

COMPENDIUM

**of the public internal control systems
in the EU Member States**

2012

EUROPEAN COMMISSION



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in the EU Member States
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Contributions from the 27 EU Member States

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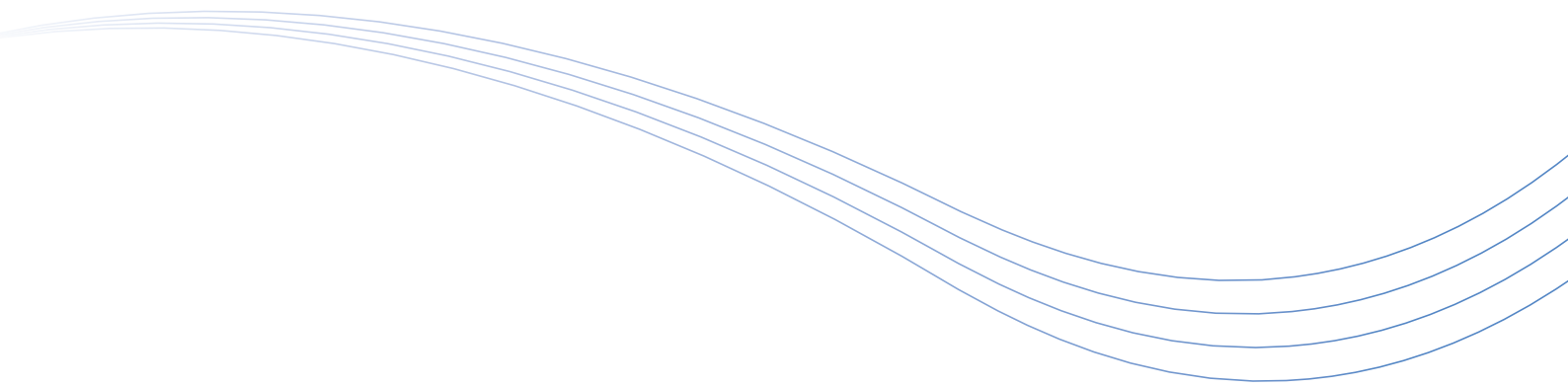
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Foreword

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We are living in times of substantial pressure on public finances at all levels in Europe. More than ever, public authorities are expected to ensure that common resources are spent efficiently and target the essentials. In a period when the management and control of public finances are at the centre of national and international attention and scrutiny, it is important that Member States discuss and share experiences on how adequate control and audit systems could contribute to good governance and transparency.

Janusz Lewandowski
Commissioner
for Financial Programming
and Budget

It is therefore my great pleasure to introduce this Compendium of the public internal control systems currently applied in EU Member States, which has been prepared by the European Commission's Directorate-General for the Budget. It is the first comprehensive and comparative overview of public internal control in the Member States, incorporating 27 national contributions.

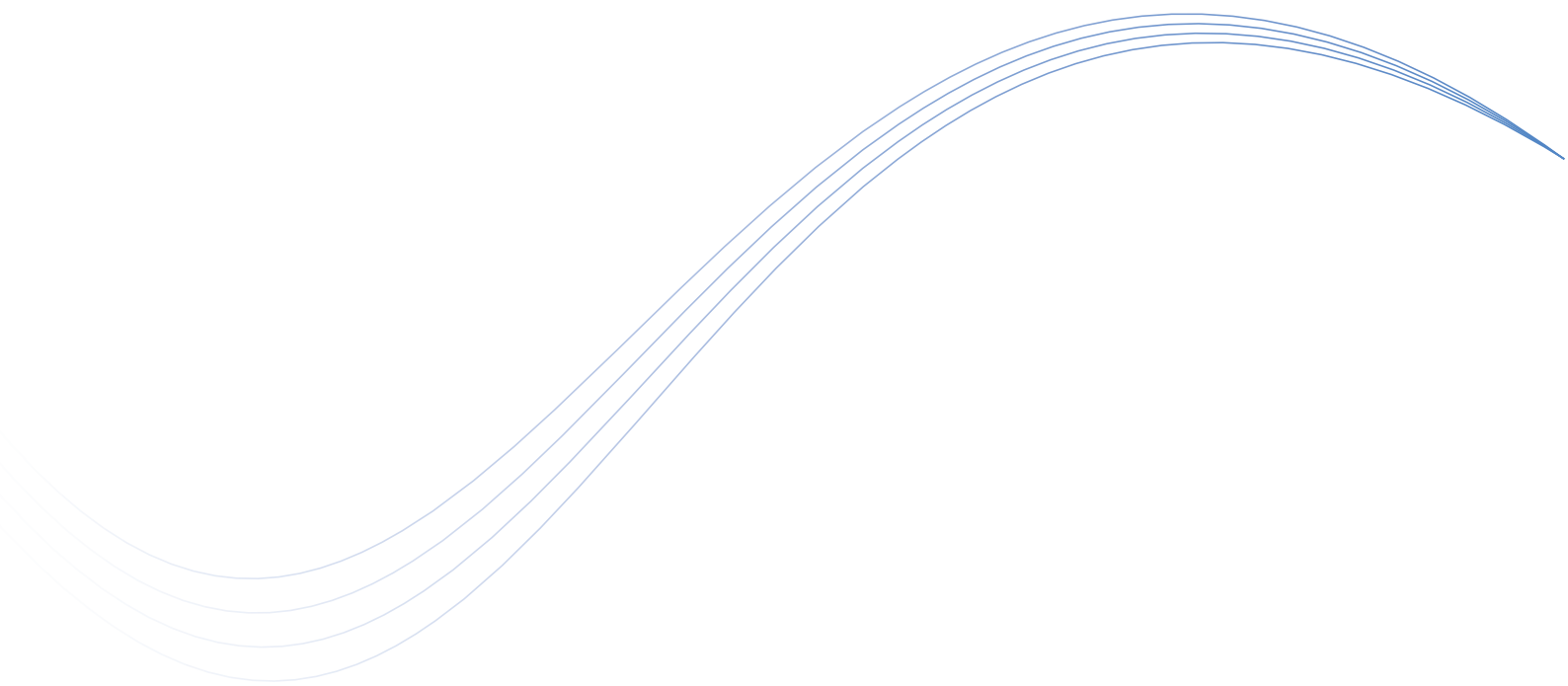
The Compendium builds upon discussions held at the Conference on Public Internal Financial Control organised by the Commission in September 2009, at which the Commission was invited to prepare an EU-wide snapshot of good practice to implement sound financial management as an integral part of good governance relating to the management and control of the national budgetary funds — income and expenditure alike. The data has been analysed by SIGMA, a joint initiative of the European Commission and OECD, principally financed by the EU; its results are also presented in this volume.

The individual contributions made by Member States not only focus on their past and present public internal control systems but also feature elements concerning the future directions their systems are likely to take. It is not surprising that the two main elements of internal control, managerial accountability and independent internal audit, feature highly on the list of issues to be improved or further developed.

It is my hope that the collection of practice and knowledge contained in this book will be used for further 'peer-to-peer' deliberations amongst Member States' experts and will help to identify the best solutions to common challenges. The Commission's Conference on Public Internal Control in February 2012 should provide a very good start to such consultations. They could eventually lead to the creation of a more structured platform by and for Member States in order to discuss and share experience in the quest for improved governance. Member States can count on the active support of the Commission to coordinate and facilitate such efforts.

In closing, I should, above all, like to express my appreciation to all those involved in the delivery of this Compendium. I also want to express my hope that it will become a catalyst for improving the overall quality of public internal control systems as well as public services in Europe — after all, the EU taxpayer is entitled to it.

