grant funds to various types of recipients.

The planning, allocation, and reporting on the use of grant funds are regulated by the Law on Budgets in FBiH and the laws on budget execution, which are enacted for each year individually. For some grants, the obligation for their allocation to certain categories is determined by specific legal provisions. Current grants in the field of social rights are implemented based on the entitlements established by the Law on the Fundamentals of Social Protection, Protection of Civilian Victims of War, and Protection of Families with Children, the Law on Pension and Disability Insurance, and the Law on Early Favorable Retirement of Veterans. The grant for displaced persons and returnees is planned and implemented based on Annex VII of the Dayton Peace Agreement for Bosnia and Herzegovina and the Revised Strategy for its implementation, which outlines the need to continue activities to ensure conditions for return and its sustainability. The grant for the railways of FBiH is planned and implemented based on the Law on Financing Railway Infrastructure and Co-financing Passenger and Combined Transport. In the FBiH budget, the most significant amounts of current grants are disbursed through the Ministry of Labor and Social Policy and the Ministry for Veterans and Disabled Veterans of the Defensive-Liberation War, whose allocations are determined by legal provisions.

Institutions in the Federation of Bosnia and Herzegovina (FBiH) award grants based on a specific legal basis (laws, strategies, contracts, etc.), but they also allocate grants without a legal basis. In the budgets of some institutions, the grant recipients are predetermined by the budget, while in others, they are not known in advance, and the allocation is made based on requests from users or through public calls. Research shows that local government budgets often increase during election years, with a notable rise in grant expenditures as regional heads utilize their discretionary powers to enhance visibility and support for their initiatives (Widawati and Widagdo, 2020). This phenomenon, known as the "political budget cycle," underscores the strategic use of grants in local governance, where political considerations can significantly shape budgetary decisions. Moreover, grants are pivotal in enabling local governments to meet their fiscal responsibilities, particularly in decentralized systems where local entities have varying capacities to generate revenue. The "flypaper effect" suggests that grants tend to stick where they are allocated, meaning that the presence of grant funding can lead to increased local spending on public services rather than being used to offset local taxes (Kusuma, 2017). This effect highlights the importance of grants in enhancing public service delivery, particularly in regions with limited fiscal resources.

In February 2018, based on the Rulebook on the Implementation of Financial Management and Control in the Public Sector of FBiH, the Federal Ministry of Finance published the Guidelines on Minimum Standards for the Allocation of Budgetary Funds through Transfers and Subsidies in FBiH (Official Gazette of FBiH, no. 15/18). These guidelines were developed as a result of a project independently carried out by the Federal Ministry of Finance and the Central

Harmonization Unit, with the aim of increasing legality, transparency, and more rational spending of budgetary funds. The guidelines established minimum standards for the allocation of budget funds from the Federation Budget, which budget users allocate through grants and subsidies for the financing of legally established rights, programs, and/or projects of other levels of government, non-profit organizations, and individuals. The minimum standards cover general and specific conditions for financing and the procedures that budget fund providers should apply when awarding budgetary resources.

The reason for creating this document stems from a conclusion made by the House of Peoples of the Federation Parliament in 2016, highlighting the need for stronger oversight and control over grant and subsidy funds, following a report reviewed by the Parliamentary Commission responsible for auditing. The guidelines provide institutions with direction to improve allocation procedures. The purpose of this document is to contribute to more transparent planning and allocation, ensuring that funds are used for their intended purpose, and to prevent the misuse of budgetary resources allocated through grants and subsidies. In addition, efforts are made to strengthen internal controls, which directly contribute to the economical, effective, and efficient spending of public money. The absence of clear guidelines can result in "soft budget constraints," where local governments rely excessively on grants without developing sustainable financial practices (Goodspeed, 2017).

The structure of grants in all countries is constantly changing. Vidović (2015) explains the differences between horizontal and sectoral state aid: "Horizontal aid does not distort market competition compared to sectoral aid, which is given to specific sectors or individual entrepreneurs. Horizontal aid has a lesser impact on the market economy and pertains to support for research and development, innovation, environmental protection, energy savings, small and medium-sized enterprises, training, employment, culture, and similar areas." Unlike horizontal aid, sectoral aid is given to specific sectors or individual entrepreneurs. According to Vidović (2015): "The European Union aims to reduce sectoral aid compared to horizontal aid because the former has a negative impact on market competition and does not affect GDP growth." It is not known how the proportion of sectoral aid compares to horizontal aid in FBiH, how it contributes to achieving the objectives of its allocation, and particularly what impact it has on market competition.

