

PEMPAL Internal Audit Community of Practice (IACOP)



NEW NATIONAL STANDARDS AND HANDBOOK FOR INTERNAL CONTROL IN HUNGARY, drafted by Edit Nemeth, chair of IACOP, head of CHU for PIFC

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Mr. Mihály Varga, Minister for National Economy

The Ministry for National Economy in recent years has published several guides/handbooks in topics of internal control. Due to legislative changes it became necessary in actuality, as well as a road map settlement of four documents updated and expanded content. Preparation of „Public Internal Control Standards & Practice Advisory” had dual

purpose, on one hand to systematize obligations, expectations regarding the internal control system; on the other hand practical assistance to the various control elements of design.



What is the content of this handbook?

In the first part of the guide can be found principles for the internal control system, followed by practical guidelines and methodological notes. The guide, determining their compliance with internationally accepted standards, takes into account the national government's internal control standards¹, adapted to the domestic administrative environment. The application of the standards outline for head of the public budgetary organization and experts which basic principles should be taken into account in order to shape their organization's internal control system. This handbook is not a mandatory internal regulation to be drawn up, but a user guide, which will help the internal control system "assembly". In general the head of the public budgetary organisation is responsible for implementation, maintenance and operation of an effective internal control system. The details of practical implementation from one organisation can change, therefore it needs to be considered the internal control system design of legislation for that body (eg. there are legal requirements which the scope defined by the central budget covers), scope of activities, the size, the management,

¹ The Hungarian public internal control system is in line with international practice and based on the INTOSAI (International Organization of Supreme Audit Institutions), the COSO (Committee of Sponsoring Organizations of the Treadway Commission) and the COBIT (The Control Objectives for Information and related Technology) recommendations.

budget size, the volume of the body. However, if an organization does not fall under a specific statutory requirement to itself even be considered as a regulation and apply it (eg. in case of local governments to employ an integrity advisor considered as a good practice in any organisation).

Useful help can be those parts of the guide, which can be found in tabular form, within an organization who is responsible for what in the design of the control environment, risk management systems and control activities in the development and functioning (eg. in case of risk management what is the responsibility of head of organisation, process owners, employees, risk management committee, internal control coordinator / integrity advisor, internal auditor).

COSO was elaborated for private sector, that's why we thought that if we would like to promote and help the implementation COSO than we should give a guideline which is understandable in Hungarian public administration context. In Hungary all public budgetary organisations should implement internal control system according to the COSO based national legislation. The practice advisory is needed very much because there is a lack of literature of internal control especially in public sector. Despite of previous guidance the organisations still have difficulties how to implement an effective internal control system. CHU tried to find out the obstacles and we found out the main troubles which are:

- lack of process based thinking;
- lack of knowledge and practical experience in implementing internal control system;
- lack of integrated risk management;
- lack of a coordinator inside the organisations who "makes things happen".

First we modified the legislation according to the above mentioned facts which came into force in October, 2016. After that we decided to make a comprehensive handbook which will give practical help to its users.

What are the challenges to publish such a guide?

The main challenge was to elaborate a handbook for all type of organisations eg. Ministries, central agencies, local government which vary in size, budget and activities. That's why we give special instructions for organisations with less than 100 employees, because in small organisation internal control system is not applicable eg. segregation of duties is very difficult, or some cases a very strict and deep control system is not cost effective. In general we are convinced that the type of organisation is not really a matter, the basic elements should be implemented in every organisation, of course they should adapt the system to their specifics. In our experience the maturity level of organisation matters more, so we suggest in the handbook that organisations should make an action plan for implementation and further development of internal control system. It is also a good practice if the internal audit unit makes a gap assessment and then time-to-time they audits the internal control system and give

2.2. Feladatmegosztás a szervezetben belül – ki, miért felelős a kontrollkezelési rendszer kialakításában és működtetésében