Janusz Lewandowski



Introduction

This Compendium provides a structured overview of the various public internal control (PIC) ⁽¹⁾ systems currently being applied by the public sector in each of the 27 EU Member States. These are systems primarily used to manage their national funds, both revenues and expenditure ⁽²⁾, rather than European funds. It is the first time that a comprehensive overview has been produced. It is based on national contributions (mainly from ministries of finance or treasuries). These contributions are not confined to the present situation only; most Member States also provide valuable information on potential future developments.

The compendium is primarily aimed at being a source of information for and discussion amongst those organisations that are responsible for the development of national internal control systems, whether they are from governments inside the European Union or outside (e.g. candidate countries, potential candidate countries and European Neighbourhood Policy countries). However, other audiences may also have an interest, e.g. supreme audit institutions, academic circles and all those who have a professional interest in being updated on the latest developments in the field of good governance in EU Member States.

How the idea of a Compendium emerged

The decision to produce a comprehensive overview of PIC systems in EU Member States was taken in September 2009 during the PIFC Conference organised by the EC (Budget DG). The conference discussed the evaluation of the pre- and post-accession introduction of public internal financial control (PIFC) in the EU-12. The Conference was an important opportunity to bring together not just the EU-12 with the EU-15 but also those (potential) candidate countries currently in the process of re-engineering their internal control systems in accordance with the PIFC model. Most delegates — representatives from Member States' central harmonisation units (or similar organisations), or from the national supreme audit institutions — appreciated the opportunity thus provided to share experience and good internal control practice with other Member States and expressed strong interest in continuing the initiative. All Member States supported the idea of the voluntary sharing of information on their existing national PIC systems, so that the current public internal control landscape in the EU could be mapped; a major facilitator for sharing best practice between peers.

The Compendium as a tool

Most delegations supported the creation of a professional 'peer-to-peer' platform for exchanges of views on PIC issues in the EU, and promoting technical discussions to identify workable solutions for common challenges. In that framework a Compendium presenting a snapshot of all the current PIC systems operating in the EU Member States was considered a key tool.

The Budget DG is happy to present the snapshot requested. In writing their contributions Member States followed a template ⁽³⁾ developed by the Budget DG focusing on the history of their PIC systems, the main elements of PIC such as managerial accountability, functionally independent internal audit and central harmonisation, the PIC environment (external audit by su-

⁽¹⁾ The acronym PIC is used here as the common name for all the internal control systems used in public administration in the EU Member States. The PIFC concept is a state-of-the-art model for public internal control that complies with international standards such as INTOSAI and IIA IPPF, and European good practice. It is used by the Commission to provide (potential) candidate countries with guidance for re-engineering their public internal control systems where necessary.

⁽²⁾ For Member States with a federal structure, only the central governments may have been covered.

⁽³⁾ See Appendix I: Suggested structure for national contributions.

preme audit institutions, parliamentary control, financial inspection arrangements) and future trends and anticipated reforms. The survey started at the end of December 2010 and within six months all 27 Member States had replied. As a matter of principle the Commission has not materially changed any of the contributions; the Member States remain responsible for the content of their contributions.

The Compendium's role in kicking off further analysis and discussions between peers

In 2011, with the kind support of the Enlargement DG and the Development and Cooperation DG, the Budget DG agreed with SIGMA of OECD, which is well known for its experience in public administration and public finance management reforms, that SIGMA would produce an overview of Member States' contributions. This overview has provided the Commission (and Member States) with the elements necessary to thoroughly prepare the peer-to-peer discussions that are to take place at the PIC Conference in Brussels on 27 and 28 February 2012 organised by the Budget DG. SIGMA's analysis overview is presented in this Compendium on page 9.

The Budget DG is very appreciative of the efforts made by all Member States to help create this Compendium as well as the excellent cooperation it enjoyed with all the stakeholders during the compilation process.

Analysis overview

1. Introduction ⁽¹⁾

This Compendium, with its 27 contributions from all EU Member States, is the first comprehensive collection of descriptions of public internal control (PIC) in EU Member States. It describes how PIC is organised and how it is meant to operate in each Member State. The ‘snapshot’ of the situation, as described in detail in this Compendium, was taken in spring 2011. All stakeholders, and in particular practitioners, are looking for solutions to problems in the field of public internal control. This Compendium is especially intended to allow them to study the solutions that have been chosen by other EU Member States. The Compendium’s descriptions of PIC systems may also be of value to anyone who is interested in the way in which public resources — whether they are national, EU or other expenditures, revenues or assets and liabilities — are managed and controlled so as to ensure their proper use for intended purposes.

Some contributions to the Compendium describe in detail how Member States have designed their control and audit systems and why. This description includes an indication of the standards (international or national) that are used as well as the rules and practices of reporting. Other contributions put more emphasis on explaining the overall context in which the audit and control systems have developed and are continuing to develop. Sometimes these systems have incorporated innovative ideas for dealing with common and well-known challenges. However, it is not only the sunny and ‘easy’ side that is described. The contributions reflect many years of serious considerations and hard work.

This overview is a first attempt to highlight similarities and differences in the reasons and ways in which PIC has evolved and developed over the last decade, illustrated by country examples. It also highlights some aspects of what the future holds, as indicated in the contributions. The overview is not intended to be exhaustive and is based on the individual contributions provided by the Member States. The contributions, however, may use the same words and terminologies for different concepts. It is recognised that solving the challenges arising from this fact for an overview will need much more in-depth analysis of the individual concepts than was possible to accomplish during this first exercise. This overview is only a starting point and more work will be needed, especially to clarify issues of context influencing individual PIC developments.

2. Main developments of PIC in the last 10 to 15 years

The reform of the public administration — or some of its aspects — has been on the agenda of many EU Member States for several decades. While the more general ‘new public management’ reforms were more intense in the 1990s, it is interesting to note that the areas of PIC seem instead to have seen more reforms since 2000. These later reforms could be explained by the objective need to adjust general reforms and could also be related to trends, such as recognition of the need to manage risk. In this period, PIC has developed into a widely used, integral and vital part of most governance systems in Europe.

⁽¹⁾ This document has been produced by SIGMA (Support for Improvement in Governance and Management) with the financial assistance of the European Union. The views expressed herein can in no way be taken to reflect the official opinion of the European Union, and do not necessarily reflect the views of the OECD and its Member States or of the beneficiary countries participating in the SIGMA Programme. SIGMA is a joint initiative of the OECD and the European Union, principally financed by the EU.

Reasons for reform

Accession to the EU has clearly been of fundamental importance for the way in which the 12 newest Member States (EU-12) have reformed their public administrations in general and their PIC systems in particular. It has also influenced the solutions to PIC systems adopted by the countries that became EU Member States in the mid-1990s (Austria, Finland and Sweden) ⁽²⁾. Later on, after accession, striving for better performance and results has seemed to be the most prominent objective.

This objective was also one of the primary motives for the EU-15, which recognised the need to adapt the public sector to a rapid delivery of the services demanded today and of the services that will be expected in the future, while at the same time striving to prevent booming budget deficits (see the contributions of Belgium, Denmark, France and Portugal) ⁽³⁾.

There are also countries where administrative reforms have been aimed at fundamentally devolving or decentralising central public powers (see Italy and Spain). In other countries reforms have been based in part on the view that some services that are delivered today by public organisations could more efficiently and effectively be delivered by non-public or partially competitive organisations (see Sweden and the United Kingdom).

Main developments in PIC

The reforms carried out over the past 15 years — and for some countries even longer — have brought fundamental changes to most of the 27 public administrations and to the environment in which they operate, which is usually referred to as the control environment. As the Spanish contribution has stated, ‘the controls of public sector economic and financial activity cannot be separated from the changing situation in which they take place’. Consequently, there have also been many changes in the way in which PIC operates and how it is organised.