State audits of grants and budgetary expenses play a crucial role in ensuring the proper use of public funds (Pham, 2020). External public audits are especially important in developing countries, where they can reveal opportunities for structural changes and effective management decisions (Karabayev et al. 2021). These audits can assess financial stability, identify problems, and propose solutions without increasing public debt (Karabayev et al. 2021). Audits help detect fraud, assess project effectiveness, and verify compliance with grant requirements (Morosan-Danila, 2023).

According to research by De La O et al. (2023), a field experiment was conducted in collaboration with Mexico's Superior Auditor of the Federation to investigate whether federal or state audits increase municipal compliance with allocation, reporting, and transparency rules of an intergovernmental grant aimed at improving local infrastructure. They assigned 85 municipalities to be audited by a federal auditor, a state auditor, or a control group. The results showed that audits did not increase compliance and examined the reasons behind this null effect. In Russia, there is a need to improve grant legislation by separating grants from budget subsidies and providing a dedicated chapter in the Budget Code (Zapolsky and Andreeva, 2019). Performance audits are emerging as a new form of state financial control, aimed at evaluating the implementation of state-funded programs and projects (Suvorova et al. 2019). Preliminary audits are particularly important for effective public fund management and can be categorized into audits of draft state budgets, actual transactions of public funds, and other state-owned property (Hrytsishen et al. 2020).

The integration of information technology in the budgeting process has been identified as a promising approach to enhance public participation and accountability in grant management. Digital platforms can facilitate citizen engagement in budgetary decisions, allowing for greater transparency and oversight of how grant funds are utilized (Mironova, 2019). By involving citizens in the budget process, governments can improve the quality of budget decisions and ensure that

expenditures align with community needs. Furthermore, the establishment of clear performance indicators linked to grant funding can enhance accountability and ensure that funds are directed towards achieving measurable outcomes. The analysis of grant performance, particularly in health financing, illustrates the importance of linking funding decisions to performance metrics to optimize resource allocation (Huy *et al.* 2015). This approach not only improves the effectiveness of grant expenditures but also fosters a culture of accountability within public sector entities.

Due to the lack of scientific research on grant auditing and the significance of state auditing in overseeing this process, this paper offers valuable insights into this issue using the example of Bosnia and Herzegovina. To demonstrate the limited number of published scientific papers on this topic, we provide a brief bibliometric analysis below using the *Dimensions* software. The bibliometric analysis employs quantitative methods to investigate the scientific activity within a specific field and is entirely dependent on available written publications that have been preserved and stored in a bibliographic database (Babajić *et al.* 2021).

The database used for the search contains 148,655,891 publications. We conducted a search for publications covering the period from 1900 to 2024. We searched for publications by their titles, abstracts, and keywords. Keywords included in the search were: "State audit" OR "Public audit" AND "Grant" OR "Transfers". The search resulted in 14 scientific papers. Out of that number, only 7 scientific papers are from the research category "Accounting, Audit and Accountability."

3. Research methodology and data sources

The population under investigation consisted of federal and cantonal ministries in the Federation of Bosnia and Herzegovina that were responsible for planning and distributing current grant funds as part of their routine duties. The study covered a ten-year period (2010-2020). The research employed the method of analyzing audit reports. During the specified period, all reports from state auditors on financial audits were reviewed. By analyzing these reports, a database was created encompassing all recommendations issued by state auditors to audit subjects over the ten-year period.

The Audit Office provides recommendations related to various aspects of grant management, including planning, distribution, supervision, reporting, and financial reporting. Consequently, the recommendations were categorized according to these aspects. All recommendations were grouped into several categories: a) recommendations related to grant planning, b) recommendations concerning the distribution of grants to end-users, c) recommendations regarding the supervision of the appropriate use of allocated grant funds, d) reporting on allocated grant funds, and e) recommendations aimed at truthful and fair financial reporting on allocated grant funds. Reporting on allocated grant funds pertains to the reporting by the audit subject to relevant authorities and the public.