Intézkedés megnevezése	Közfeladat elvégzéséért felelős	Felügyelő	Munkatársak	Kezeltbizottság / Bizottság / Felügyelőbizottság	Az intézkedés megvalósításáért felelős	Belső ellenőrzés
Kezeltbizottság felállításának és működésének biztosítása	Közfeladat elvégzéséért felelős	Felügyelő	Munkatársak	Kezeltbizottság / Bizottság / Felügyelőbizottság	Az intézkedés megvalósításáért felelős	Belső ellenőrzés
Belső ellenőrzés felállításának és működésének biztosítása	Közfeladat elvégzéséért felelős	Felügyelő	Munkatársak	Kezeltbizottság / Bizottság / Felügyelőbizottság	Az intézkedés megvalósításáért felelős	Belső ellenőrzés
Belső ellenőrzés felállításának és működésének biztosítása	Közfeladat elvégzéséért felelős	Felügyelő	Munkatársak	Kezeltbizottság / Bizottság / Felügyelőbizottság	Az intézkedés megvalósításáért felelős	Belső ellenőrzés
Belső ellenőrzés felállításának és működésének biztosítása	Közfeladat elvégzéséért felelős	Felügyelő	Munkatársak	Kezeltbizottság / Bizottság / Felügyelőbizottság	Az intézkedés megvalósításáért felelős	Belső ellenőrzés

It help to them to delegate the different tasks and elaborate a functioning risk management system. The handbook also give detailed methodological support with explanation of definitions and practical examples how a certain element can be implemented and how the different elements of internal control system are related and lean on each other.

Why we needed national standards?

National internal control standards are not new for Hungary, the first version was published in 2009, and the first guideline for internal control in 2010. The main purpose of the standards was to define and "translate" the COSO elements into the Hungarian public administration. We all know very well the differences between private and public sector and also



feedback on progress. It is also a big challenge to provide support for users who has different level of knowledge and experience. If we gave very general guides we risk that less advanced users will be not helped or if we gave very detailed explanation the advanced users may feel it is more like a learning material. We tried to find the golden mean and explain everything in the guide which is absolutely necessary, and what we experienced as a weak point in previous experience.



Shared internal audit function within local administration in Romania, from Mioara Diaconescu, head of CHU for IA

Romanian legal framework stipulates that every public entity must establish an internal audit function by a dedicated structure with minimum 2 employees. For most of central administration entities, this request is not an issue. Things are different in local administration where the resources (material, financial and human) are quite insufficient.

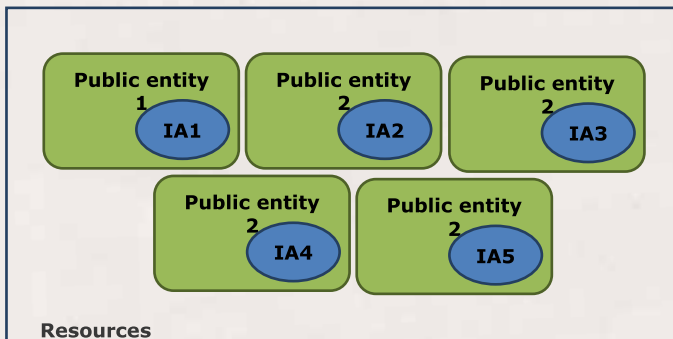


Figure 1. Individual audit structure

To support the managers form these entities, the existing legal framework allows the cooperation among several local entities. One of them may be defined as organizer, or this role can be played by an associative structure of these entities. The cooperation is about sharing an internal audit function, together with the necessary resources.

The base requirement is that the shared internal audit function should be less expensive than individual internal audit function.

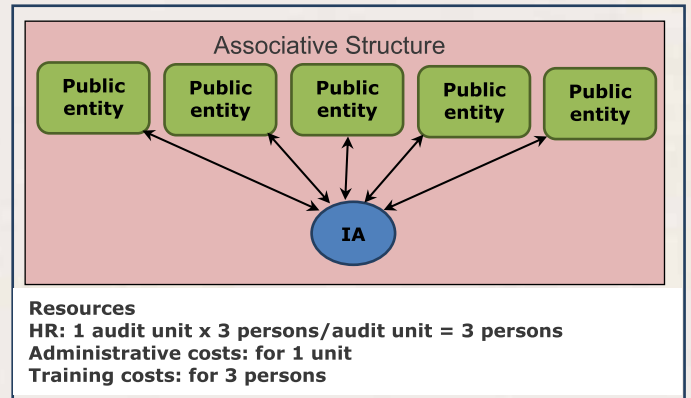


Figure 2. Shared audit structure

Functional particularities of the shared internal audit units

The shared internal audit system (cooperation system) has a several particularities given by the local administration and by the local framework, as follows:

- Each entity should have an annual and strategic audit plan. Then, all this plans are cumulated in a centralized annual and strategic audit plan;
- The internal auditors are administratively reporting to the management of the associative structure. In terms of internal audit activity, they report to the managers of cooperation members;
- Internal audit reports are communicated and endorsed only by the management of the audited entity;
- It should be unanimous decision as regards the organization of the audit activity: centralized plans approval, financial resources approval, increasing/decreasing human resources, extending the cooperation agreement, etc.
- An annual audit report is issued for each member. Then, a consolidated audit report is drafted;
- There are specific demands in terms of confidentiality.

Strong points got under implementation of shared internal audit fictions are:

- Small public entities have access to internal audit function;
- Important economy for financial resources.



Weak points we face:

- There are difficulties as regards decision making due to the lack of implication of the managers of the member entities;
- Lack of qualified human resources (auditors);
- Restrictive legal framework in terms of financial resources.

For further development legal framework needs to be improved in order to ease the decision making and financing process. Active implication of CHUIPA in professional training of the internal auditors also needs to be ensured.



News Concerning the Developments in Internal Control System in the Republic of Croatia

In July 2015, the new Act on Public Internal Control System was adopted and published in the Official Gazette No. 78/15. The text below outlines the news regarding the application of the provisions stipulated in this Act, and the rulebooks based thereon, regarding the state and local/regional owned companies (hereinafter referred as: "Companies")

The Act on Public Internal Control System (hereinafter referred to as: "the Act") regulates public internal control in the Republic of Croatia, as well as the responsibilities, relations and competences within the development of system of internal controls. Until the adoption of this Act, the Public Internal Financial Control Act adopted in 2006 was in force, but only budget users (from state and local/regional level) were required to apply its provisions. Application of the new Act is mandatory for the Companies entered in the Register of Companies and Other Legal entities

required to provide the Fiscal Responsibility Statement published by the Ministry of Finance.

It should be noted that even prior to this Act system of internal control was established in Companies; however, now they are legally obliged to establish and to use a systematic approach regarding the application and development of the internal control system. There are currently 63 state-owned enterprises and 665 companies owned by local/regional units in the Republic of Croatia that must adhere to the provisions of the Act.

1. Novelties arising from the Public Internal Control Act

Regarding the wider scope of application of the provisions to include Companies, the Act introduces the following novelties:

- It stipulates the responsibility of the person in charge of the institution ((CEO, director, board) for the development of the internal control system and the head of organisational units of the institution for the development of the internal control system within their scope of competence.
- It regulates the responsibilities of the person in charge of the institution regarding the implementation and ensuring the conditions for performing the task of internal audit
- Companies shall submit the information on their internal audit unit to the Ministry of Finance for the purpose of managing the internal audit unit register.
- Only a certified person shall perform the internal audit (the company internal auditor must be professionally authorised by the Minister of Finance in order to perform public internal audits, or he/she must possess a certificate of a certified internal auditor issued by a professional organisation).
- If applicable, the functional responsibility of internal audits in companies towards the audit committee shall be acknowledged.
- The responsible persons in Companies, as well as other budget users, must submit reports to their founders regarding the functioning of system of internal controls in accordance with the legislation which regulates the Fiscal Responsibility Statement.

²The Public Internal Control Act is available on the web-site of the Ministry of Finance:
<http://www.mfin.hr/adminmax/docs/Zakon%20o%20sustavu%20unutarnjih%20kontrola%20u%20javnom%20sektoru.pdf>



When it comes to Companies, it should be noted that, in accordance with the provisions of the Act, the entire internal control system shall be supervised by the Public internal control council, the advisory body of the Minister of Finance, whose members now for the first time include Company representatives too. The aforementioned Council shall submit reports on their conclusions to the Government of the Republic of Croatia.