The most striking developments in PIC components in Europe have resulted from an increasing attention to objectives and performance management, to risks and governance as a whole, including accountability, and to the quality of service delivery and cost efficiency. These developments have led to the wide introduction of international or national standards, clearly defined legal bases and clearer mandates for control, internal audit and — where it exists — financial inspection. The functional independence of internal auditors has increased, and the programme of audit work has developed, focusing more on economy, efficiency and effectiveness and on the provision of information and assurance with regard to system operations. Reporting requirements have increased, as have requirements for specific knowledge and competence of civil servants responsible for financial management and audit.

Public internal control has of course always existed in one form or another in each country. However, it has been modernised in a comparatively short period of time (over the past 10 to 15 years) all over Europe. During this period it has developed as a commonly known concept that is widely used. PIC has become an integral and vital part of a modern governance system. Practitioners in public financial management and control, including internal auditors, have become, or are becoming, a professional category of staff with formal qualifications and with special, long-term training programmes which are sometimes provided by institutes that are external to the public sector.

However, it should be underlined again that there are many differences between countries — even neighbouring countries — in terms of ‘why, when and how’ reforms in the public sector and in PIC are carried out.

3. The specific parts of PIC

3.1. Internal control environment

PIC systems differ from country to country as they have to fit into the respective overall governance arrangements with each of the constitutional stakeholders — government, parliament and the supreme audit institution — as well as the accountability arrangements that exist between these

⁽²⁾ See the 1996–2001 SIGMA/OECD publications 4, 19, 20 and 32.

⁽³⁾ References to countries do not necessarily mean that there are no other countries that would fall in the same category.

stakeholders. Within the government, internal accountability arrangements are also a determining factor, as is the content of accountability of those responsible for carrying out public tasks. A distinction can be drawn here between legal accountability for compliance with rules and regulations and managerial accountability for the use of public resources to achieve goals. Budgeting and accounting arrangements also have to be taken into account.

Accountability arrangements

Each of the contributions of the EU Member States places the description of the PIC system within the context of the country's overall governance arrangements, explaining the reasons for specific developments as well as the causes and effects of solutions that characterise the system. The contributions refer primarily to the organisation, management and accountability arrangements of the executive. However, they also set out the context regarding the role of the other constitutional stakeholders. Parliament has a major role to play with regard to the adoption of legislation, not least the adoption of the budget, monitoring its implementation and holding the government to account. The role of the supreme audit institution (SAI) is to report to parliament on its assessment of the reliability and completeness of the financial and non-financial information provided by the government. To some extent, regional and local governments are also taken into account, although this Compendium focuses on the central government level.

The devolution and decentralisation of political and administrative powers, including the existence of autonomous layers of the public administration (at central, regional and local levels) or the use of various types of organisations (semi-public, private) to deliver public services and to raise fees/taxes or channel budget funds, determine the conditions for the way in which PIC systems are designed, and by whom.

Although general orientations can be distinguished and while all EU Member States have the main democratic arrangements in place, the way in which governments are constitutionally organised differs significantly from country to country. These differences relate to the organisation of the administration and the accountability of government to parliament, but also to the budgeting and accounting systems that have been developed in the light of each country's specific situation and needs. The issue concerning who the managers carrying out public tasks are and what exactly they are responsible for has also not been dealt with in similar ways in the countries. However, all of these issues have a significant impact on the way that PIC is understood and organised.

Most countries describe their public administration as being organised in a monocratic and hierarchical way, performing its activities on the basis of the principle of legality. The administration is generally organised according to the ministerial rule, i.e. in ministerial portfolios or sectors, where line ministries have overall responsibility for their sector, including for subordinated organisations, with line ministers politically accountable to government and/or parliament for the decisions of their sector.

Some countries have, in addition, created agencies, which operate under the political responsibility of the respective line minister. The Netherlands, for example, has created 40 internal agencies for policy performance and operational management activities under the full political accountability of the respective minister, with hundreds of law-based, 'arm's-length' agencies under the limited political accountability of the minister. Sweden is one exception to the ministerial rule, as ministries do not have subordinate administrations. Day-to-day administrative work in Sweden is exercised by central agencies, which work independently from ministries, and the heads of these agencies are directly accountable to the government.

In most countries the political head of the ministry has political responsibility for his/her sector, but is also accountable to the government and/or parliament for executive decisions, including financial management decisions and, sometimes, results. In several countries, however, there is a clear division between the political and the executive heads of a public entity. In Malta, permanent secretaries, and since recently in Hungary, administrative state secretaries, are responsible and accountable for management decisions. In France, programme managers integrate political and managerial responsibility under the minister's authority for the respective programmes that are assigned to them. In Italy and Spain, while political management organs have been given the task of defining the objectives to be pursued, administrative managers are responsible for

the basic organisation of the offices and for overall staffing levels. In Ireland and the United Kingdom, the accounting officer, who is usually the most senior civil servant, is even directly accountable to parliament.

Responsibility of public managers

All of the contributions describe functional and financial delegation of decision-making arrangements within public entities aimed at ensuring that top managers are supported across the full spectrum of their responsibilities. This delegation of decision-making includes the setting-up of units responsible for preparing budgetary and financial management decisions. Some countries have enhanced the financial function considerably, transforming it from a pure accounting function to a broader financial management and control function.

However, management and accountability arrangements within public administration entities differ significantly from country to country, as does the spectrum of responsibilities of the executive level of administrative authorities, such as ministers, directors of agencies and heads of departments and units (public managers). Some countries (such as Germany, Greece and Luxembourg) have kept to a large extent the traditional legal and hierarchical arrangements, whereby managers are legally responsible for regularity and propriety as well as economy and efficiency in the use of an entity's resources.

Apart from legal requirements, more and more countries nevertheless seem to expect the executive level of administrative authorities to ensure that the specific policy objectives that are planned, implemented and accounted for annually can be achieved with the resources available. In Denmark, for example, state institutions must set objectives for their work and monitor the results in their annual reports; incentives for managers can be performance-based salary contracts and other measures, and the institution's management must ensure the optimum utilisation of resources in accordance with the institution's objectives. France has also introduced an objective-oriented management. In the Netherlands, the policy programme is set by the government. In Malta, a Public Service Agreement is signed by every ministry, with the aim of charting in a direct manner the outputs expected from each ministry and identifying the officials responsible for the achievement of these objectives.

In those countries, the budget and organisational arrangements, as well as administrative laws, usually give managers a rather large amount of discretion in the use of public funds. In the United Kingdom, for example, departments have considerable freedom to decide how they will organise, direct and manage the resources at their disposal. In return, managers are held accountable not only for the application of rules and regulations in their decision-making but also with regard to the results achieved. It seems that the more discretion countries give to public managers, the more those countries focus on the proper functioning of internal control systems and the reporting on progress of achieving the objectives and related constraints.

Budget and basis for accounting

About half of the countries seem to have an input-oriented budget (Estonia, Germany, Greece, Hungary, Poland and Spain), but many of those countries are currently in the process of introducing or are planning to introduce an output-based budget (Austria, Ireland, Portugal, Romania, Slovenia), usually aimed at relating the budget to programmes. Several contributions explain that the introduction of the managerial principle in public management is closely connected to this emphasis on outputs and on an evaluation of the achievement of targets set (see Slovenia). A few countries have already moved towards an output-oriented budget that is based on policy objectives (e.g. Denmark, France, Sweden and the United Kingdom).

The accounting approach at the central level of government is reported by several countries to be cash based (see Germany, Ireland, Malta, Portugal, Slovenia and Spain), but an increasing number have adopted a modified, accrual-based accounting system (see the Czech Republic, Denmark, France, Greece and Sweden) or a mixture of approaches (the Netherlands). Only a very few countries have established full accrual-based accounting (see Estonia).