Additionally, an analysis of the implementation of recommendations within the specified time frame was conducted. Recommendations that were only partially implemented were not included in the count of implemented recommendations, as it is the practice of the Audit Office to often repeat such recommendations in subsequent reports for the same audit subject.

It is important to highlight the limitations of the conducted research. Specifically, the number of recommendations issued by the Audit Office may vary depending on whether recommendations are given individually for each identified irregularity or consolidated into a single recommendation. For instance, one recommendation may address both grant planning and reporting on allocated funds. Some of the more recent recommendations arose because the audit subjects included grants with smaller monetary amounts (due to qualitative significance). Consequently, there has been an increase in both the number of identified irregularities and the number of recommendations made by auditors. Additionally, recommendations in some cases pertained to the same grant but were provided to improve the existing practices of the audit subjects.

Furthermore, audit subjects introduced various types of grants they administered. This expansion increased the scope of the audit, as well as the number of findings and recommendations. Moreover, the Audit Office did not assess the implementation of certain

recommendations because, in the following year, audits did not cover activities that would allow for the evaluation of those recommendations. Audits of cantons were not conducted every year between 2010 and 2020, and the study focused on all reports produced during this period.

4. Results and discussion

Over the ten-year period, the continuous auditing of grants as part of financial audits and the monitoring of recommendations led to a 75% reduction in the number of recommendations (Figure 1). In 2010, the number of recommendations issued by state auditors regarding grant management was 224, while in 2020, it decreased to 56. Given that state auditors repeat recommendations in their findings until they are implemented, it is evident that the continuous auditing of grants has significantly reduced irregularities.

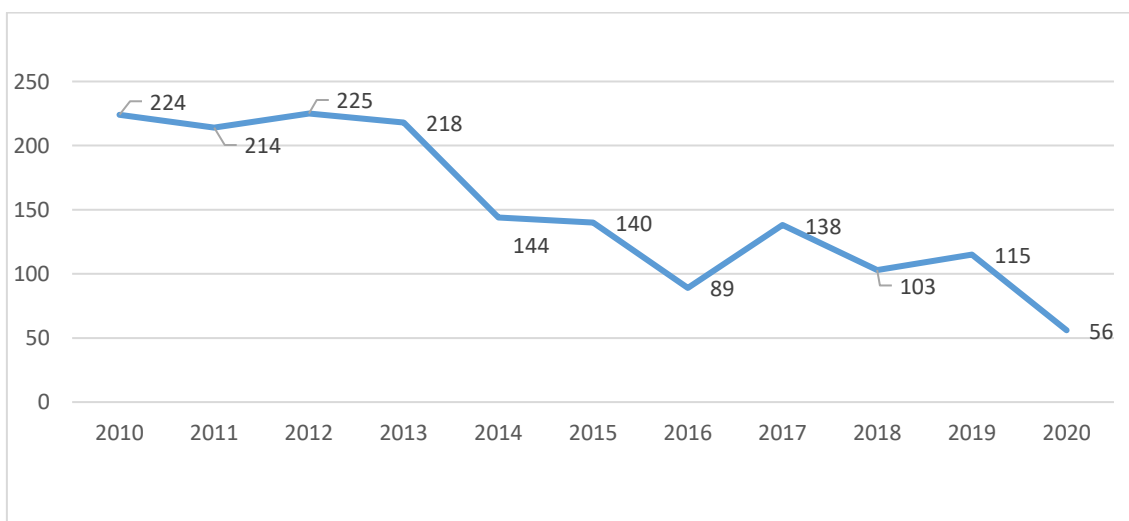


Figure 1. Total number of recommendations given by state auditors related to grants
Source: Results of the Author's Own Research

The total number of recommendations made by state auditors over the 10-year period was 1,666, broken down as follows: 245 recommendations related to grant planning, 684 recommendations concerning the allocation of grant funds, 554 recommendations pertaining to the supervision of the designated use of allocated funds, 74 recommendations on reporting on grant implementation, and 109 recommendations regarding the accuracy of accounting for grants.