Based on the Act, the following rulebooks, which elaborate the provisions of the Act in more detail, have been adopted:

- Rulebook on Public Internal Control (Official Gazette No. 58/16, and
- Rulebook on Public Internal Audit (Official Gazette No. 42/16).³

2. *Novelties in the Rulebook on Public Internal Control*

Whereas the Act defines the components of the internal control system which are based on the International Internal Control Framework (COSO Framework), the Rulebook on Public Internal Control also defines the Framework for the development of the internal control system which includes the elaboration of the five interrelated components of internal control (the control environment, risk management, control activities, information and communication, monitoring and assessment). Furthermore, methods, principles and procedures for each component shall be developed and they shall represent the key requirements of internal control, which should be implemented by public institutions in their business operations and which should help them apply and develop the internal control system. Pursuant to the Rulebook, the responsible persons of Companies shall also apply the principles, methods and procedures, given in the Framework for the development of the internal control system, in practice.

Regarding the further development of the internal control system and the work methodology, it is necessary to update the Manual for the Financial Management and Control from 2012. Temporarily only budget users are required to apply its provisions. Since the Republic of Croatia has implemented the twinning

project funded by the European Union called “Further development of internal control system and work methodology”, for the period February 2017 - February 2018), which is aimed at developing the internal control system through the improvement of work methodology to serve the needs of budget users and Companies, apart from updating the existing Manual, which will then be named the Manual for the Internal Control System for Budget Users, another special Manual for the Internal Control System for Companies will be developed, which will take into account their specificities.

3. *Novelties in the Rulebook on Public Internal Audit*

Regarding internal audit, the Rulebook on Public Internal Audit regulates, among others, the criteria for the establishment of internal audit in the public sector, i.e. the criteria for the establishment of internal audit in Companies. Companies with over 50 employees and an annual revenue of over HRK 400,000,000,00 (EUR 53,333,333,00) shall form an independent unit for internal audit. Currently, 14 Companies are legally required to form an independent audit unit. Other Companies may decide to introduce internal audit either by forming a unit for internal audit or by appointing an internal auditor.

Most of the Companies which are required by the Rulebook to establish their own internal audit unit are strategically significant institutions. Although most of the institutions have already established internal audit units, mostly pursuant to the Anti-Corruption Programme for the companies predominately state-owned from 2010. (one of the measures of the Programme was also to establish the prerequisites for preventing corruption on all levels, for which, among others, the establishment/strengthening of internal audit was planned), the adoption of the new Act has made it possible **for the first time to have legal grounds for the establishment of internal audit.**

Another novelty in the Rulebook on Public Internal Audit is that the established internal audit unit in the Company is required to cooperate with the internal audit unit in the competent ministry, county or city when it comes to the development of internal audit plans and conducting joint audits, and in case when the Company is not required to establish an internal audit unit, the internal audit unit of the competent ministry, county or city shall audit that Company.

³Rulebook on Public Internal Control and Rulebook on Public Internal Audit are published on the web-site of the Ministry of Finance:

<http://www.mfin.hr/adminmax/docs/Pravilnik%20o%20sustavu%20unutarnjih%20kontrola%20u%20javnom%20sektoru.pdf> <http://www.mfin.hr/adminmax/docs/Pravilnik%20o%20unutarnjoj%20reviziji%20u%20javnom%20sektoru.pdf>



Conclusion

It is clear from the aforementioned that the obligation of establishing and developing the internal control system (and internal control as a part thereof) has been introduced for the Companies for the first time, by the Act on Public Internal Control System.

Companies are financed by the state budget or the budgets of local (regional) self-government units, and their aim is to achieve the objectives of the competent ministry, i.e. local (regional) self-government unit, therefore, in order to have quality public services and to serve public interest, it is necessary to have an internal control system which should enable the legal, purposeful, cost-effective and efficient use of public resources. On the other hand, Companies are also the potential spending units of the European Union funds, the use of which also requires the establishment of an efficient internal control system.