3.2. The concept of internal control

Not all countries interpret the concept of internal control in the same way. While some countries have special internal control institutions that are independent from those they control, others give the responsibility for internal control to the respective administrative entities. In some countries this decentralised system of internal control is embedded and forms an integrated part of the administration. The need to establish internal control, report on it and apply a risk management approach can be spelled out explicitly in laws and regulations or derived from an existing legal basis. In decentralised systems, top managers have to report on the functioning of internal control systems. More and more countries also require top managers to apply systems for managing or mitigating the risk of not achieving set objectives.

Different definitions of an internal control system

The system of internal control is described mainly in two different ways in this Compendium. Some contributions (see Luxembourg and Spain) describe it as the entire control system within the public administration and the sum of all institutions involved in controlling public funds ('internal' in this context is understood as internal to the executive, as opposed to external control, which is exercised by the SAI and parliament). Those countries also have special control bodies, such as Spain's *Intervención General de la Administración del Estado* (IGAE) or Luxembourg's *Inspection Générale des Finances*, which are independent from the authorities and entities of which they are controlling the economic and financial management. Those systems are called centralised internal control systems.

Other countries (such as Denmark, the Netherlands, Sweden, the United Kingdom and the 12 new Member States) understand the PIC system to mean the conceptually comprehensive and harmonised approach of government to ensuring that all public entity managers establish, maintain and monitor their integral management processes. Internal control in those countries is designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission the general objectives are met. These objectives are the orderly execution of ethical, economical, efficient and effective operations; fulfilment of accountability obligations; compliance with applicable laws and regulations; and safeguarding of resources against loss, misuse and damage. It is interesting to note that today some countries, such as France and Portugal, where strong special control institutions used to exist, have started to decentralise especially *ex ante* controls and thus to increase the responsibility and accountability of public managers. Those systems are called decentralised internal control systems.

Legal basis

Many of the countries with a decentralised control system need to have internal control systems that are established within public entities clearly spelled out in the legal basis of these entities, either in specific laws (see Greece and Slovakia) or explicitly included in other financial regulations (e.g. in Finland, the definition and responsibilities for internal control is described in the Budget Act; in Hungary, it is included in the Act on Public Finances as well as in special government regulations and in guidelines and manuals; in Estonia, internal control is mentioned in various legislative acts, such as the Government Act).

In some other countries internal control is not explicitly mentioned, but a clear framework for the internal control of institutions has been created in existing rules and regulations (e.g. Denmark, based on the Public Accounting Order/Guidelines for Responsibility for Management). Many countries explain that their legislation and their financial management and control practices have implemented the interrelated components set out in the model of the Committee on Sponsoring Organisations of the Treadway Commission (COSO), as well as the guidelines for internal control standards in the public sector of the International Organisation of Supreme Audit Institutions (INTOSAI). This is the case especially for the newest EU Member States, but also for other countries, such as Finland, the Netherlands and the United Kingdom.

Responsibility for and reporting on internal control

Setting up, monitoring and reporting on the functioning of the respective internal control systems within public entities is part of the management responsibilities in those countries that have explicit decentralised internal control policies. This reporting requirement is usually combined with the annual report or the annual financial statement of the entities. In Lithuania, each year the top manager of the public legal entity presents a report on the state of financial control in the public entity. In Poland, ministers report annually on the execution of the annual activity plan of the whole sector for which they are responsible and submit a statement on the status of management control for the preceding year. In Finland, the report on operations, included in the final accounts of an accounting office, must include an assessment of the appropriateness and adequacy of internal control and related risk management, as well as a statement on the status of internal control and key development targets, drawn up on the basis of the assessment (assessment and statement of assurance of internal control). Accounting officers in the United Kingdom sign annually a statement on internal control, declaring the officer's approach to, and responsibility for, risk management, internal control and corporate governance.

Risk management

For most countries with an explicitly decentralised internal control system, risk management is also a mandatory requirement for public management. In Estonia, for example, the government regulation on strategic planning stipulates that any state authority is to submit a summary of risk analysis and an analysis of the activity environment. In Sweden, most agencies must perform a risk analysis aimed at identifying the circumstances constituting a potential risk that the entity would be unable to meet the objectives in accordance with the requirements established by the government. If necessary, measures are to be taken to mitigate or manage risks related to not meeting those objectives. Other countries, such as Ireland, indicate that formal risk management strategies are not in place in general, but they are implemented informally by some departments. A few countries, on the other hand, do not explicitly mention risk assessments at all as a part of their internal control arrangements (Germany, Italy, Luxembourg and Spain).

3.3. Internal audit

Almost all Member States have an internal audit function in place, but it does not necessarily cover all areas of the public administration. Formal and informal ways are used to achieve a relevant level of coordination and harmonisation. Traditional compliance and financial audits are supplemented increasingly by consultancy services and audits of performance, requiring professional and well-trained internal audit staff. Some of the Member States have established audit boards and/or audit committees.

Existence of internal audit and legal basis

Of the 27 Member States, the vast majority have an internal audit function in place. Three countries are currently relying on other arrangements, but have plans to introduce internal audit in the public sector. Luxembourg is considering, as a link to its preparation for budgetary reform, either establishing an internal audit unit within each ministry of a certain magnitude or establishing an internal audit unit attached to the Ministry of Finance. Greece has adopted a law for the establishment of internal audit, the implementation of which is pending upon the signature of the required presidential decree. In Italy, a commission has been entrusted with issuing directives in order to provide at least a minimum legal base for internal audit. The Spanish system, which gives great importance to an *ex ante* form of control called preliminary control of legality, has also put in place a form of internal audit carried out subsequently and systematically on the economic and financial activities of the state public sector by the abovementioned IGAE.

Some countries, such as France and Portugal, have undertaken during the past decade a comprehensive structural reform of the public sector, which includes moving from a traditional legalist and input-oriented system (as referred to in the Portuguese contribution) towards a system that is more performance oriented. Internal audit now exists in all line ministries and, ideally, it focuses on the reliability and efficiency of internal control systems and value for money. The

function of financial inspectors in Portugal has been refocused from transactions/operations towards areas where the financial risk is considered to be high.

The majority of countries that have internal audit have established the function in specific laws or regulations. Internal audit is not a regulatory requirement in the United Kingdom, but it is nevertheless enshrined as a mandatory part of governance and assurance arrangements within central policy rules and, de facto, every government department and 'arm's-length' body has an internal audit service. There is no explicit legal basis in Germany either, but apparently all departments follow the recommendations made by the Federal Ministry of the Interior, in agreement with all other ministries.

Some 18 contributions indicate that their internal audit activities are based on specific standards. It is clear that the Institute of Internal Auditors, via its 'Standards for the Professional Practice of Internal Audit', has also played a prominent role as the de facto standard-setter for public internal audit systems, which is very similar to the way in which the COSO model and INTOSAI have shaped internal control standards. However, a noticeable development in recent years, not the least for the EU-12, is that later laws or regulations on internal audit refer to recognised international standards and good practice rather than to specific standard-setters.

Internal audit coverage

Most internal audit systems do not cover all parts of the public sector or every part in the same way. Even the coverage of the central government part varies from country to country. The following examples will illustrate this situation.

Lithuania plans to amend existing legal acts for the elaboration of internal audit in municipalities. In Estonia, work is continuing in the implementation of both internal control systems and an internal audit function in local governments. In both of these countries there is a need and an ambition to ensure more coherent and comparable information on the performance of the public sector, not least for accountability purposes.

Efforts aimed at achieving cost efficiency also explain the variation of internal audit coverage. In Romania, for example, public internal audit structures have been established within each public entity and with the same tasks, ranging from legality to audit of economy, efficiency and effectiveness. However, for local public entities with a budget up to EUR 100 000, there is no obligation to set up a unique internal audit function. In those cases internal audit is instead limited to regularity audits, which are performed by the existing internal audit offices of one of the ministries. Romania has also a system in place aimed at extending internal audit coverage to local administrations as well. A structure has been put in place allowing town halls to cooperate in the framework of an association to establish a common internal audit service. Another step that is being taken gives town halls the possibility of forming partnerships (of two or more), thereby using a more cost-effective way of creating an internal audit service.