The most frequent criticisms from auditors during financial audits of Federal ministries were that current grants were planned, approved, and executed in a non-transparent manner and without clear criteria. Evaluations and rankings of grant allocation requests and the determination of fund amounts were not in accordance with the Law on the Execution of the Budget for the given year, and prescribed oversight of the designated use of transferred funds was not conducted. In some institutions, funds for grants were planned in the FBiH Budget even though there was no legal basis for this. Common criticisms from auditors during financial audits at the cantonal level included the distribution of current grant funds being carried out without clearly established criteria, the absence of contracts with fund recipients, and the lack of expenditure reports and adequate supervision over the spending of these funds. Additionally, data on grant recipients and the amounts awarded were not published in accordance with the principle of transparency. Given that these are public funds, for which one of the fundamental spending principles is complete transparency, we cannot agree with or accept that data on recipients of these funds is not publicly available for the protection of their personal data, especially considering the nature, purpose, and sensitivity of this matter and category of recipients.

In the following representation (Figure 2), the total number of recommendations by year is presented, categorized by the basis for issuing the recommendations.

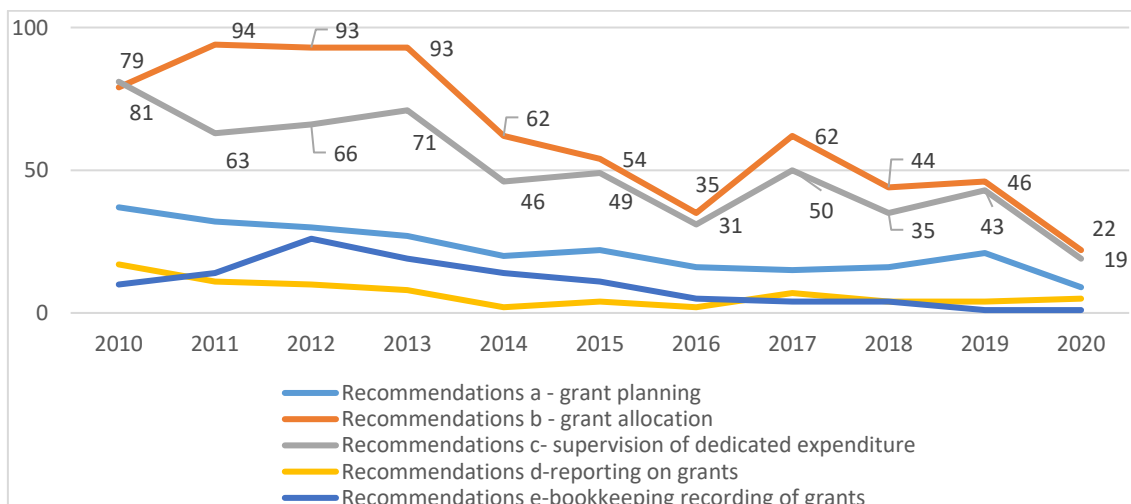


Figure 2. Total number of recommendations by type
 Source: Results of the Author's Own Research

From the figure representation, it is evident that the highest number of recommendations during the observed period was related to the distribution of grants (e.g., distribution was not carried out according to measurable criteria, lacked transparency, etc.). The number of recommendations regarding grant distribution decreased by 93.8% over the observed period. The fewest recommendations were given for bookkeeping and reporting on the implementation of grant funds. Compliance with these recommendations over the 10-year period was 90% or more. The next graphic (Figure 3) will show the total number of implemented recommendations related to grants.

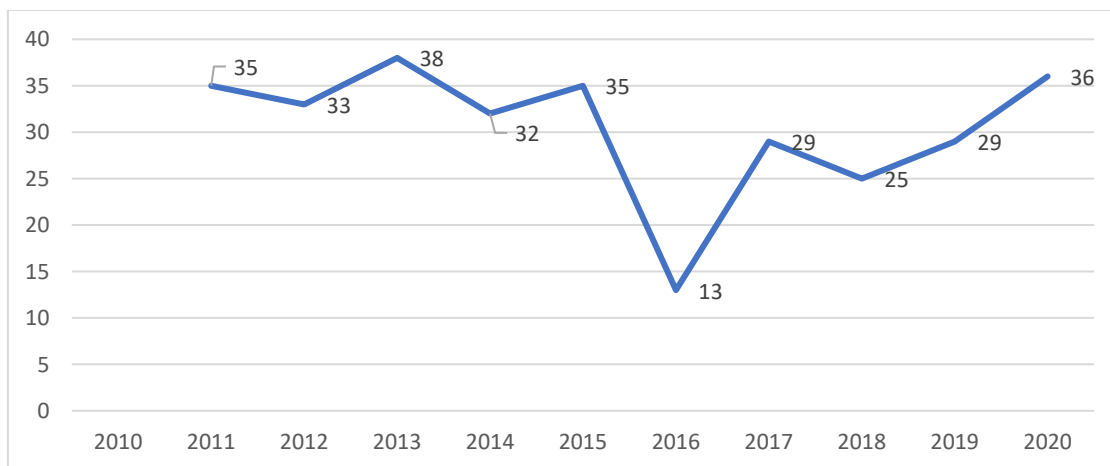


Figure 3. Total number of implemented recommendations related to grants by audited entities