„News from Bosnia and Herzegovina - Member States on the Development of Internal Control”, Njegosh Pavlovoci, counselor of the PIFC CHU director, MoF

The Strategy for the Development of Public Internal Financial Control in the Institutions of Bosnia and Herzegovina for 2016-2018 (hereinafter: the Strategy) was adopted in December 2016. This is the second strategical document for this area in the institutions of Bosnia and Herzegovina. Strategies for the entity level had been adopted prior to this one. The Strategy comprises the analysis of the current state of PIFC, including the analysis of the legislative and institutional framework which focuses on the practical implementation of these systems, especially in the budget cycle processes. Taking into account the current status, the perceived weaknesses and difficulties, and the recommendations of the European Commission,

the Strategy defines the goals and activities for further development which will align PIFC with EU standards and practices.

The Strategy is also a demonstration of the strong commitment of Bosnia and Herzegovina institutions to ensure that the further development of PIFC results in its stronger integration into the management processes for B&H institutions. The aforementioned integration should result in the visible contributions of these systems to ensuring management responsibility in institutions, achieving more legality and regularity in budget expenses and realising the objectives for the allocated budget funds.

The Strategy implementation should improve the quality of PFM by aligning it with EU standards and practices, ensure greater transparency and responsibility, and reduce the number of negative external audit reports. The realisation of the Strategy objectives and measures contributes directly to the meeting of requirements in the process of further EU integration of B&H. A quality IC system is also the crucial factor for ensuring the right to access and use the EU Instrument for Pre-Accession Assistance (IPA). As we already know, the CHU of the Ministry of Finance and Treasury of Bosnia and Herzegovina was established to introduce and develop PIFC in B&H institutions which was based on the recommendations of the European Commission and the best practices in EU member states.

The establishment and development of the PIFC system entails two areas:

- the establishment and development of financial management and control, and
- the establishment and development of a functionally independent internal audit.

The achieved results are more visible in internal audit than in financial management and control, since the development of PIFC started with the development of internal audit.

The activities of the CHU of the Ministry of Finance and Treasury of B&H have resulted in the development of the legislative and institutional framework as a prerequisite for the development of PIFC, including the implementation of analyses and pilot trainings for target user groups by using consultant support and realising projects financed by the EU. Apart from the achieved results, the problems and difficulties encountered in practical implementation, which have been identified and presented in the annual consolidated reports from internal audit and financial



management and control in B&H institutions, show that the integration of PIFC into management processes implies further efforts on behalf of the CHU of the MoF and Treasury of B&H and management in all B&H institutions.

In addition to the Strategy, a legislative framework has been created for all government levels and areas of FMC. Thus legislation has been adopted and published on all government levels in B&H which regulates the FMC area in the public sector. The legal basis for FMC has existed on the institutional level in B&H since 2012 when this area was legally regulated, while at the level of the entities: the Law on FMC in the Public Sector of B&H was adopted in May 2016 in the Federation of B&H, and in Republika Srpska, the Law on Public Financial Control in RS was adopted in November 2016. The internal audit area had previously been regulated on all government levels in B&H.

The characteristics of all listed legal solutions are:

- based on PIFC
- FMC is implemented through five

interconnected internal control components based on the COSO model which include: the control environment, risk management, control activities, information and communication, monitoring and assessment;

- FMC represents the comprehensive system of policies, procedures and activities established and managed by the responsible head of the institution;
- the FMC system is based on risk management and it provides reasonable insurance that all institution goals will be met in a regular, cost-effective, efficient and effective way.

Law on FMC	Government level	B&H	FB&H	RS
FMC DEFINITION		+	+	+
COSO FRAMEWORK		+	+	+
RESPONSIBILITY OF THE HEAD MAN		+	+	+
STATEMENT OF RESPONSIBILITY		+	-	-
FMC REPORTING		+	+	+

Overview of the currently adopted FMC regulations:

Government level	B&H	FB&H	RS
LAW	+	+	+
MANUAL	+	+	-
STANDARDS	+	+	+
RISK MANAGEMENT	+	+	-

Our FMC standards are based on the COSO framework and developed from it. The standards have been approved (their essence and their content) by the EU. At the institution level in B&H, the CHU is in charge of

system coordination, and individuals responsible for coordination are appointed at every institution by the institution head. The institution level in B&H does not encompass local communities.