In Sweden, only those few agencies that manage complex or sensitive operations, possess large assets, transfer huge funds or have a high cost base are obliged to set up internal audit. The Belgian regulations explicitly allow internal audit activities to be carried out in three different ways: by a permanent, dedicated audit service; by a permanent, shared audit service for a number of institutions; or by an external service. These possibilities are already possible or will soon be possible in other countries as well, under certain conditions (see contributions from Denmark, Estonia, the Netherlands, and Slovenia).

The Spanish contribution illustrates the new complexities that arise from a public audit and control point of view when a centralised public sector is reorganised fundamentally and the demand for control and audit will concern different types of organisations with different reporting demands. A way forward that is suggested in the contribution is a wider and more common use of the single audit concept, including techniques, procedures and reporting arrangements, which would allow cohesive action by all control/audit bodies.

New challenges, new types of audit

The programme of audit work has developed considerably for internal auditors. Today's work programme is far from the task of checking compliance with mainly financial regulations and

policies. A basic component of today's work programme for most internal audit functions is the audit of financial information and of the regularity of financial management, aimed at assuring the minister or the top management of an entity as to how the internal control systems and procedures of the entity are functioning. This assurance is sometimes linked to the obligation of the minister/top management to sign a statement/make a declaration on the functioning of the entity's internal control systems.

However, the introduction of performance-based budgeting, evaluations, risk-based management, the growing complexity of the technology used to deliver government services, etc. seem to have a considerable effect on the demand that is made on internal audit. There are increased requests for more varied expertise, more consultancy services and higher quality of services. Only the contribution of Estonia indicates that the demand for consultancy services has decreased.

The extension of the scope of internal audit services is also reflected in the various and increasing types of audits regularly conducted by internal audit functions: compliance, inventory, financial, financial assurance, management, operational, systems and IT audits are often mentioned in the contributions. Security, information security and performance audits are also mentioned frequently.

Internal audit relation with external audit

With a few exceptions, there seem to exist continuous, and in some cases elaborate, working relations between public internal audit and external audit entities (SAIs). These relations have developed over time, and in some countries they are formal and laid down in laws and regulations, but they are equally often based on initiatives taken by the audit organisations themselves, for example in order to avoid duplication of work and facilitate the process for the auditee. How this relationship has been defined depends of course on the precise mandate and role of the respective institutions.

A common 'basic' relationship between internal and external audit is described in the Maltese contribution. The SAI of Malta has access to and can use the work of internal audit for evaluating the effectiveness of internal control. Internal audit is also well placed to provide the SAI with information on the effectiveness of the systems used. However, the SAI always has full responsibility for the conclusions drawn from such information. Internal audit provides the SAI with the annual audit plan, and the heads of the two institutions liaise on various professional matters.

This description captures the situation in most countries, as long as a few more components are added, such as internal audit providing audit plans and reports to the SAI, audit organisations cooperating on methodological and training matters, and the SAI having the possibility, as an advisor or observer, to take part in regular meetings of the heads responsible for internal audit (see Austria, Bulgaria, Cyprus, Denmark, Hungary, Latvia, the Netherlands, Poland and the United Kingdom).

Use of audit boards and audit committees

The use of audit boards and audit committees to improve the governance of institutions by strengthening the internal control mechanisms and increasing the quality and value of audit activities does not seem to be a concern in most of the countries. In principle there is a distinction between at least two categories of audit boards and committees. One category is centrally placed and has primarily an advisory function in relation to the government or to part of the government on PIC matters, including internal audit. A second category is more directly concerned with the management and operations of existing internal audit functions and covers parts of the government.

However, these boards or committees may play very different roles, have different mandates and cover more or less of the public sector. Today they are more common at central government level than in any other part of the public administration, but the coverage is far from being comprehensive.

The advisory type of boards and committees can be found for example in Hungary, with the Public Internal Finance Control Interministerial Committee providing guidance for the improve-

ment of the PIC system and, in Finland, with the Advisory Board for Internal Control and Risk Management for the development of internal control and the planning of cooperation and joint measures across sectors of government.

Other examples illustrate the diversity of audit committees, which focus more on management and operational matters for internal audit. Poland has 17 audit committees corresponding to the 17 ministries, all of which were recently established (2010). Such a committee may inform and give advice to the minister about risks connected with the implementation of activities throughout the entire area of responsibility of the ministry. The aim of the audit committee is to provide consulting services and guidance with a view to ensuring adequate, efficient and effective management control and efficient internal audit throughout the entire portfolio a minister is responsible for. Latvia has four audit committees, consisting of senior management officials. The task of these committees is limited, however, to keeping management informed of the results of internal audits and advising on the implementation of any recommendations stemming from these audits.

However, it seems that the number of such committees in decentralised structures or in regional and local administrations is growing slowly, if at all. The contributions of Bulgaria and the Czech Republic both indicate that managers question the relevance of such committees and, as stated in the Czech contribution, 'Audit committees and/or audit boards did not find support in the Czech public sector as the new concept of internal audit is perceived (with some exceptions) as another bureaucratic and economic burden without an apparent benefit to the public sector.'

Building competence and certification of public internal auditors

Considerable public resources have been and are continuing to be invested yearly in building the competence of managers and staff of internal audit units and institutions. Investments have also been made in professional networks, seminars and conferences for internal and external auditors, often including both public and private sectors.

There is a requirement in at least half of the countries for each internal auditor to continuously maintain or upgrade his/her professional knowledge and experience. Training programmes have been developed for this purpose, and training is often delivered via those entities responsible for the coordination and harmonisation of internal audit, in collaboration with the country's audit professionals, using internal training facilities and trainers for example from the administration, universities or private organisations. Alternatively, the internal auditor may be given the opportunity to follow distance e-training or other training provided by certified educational institutions.

In Bulgaria, Hungary, the Netherlands and Slovenia a public internal auditor must be registered, authorised, certified or otherwise able to prove that he/she has undergone the required professional education in order to be in a position to serve as a public internal auditor. In Denmark, the head of the internal audit service within the Ministry of Finance is certified (Certification Scheme for Public Auditing). Estonia and Lithuania are currently considering the introduction of national certification in order to better meet the demands and needs of their public sectors.

3.4. Coordination and harmonisation of internal control and audit

The coordination and harmonisation of internal control and audit in the public sector at large or in the government sector is achieved in many different ways. More than half of the countries have established special units for this purpose.

Coordination and harmonisation

A clear majority of the countries have taken steps to ensure that internal control, including internal audit policy and methods, is coordinated and harmonised throughout the central government administration. Several countries are considering at the moment ways of establishing similar coordination with other parts of the public sector as well. The ways to achieve coordination of policy and methods range from making recommendations to establishing professional networking arrangements between financial controllers and internal and external auditors, and finally to setting up 'central harmonisation units'. More than half of the countries do have such

special entities, which have responsibility for proposing regulations, harmonising the standards of the various internal control components, monitoring overall quality and performance and establishing and coordinating training activities (see, for example, Finland, Lithuania, the Netherlands, Portugal and Slovenia). In most cases these entities are part of the Ministry of Finance, and sometimes they are also backed up by independent advisory boards or committees.

Several countries have no specific harmonisation arrangements. However, they may instead have forms of networking arrangements, which may provide the necessary level of coordination and harmonisation (see, for example, Austria, Cyprus, Denmark, Germany and Latvia).

The Czech Republic recently abolished its central harmonisation unit for efficiency reasons. Other countries (see France, Hungary, Portugal and the United Kingdom) have underlined the importance of such structures, especially for creating good and efficient cooperation arrangements between managers of public entities and financial controllers and auditors.