Source: Results of the Author's Own Research

Annual implementation of recommendations has varied from 25 to 38 recommendations related to grant management. An exception is the year 2016, where the number of adopted recommendations was significantly lower compared to other years. This was likely due to the fact that no audits of cantons in the Federation of Bosnia and Herzegovina were conducted for the year 2016, resulting in no recommendations related to grants for that year. The number of adopted recommendations in that year was only 13. The following chart (Figure 4) provides an overview of the number of implemented recommendations by type.

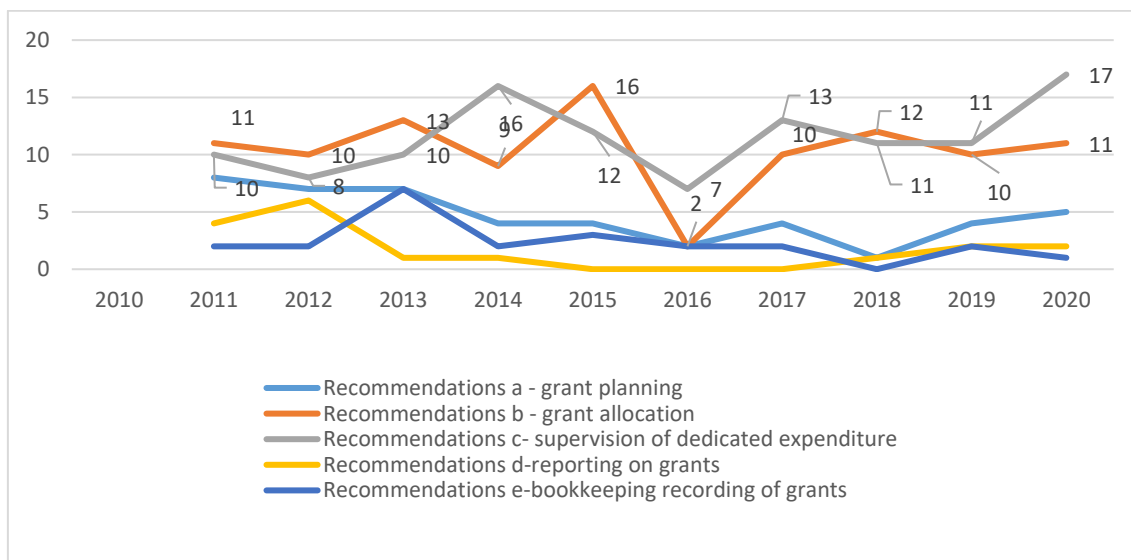


Figure 4. Total number of implemented recommendations by type
 Source: Results of the Author's Own Research

The highest number of implemented recommendations during the observed period pertains to recommendations related to the distribution of funds and oversight of the intended use of funds. During the observed period, 104 recommendations related to the distribution of funds and 115 recommendations related to oversight of the intended use of funds were implemented. This indicates that audit subjects established clear criteria for fund allocation, developed a clear method for scoring and ranking, and created a link between the achieved score and the amount of funds based on the scoring achieved.

Audit subjects ensured that grant funds were allocated more fairly and according to actual needs. Additionally, better oversight of the intended use of funds was secured through contracts outlining mutual rights and obligations with legal entities and institutions receiving the funds, binding them to submit reports on the intended use of the funds. Some institutions included contractual obligations for the return of funds if they were not used as intended and/or restrictions on applying for future public calls for funds in the case of failure to submit reports or misuse of funds. Furthermore, some institutions introduced physical field visits and oversight of the intended use of funds into their practice.

The following graph (Figure 5) provides an overview of the percentage of implemented recommendations relative to the number of recommendations given per year.