Higher government levels implement and apply this concept more. There are, of course, problems in implementation and understanding at all government levels, especially at the local level. At the institution level in Bosnia and Herzegovina, which I represent, the implementation of this concept is at a good level, which entails the acceptance and application of the concept through the adoption of regulations and reporting. The CHU of the Ministry of Finance and Treasury of B&H draws up the Annual Consolidated Reports on internal audit and FMC and it publishes them, after they have passed the planned adoption and approval procedures in the Ministry of Finance and Treasury of B&H and the Council of Ministers of B&H. These reports, containing detailed information for every institution, are available here:

<http://mft.gov.ba/srb/index.php/2012-07-03-21-44-45/izvjestaji>

At the institution level in B&H there is one satisfactory step in implementing regulations concerning IA and FMC which has been supported not just by the CHU but also by other stakeholders (management of the institutions, internal audit and external audit).

The FMC methodology for the institution level in B&H has been published by the CHU of the Ministry of Finance and Treasury of B&H. The FMC methodology (FMC standards, FMC Manual, Risk Management Guidelines, Ordinance on Reporting...) has been prepared by experts employed by the EU - the European Commission, within the framework for Strengthening the Public Financial Management System realised by B&H (the project ended in 2015). All these regulations, as well as the regulations on internal audit, are available here:

<http://mft.gov.ba/srb/index.php/2012-07-03-21-44-45/2012-07-03-21-46-54>

It should be recalled that since the last PEMPAL event held in Moscow, several FMC training sessions organised by the CHU for various target groups have been conducted in B&H. Training sessions for internal auditors have also been carried out within the scope of CPD and certification.



MACEDONIAN PUBLIC SECTOR IMPROVE SKILLS RISK MANAGEMENT, AND INTERNAL AUDITORS IMPROVE THEIR SKILLS AND CAPABILITIES

Trajko Spasovski, Head of the Public Internal Financial Control in the Ministry of Finance of Republic of Macedonia shares that the public sector establish effective and proportionate measures to mitigate operational risks and begins applying the methodology for managing risks of fraud and corruption. The implementation of project Training of Internal Auditors in the Public Sector (TIAPS) helped to improve the skills and abilities of Macedonian Internal Auditors.

Ministry of Finance in 2014 published Guidelines for the preparation of risk management strategy and Guidelines for the risk management process. In 2015 published Guidelines for risk management which provide practical and theoretical advice and recommendations on how to implement the principles and key elements of the methodology for risk management.

So far 68% of the direct budget users and 40% of the of local self-government units adopted risk management strategies, and 54% of the direct budget users and 32% of the of local self-government units developed risk registers and action plans for risk mitigation.

This process would not have been so successful if simultaneously is not implemented process of decentralized management of budget funds, that which successfully began to be implemented in 73% of direct budget users and 68% of local self-government units. Given that preventing corruption in other countries in the region and in our country, is a major challenge, the Ministry of Finance prepared "Guidelines for risk management of fraud and corruption" that on 9 and 10 March, 2017 were presented at the workshop organized by the State Commission Against Corruption and the TAIEX instrument of the European Commission.

The main objective of this document is to provide guidance how public sector entities to show that attempts at fraud will not be tolerated. This document provided basic methodological guidelines and support tools for self assessment on impact and likelihood of fraud and corruption on the basis of specific risks that are determined based of knowledge from previously detected cases of fraud and based on generally accepted and repetitive patterns fraud.

The Ministry of Finance of the Republic of Macedonia has adopted a legal framework and established an institutional framework for the development of an effective internal audit system. In order to strengthen the administrative capacities of public sector internal audit, the Ministry together with the donors, USAID and Ministry of Foreign Affairs of Republic of Slovenia, in cooperation with the CEF and CIPFA, implemented the Training of Internal Auditors in the Public Sector (TIAPS) from 2012 to 2016.

The project consisted of three training and examination cycles involving 133 participants, out of whom 83 passed the exam successfully and received the international certificate for public sector internal auditor. With this, 41% of the total 208 internal auditors in the public sector have gained international certificikat for certified internal auditor.



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