Portugal considers that an effective and practical harmonisation and coordination structure has an important role in overcoming resistance to a more fundamental reform of the control and audit structures in an administration.

4. Financial inspection

An ex post financial inspection service is established in about half of the countries. The organisation and reporting requirements of the inspections differ considerably.

Financial inspection is usually understood as an *ex post* control activity exercised by either inspectors of a centralised control body, who are independent from the entity they inspect, or inspectors working in a separate unit of the entity they inspect. The aim of the financial inspection is to rectify major irregularities and dysfunctions and to impose administrative sanctions. In a few cases, the financial inspection service is reported to have *ex ante* tasks (see Belgium).

The financial inspection function is well established in the majority of the EU-12, such as Bulgaria, Hungary, Poland, Romania and Slovakia, as well as in Belgium, France, Greece, Italy, Portugal and Spain. By contrast, no central institution responsible for financial inspection exists in the Nordic states (Denmark, Finland and Sweden), the Baltic states (Estonia, Latvia and Lithuania), Austria, Germany, the Netherlands or the United Kingdom. In those countries the function is embedded in the financial management and internal control system.

The organisation of financial inspection differs considerably among the countries. In the EU-15, where financial inspection functions exist, such as in France and Spain, the function is historically an important part of the financial management and control system and comprises a huge number of staff. During their accession period, the EU-12 established the internal audit function but nevertheless kept the financial inspection function in order to bridge the gap while internal audit was still in the development stage. However, they changed the focus of their traditional financial inspection function towards inspecting or investigating more serious cases of mismanagement and suspicions of fraud and corruption triggered by complaints and other information. The number of inspectors in EU-12 countries is lower than in the old Member States, but it is nevertheless significant.

Reporting requirements also differ in the different systems. While in the EU-12 financial inspection usually reports to the Ministry of Finance, in countries where the SAI is organised as a court of accounts with judicial power (France, Italy, Portugal and Spain), financial inspection also has to report any irregularities detected to the Court of Auditors, which then opens a financial responsibility procedure and requests the reimbursement of any undue payments made by managers.

5. What will the future bring?

Looking towards the future, the contributions mainly describe the next steps for already-decided and ongoing reforms of the countries' public administrations or PIC systems. Such steps, when they relate to more general administrative reforms, concern, for example, ongoing devolution from central government to implementing entities, and the existing control/audit systems in

particular will suffer the consequences of this devolution (see Spain). Or, in the case of Italy, an even more fundamental transformation of the state into a federal republic will increasingly include the transparency of the public administration, establishing relevant monitoring and reporting practices and clarifying the measurement and evaluation of organisational and individual performances. Other contributions describe the intentions or decisions already taken to establish reporting, accounting, internal control and audit systems at regional/local government levels or for non-public/partly public services, with the ambition of ensuring an equal level of protection, transparency and effectiveness, irrespective of where public resources are spent (see Estonia, France, Lithuania, the Netherlands and Romania).

Next steps related to ongoing public expenditure reforms that are often mentioned in the contributions are better integration of strategic planning at government level with the budget (Estonia); streamlining budget execution and financial control/audit solutions (Portugal); and improving the monitoring of government spending and policy performance by introducing new procedures and systems for measurement, evaluation and risk management (Estonia, France and Portugal). A prominent aspect that is common to most contributions is the struggle for better quality and more efficient solutions for internal control and, especially, internal audit. Some countries (see Estonia, Hungary and Lithuania) plan to introduce systematic quality assessments, quality monitoring or quality review systems. The contributions of Estonia and the United Kingdom offer an additional perspective related to quality, namely the need to ensure that the information provided to those responsible for setting priorities and defining programmes will allow them to read across public programmes and entities as well as across private and public sector accounts. The internal audit services then become more oriented towards strategic objectives of programmes or entities.

The need for more efficient internal audit — and proposed solutions for meeting this need — is pointed out by several countries. Some complementary ways of achieving better cost efficiency are mentioned. The Czech Republic, Latvia and Slovakia plan to simplify and streamline control and audit systems within the government sector, but also between the government and other parts of the public sector. Other countries will reduce costs and increase efficiency by centralising support services, such as internal audit, staff management and office housing (the Netherlands), and also by improving the management of all information across the entire public sector, with the help of new information systems and Internet-based solutions.

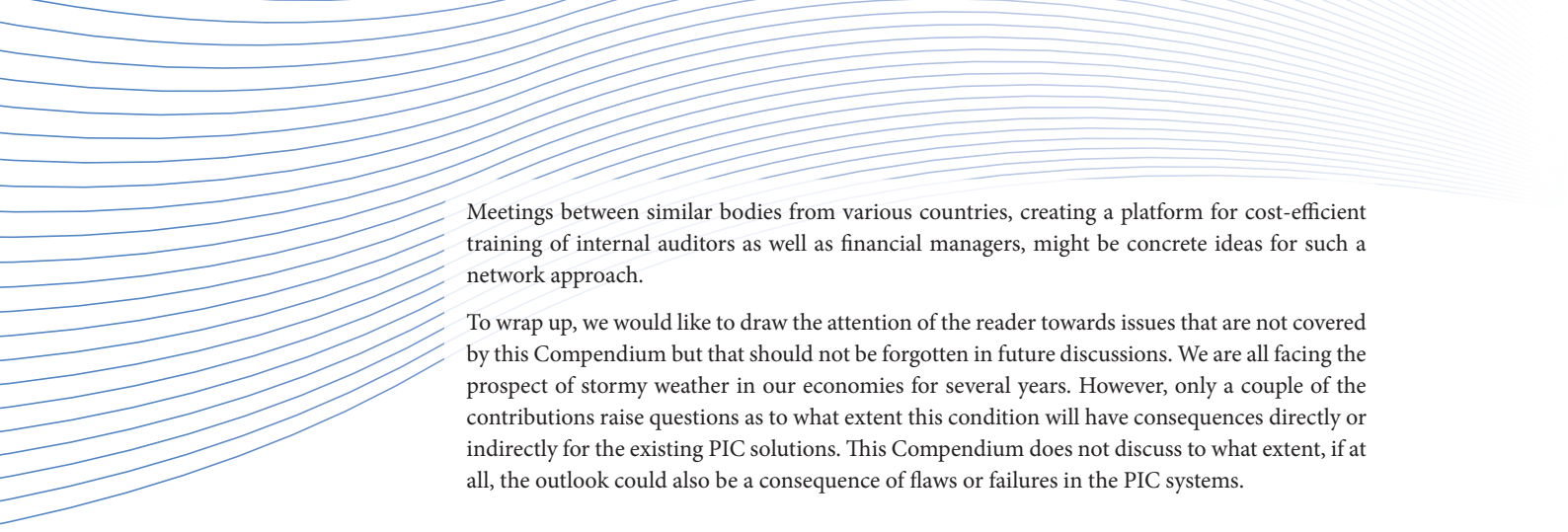
However, the future may also take very different directions from what was hoped and planned at the beginning of 2011. The Spanish contribution raises the fundamental question: in which aspects does the current and developing PIC system need to be adapted, or more radically changed, as a consequence of the austerity and other measures that countries have recently started to implement, or will have to design and implement? Also, what role, if any, is there for PIC institutions in designing or participating in the implementation of these measures? Solutions that countries could easily afford a few years ago might be out of reach in the future for financial reasons.

6. Concluding remarks

The wave of public administration reforms, which started in some countries at the beginning of the 1980s, has become to some extent a ‘pan-European movement’, and as this Compendium shows, none of the EU Member States has remained unaffected, also with regard to PIC. However, the countries have followed their own specific trajectories and developments in PIC at different speeds and in different directions, due to a disparity in the starting positions with regard to administrative traditions and state infrastructure but also due to a disparity in targets.