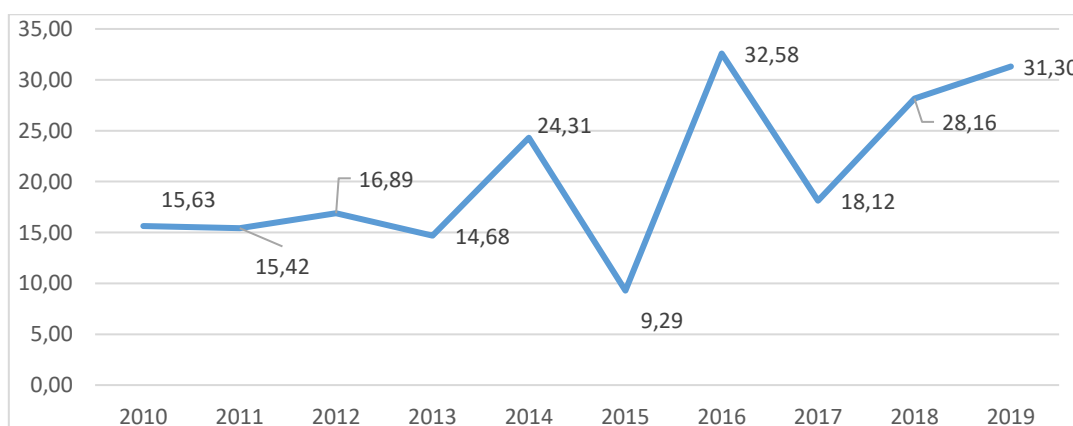


Figure 5. Percentage of implemented recommendations relative to the number of recommendations given per year – grants total
 Source: Results of the Author's Own Research

By examining the percentage of implemented recommendations relative to the number of recommendations given per year, it is evident that the percentage of recommendations acted upon has significantly increased in recent years. Specifically, in the first three years of the observed period, the percentage of recommendations implemented was up to 17%. From 2016 onwards, the percentage of implemented recommendations increased to over 18%, with the last two years of the observed period showing rates of 28% and 30%, respectively.

It is important to note that grant audits are not the only means of identifying irregularities in grant management. Public sector institutions should also have appropriate internal audit controls to ensure that grants are managed properly and that all related transactions are well-documented.

5. Conclusion

The value of grants in institutional budgets, especially at higher levels of government, represents a significant percentage of total expenditure. Therefore, the planning, allocation, and reporting of grant expenditure must be strictly regulated by law. In addition to stringent and detailed legislative requirements, there must also be an adequate control mechanism for the expenditure of public funds through grant distribution. This mechanism is provided by state auditing institutions. Common issues identified by auditors during grant audits of Federal and Cantonal ministries included non-transparent planning, allocation, and inadequate oversight of fund usage. Often, the criteria for fund distribution were not measurable, nor were the outcomes of the expenditure.

Based on the conducted research, it is concluded that continuous auditing of grants in the public sector significantly contributes to more efficient grant management and a higher level of compliance with legal and regulatory requirements, as well as the strategic goals intended to be achieved through the allocation of these funds. Over the ten-year period, the number of recommendations related to various aspects of grant management was reduced by 75%, indicating an improvement in management and oversight practices regarding the allocation and expenditure of grants in the Federation of Bosnia and Herzegovina (FBiH). It is particularly noted that stricter guidelines and clearer rules have a strong impact on reducing the number of identified irregularities. These results not only fill a gap in the literature on the significance of grant audits but also provide insights into the most common causes of irregularities and the importance of stricter legal regulations in grant management.

The audit of grants in the public sector is essential for promoting accountability, transparency, and effective resource allocation. By implementing best practices and addressing existing challenges, governments can enhance the effectiveness of their audit processes, ultimately leading to improved public financial management and better outcomes for citizens. Future research could focus on a comparative analysis of grant management practices across different countries, assessing the long-term impact of audit recommendations on transparency and resource utilization. The role of technology, such as data analytics and blockchain, in enhancing grant oversight warrants exploration, as does the impact of public perception on trust in government institutions. Studies should measure the effectiveness of various control mechanisms and examine the relationship between grant allocation criteria and performance outcomes. Additionally, the influence of legal frameworks on grant management practices, case studies of successful grant management implementations, and insights into how measurable and outcome-oriented criteria affect the use of public funds would further contribute to understanding and improving grant management and auditing processes on an international level.

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