An obvious conclusion of this overview is that public administration reform in general and reforms in public internal control in particular are never finalised. Administrations continue to look for cost-efficient solutions to specific challenges in a rapidly changing environment. As in the past, public administrations with all kinds of administrative traditions will have to remain creative when adapting to new requirements.

Notwithstanding the differences between countries, there are a multitude of similarities existing today with regard to the different parts of PIC, and not least internal audit. These similarities might create an opportunity and rationale for cross-border networks focusing on further benefiting from other countries experiences in the specific European context and finding synergies.



Meetings between similar bodies from various countries, creating a platform for cost-efficient training of internal auditors as well as financial managers, might be concrete ideas for such a network approach.

To wrap up, we would like to draw the attention of the reader towards issues that are not covered by this Compendium but that should not be forgotten in future discussions. We are all facing the prospect of stormy weather in our economies for several years. However, only a couple of the contributions raise questions as to what extent this condition will have consequences directly or indirectly for the existing PIC solutions. This Compendium does not discuss to what extent, if at all, the outlook could also be a consequence of flaws or failures in the PIC systems.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

Federal budgeting is subject to substantial changes at the moment. It is being developed in two stages (2009 and 2013) from a cash-based governmental accounting (cameralistic) system including multiple-phase accounting to a budgeting and accounting system based on accrual principles which facilitates budget control both by presenting accrual consumption of resources and by cash flows indicated in the cash flow statement. There is also a statement of the financial position in the sense of a federal balance sheet.

The initial stage of the budget law reform, applicable from 1 January 2009, has the following objectives.

- The federal budget planning is stated for several years and is binding. For the first time, a financial framework with binding expenditure ceilings has been established. These ceilings were defined as binding on the level of five headings, rolling for four years to come. The amount of a majority of the ceilings is thus fixed. Only in the case of items dependent on economic cycles or on tax revenues have variable limits been specified, the amount of which is to be determined on the basis of clearly defined parameters. The expenditure ceilings are approved by the parliament, which can also change them. The required budgetary discipline is supported politically in this way, although it is always possible to react to changed priority settings. The parliament is thus always the final decision-maker in the matter of the budget.
- With the budget planning extended over several years, planning security is enhanced for all the participants and a predictable, sustainable budget policy is supported. The strategic report accompanying the Federal Budgetary Framework Act contains all the information necessary in order to allow the figures of the binding budget planning to be traceable over several years. The strategic report thus becomes, together with the Federal Budgetary Framework Act, a key budget planning document.
- Also from 2009, incentives are determined for each department, supporting them in using the tax money efficiently: the funds not used up at the end of the year are generally not forfeited, but rather transferred into a reserve fund, and they can subsequently be used with no obligatory assignment, i.e. according to the priorities of the department. In this way, every minister becomes his/her own Minister for Finance and he/she is able to extend his/her own scope of action by a wise and efficient administration of the budget funds. This leads to a more efficient use of tax money for the benefit of the citizens.

⁽¹⁾ Contributed by the Federal Ministry of Finance on 14 March 2011.

At the moment, the federal Ministry of Finance is developing the second stage of the budget law reform, to become applicable from 2013. The following objectives are being pursued in the second stage.

- The desired effects and benefits of policies and administration will be integrated into the budget. Such performance-oriented budgeting is intended to clearly and transparently indicate to the wider public the kinds of results which are achieved when the tax money is used.
- Another significant aspect of the performance-oriented budget is 'gender budgeting', which has been introduced with the budget law reform in Austria, and the legal basis for which has already been established in the federal constitution. The federation, the states and the municipalities are obliged to aim at the real equality of genders when providing the budget.

The second stage of the budget law reform involves a fundamental further development of budgeting in the federation with regard to a new budget structure and, in connection with this, a results-oriented management of the departments. Emphasis is placed on the ongoing development of the federal accounting. The truest possible indication of the financial situation of the federation, which has been included in the constitution as a new budget principle, will bring a transition from the traditional governmental accounting to an accounting oriented in commercial terms without losing sight of the particularities of a public budget.

To a large extent, the development of the PIC systems is related to the budget law reform, and it essentially includes an extension of the audit universe towards performance orientation.

The supervisory functions (in the broader sense) are provided basically as follows.

Parliament

The general parliamentary supervisory powers also apply in connection with budgeting (the rights of interpellation, enquiry and resolution). The National Council may request the execution of particular inspections by the Court of Auditors. The National Council receives a number of reports on administration or from the Court of Auditors. The principle of performance orientation applicable from 2013 leads to an extension of parliamentary competences, particularly those of the budget committee.

Court of Auditors

The tasks of the Court of Auditors within the scope of budgeting are essentially related to participation in lawmaking and the associated supervision and accounting.

This includes the following:

- countersigning of deeds, by which financial debts are substantiated;
- being informed in the event that budget forecasts are exceeded — generally before implementation;
- participation in adopting significant implementing rules for the Federal Budget Act;
- preparing the federal statement of accounts (*Bundesrechnungsabschluss*) and its submission to the parliament (National Council) as its own legislative enactment;
- from 2013, being given, as part of the second stage of the budget law reform, a function within the budget planning process for the first time.

If EU funds are involved in the federal budget, the European Court of Auditors also becomes entitled to exercise supervision of the budgeting institutions.

Federal government

Within the budgeting process, the federal government is responsible for decision-making in respect of the stability programme, the strategic report, the Federal Budgetary Framework Act drafts and the Federal Finance Act (*Bundesfinanzgesetz*), etc. It is also competent to approve the expenditure commitments and dispositions on interests in companies proposed by the Minister for Finance.

Federal Chancellor

The federal Chancellor exercises coordination functions in human resource planning and, from 2013, in the performance orientation of the budgeting process.

Federal Minister for Finance

The federal Minister for Finance exercises particular tasks within the budgeting process in compliance with the federal constitution and the federal budget act, including:

- responsibility for the overall budgeting process;
- responsibility for drawing up the draft Federal Budgetary Framework Act (including the strategic report) and the draft Federal Finance Act as well as the stability programme;
- responsibility for enacting implementing rules;
- possessing a number of participation rights in other institutions;
- responsibility for interdepartmental budget control.



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Budget institutions

The Federal Budget Act (1986 similarly to 2013) differentiates the institutions involved in the budget process according to the stage of the activities (planning, decision-making, execution and supervision). Correspondingly, it discriminates between regulatory (responsible for planning and decision-making) and executive (responsible for execution and partly for internal control) institutions, whereby adherence to the four-eye principle is also foreseen within the regulatory institutions. The executive institutions include the Federal Accounting Agency, the accounting offices, the paying agencies and the purchasing agencies.

► *Federal Accounting Agency*

The Federal Accounting Agency is a public legal institution that assumes the accounting tasks of the federation.

The scope of responsibilities includes in particular:

- organising, acquiring and recording accounting data, including passing them on to the Federal Computing Centre GmbH;
- processing payments (excluding cash payments);
- supervising adherence to the forecasted amounts and settlement of receivables and debts of the federation in accordance with their maturity;
- preparing the annual closing of accounts;
- internal control; and
- measures related to the establishment and cancellation of accounting offices and paying agencies.

► *Accounting offices*

The scope of responsibilities of accounting offices particularly includes the accounting tasks for the institutions authorised to make payments ('teilanweisende Organe').

► *Paying agencies*

Paying agencies are established at institutions involved in the processing of cash.

► *Purchasing agencies*

Purchasing agencies are basically responsible for the clearance and administration of both movable and immovable federal assets (except for money, receivables, intangible assets and

federal interests); however, this applies only to the extent to which these tasks have not been assumed by the Federal Accounting Agency or the accounting offices.

The executive institutions are subject to the right of objection: arrangements, the form or content of which are contrary to the budget law, are to be returned to the regulatory institution unexecuted. If the regulatory institution insists that such arrangement shall be implemented, it must be implemented ('persistence regulation'); however, such a case is to be reported to the Minister for Finance and to the Court of Auditors.

2. Public internal control environment

Budget objectives

The constitution states that the objectives of the budget process are overall economic balance, sustainably arranged budgets and real equality of genders.

Budgetary principles

The budgetary principles of economy, profitability and usefulness are explicitly declared by the constitution as binding principles for the federal administrative bodies, and the supervisory standards of the Court of Auditors are defined correspondingly.

From 2013, the budgetary principles will be presented in a conceptually and materially extended framework, including:

- efficiency (includes also profitability and economy);
- transparency (clear arrangement of documents and processes);
- the truest possible indication of the financial situation of the federation;
- orientation to performance (taking into account the effects achieved with public funds in all the budget phases, thus including usefulness, and replicating the equality of genders).

Performance-oriented impact assessment

The principle of performance orientation also includes comprehensive responsibilities for the assessment of the impact of the regulatory measures. Financial, economic, environmental and consumer protection aspects shall always be covered.

The assessment measures are also subject to mandatory reporting within the framework of performance control.

Budgetary and accounting systems

With regard to the current system of transition from a cash-based accounting system to an accrual accounting system and from input-oriented to performance-oriented budgeting, please refer to Section 1.

External audit

The main task of the Court of Auditors is subsequent external accounting and management supervision. Its additional tasks related to budgeting are described in Section 1.

The internal control measures set forth in the federal budget law include material and computing inspections, the inspection of activities with respect to adherence to the budgetary regulations and, in individual cases, unexpected subsequent inspection. They are performed by the executive institutions (in particular by the Federal Accounting Agency).

Fraud and/or irregularities

In the event of improper conduct, the disciplinary law for public officials or, as the case may be, the penal code, is applied. The Central Public Prosecution Service for Fighting against Corrup-

tion was established at the beginning of 2009. Effective from 1 January 2010, the Federal Bureau of Anti-Corruption was established at the Ministry of Interior. Its activities are focused on the prevention and identification of the abuse of public authority, bribery, acceptance of gifts, etc.

3. Concept of public internal control

3.1. Managerial accountability/responsibility

The explanation shall be preceded by the following.

The Federal Ministry of Finance (BMF) consists of six directorates-general (DGs):

- DG I — Corporate Operations and Services;
- DG II — Budget and Public Finances;
- DG III — Economic Policy and Financial Markets;
- DG IV — Customs and International and Organisational Affairs in Tax and Customs Administration;
- DG V — Information Technology and Public Relations;
- DG VI — Tax Policy and Tax Law.

The directorates-general are supervised at the top administrative level by a secretary-general.

The current situation is discussed in this chapter, not the intended status resulting from the budgetary reform in 2013.

The administration is organised hierarchically and performs its activities on the basis of the principle of legality (a strict adherence of administration activities to the law). In the context of international administrative developments, the BMF can be considered as adhering to the new public management with an approach of good governance.

The strategies of the ministry are based on the governmental executive agreement and on the international, particularly European guidelines, and are documented in a strategic paper. The planning and implementation of the annual goals is based on 'management by objectives', which is also related to human resource tools, such as appraisal interviews and the compensation system. The preparations for piloting the performance orientation by its initial implementation at the BMF are very advanced.

The PIC system affects all the units involved in public finance, in particular:

- the Corporate Operations and Services DG in terms of the BMF budget;
- the Budget and Public Finances DG in terms of the federal budget;
- the Economic Policy and Financial Markets DG in terms of the financial aspects of these topics;
- the Customs and International and Organisational Affairs in Tax and Customs Administration DG in terms of taxes and customs, to the level of tax offices and customs offices;
- the Information Technology and Public Relations DG as the IT unit for the federal budget and the BMF budget, as well as the expert organisation for accounting, processing payments and cost-performance accounting, and for the Accounting Agency;
- the Tax Policy and Tax Law DG in terms of tax estimates and assessment of the consequential costs of regulations.



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The principle of managerial accountability/responsibility is particularly anchored in the principle of legality, in the hierarchical, monocratic structure of public administration and in the control and coordination instruments outlined in Section 1. It is complemented by internal administration instruments such as 'management by objectives', human resource measures for target-oriented conduct (e.g. appraisal interviews, compensation systems) and by internal audits. The aspects of performance orientation will be even more emphasised by the budgetary reform in 2013.

The internal control system (in the sense of the five indicated components) is primarily established on the level of directorates-general and adjusted to the needs of the particular operating areas. Organisationally interrelated topics are attended to jointly by the responsible directorates-general.

- For example, a close interrelationship exists in the area of financial operations with institutions such as the National Bank, the Kontrollbank, the Financial Market Authority and the Austrian Federal Financing Agency.
- Also, specialised assessors exist for the collection of taxes and customs fees, verifying the quality, efficiency and effectiveness of the administrative activities.

A central risk management unit for the overall Ministry of Finance is currently being established.

In compliance with the monocratic structure of public administration, lower managers are accountable to their particular directors-general. These directors-general and the secretary-general are in turn accountable to the minister. The minister is responsible to the parliament.

In the financial sector, the decision-making powers are delegated on the basis of the authorisation rules and particular values to the officials of various administrative levels with strict attention to the separation of incompatible functions within an internal control system. The decision-making powers in the management area (particularly management, organisation, human resources and infrastructure) are determined on the basis of task descriptions of the officials. The delegation of responsibilities and powers, however, is never unrestricted. The basic responsibility and obligation to supervise always rests with the next level of authority.

The policies are hierarchically related to each other. The top policies of the ministry are generated on the director-general level and fixed on the political level. The strategies on lower levels are derived by the responsible managers and fixed by the particular director-general, etc. Ultimately, all of the members of personnel are concerned with the implementation of the policies. Annual targets are determined for each workplace and their achievement is evaluated in the next year.

Tasks like budget preparation, preparation of authorising officers' financial decisions, subsequent control processes, tendering and contracting, management advice, accounting and elaboration of financial procedures and guidelines are the primary responsibility of the 'Controlling and Department Budget' division. The 'Procurement and Infrastructure' division is also responsible for tendering and contracting. The subsequent control is provided in particular by the accounting agency. As concerns tasks reaching beyond the departmental budget, i.e. involving the federal budget, these are implemented by the appropriate section.

At present, budget planning for the departmental budget is (still) input oriented. The determining of the department objectives was discussed above.

The following applies to the federal budget.

The Minister for Finance follows the budgetary guideline of a balanced budget over the economic cycle. He/she is responsible for EU budgetary affairs as well as for financial relationships with the states and municipalities (equalisation, stability pact). He/she creates the following draft documents:

- Federal Budgetary Framework Act (BFRG);
- Federal Finance Act (BFG);
- federal budget forecast;
- strategic report;

- budget report and work instructions and papers, together with other budgetary institutions.

Furthermore, he/she administers the federal budget, i.e. he/she:

- is entitled to create budget reserve funds;
- manages expenditure commitments, subject to approval by the federal government;
- approves expenditures exceeding the budget ('overspending');
- must participate in and approve the federal intentions to implement significant regulations (laws, ordinances and charges).



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Federal assets

He/she is responsible for allowances for federal assets (e.g. transfers, charges, abandonment) and is entitled to settle financial debts and federal liabilities.

Interest, budget, financial and human resource controlling

He/she enacts directives and ordinances.

The internal control system shall:

- support adherence to the applicable regulations and strategic orientation;
- enhance the efficiency of administrative activities;
- provide for the public expenditure requirements;
- efficiently manage the public funds;
- guarantee the regularity and reliability of administrative activities; and
- protect information legally subject to confidentiality.

It therefore covers also all the financial decisions.

The Federal Statement of Accounts is established on the basis of the annual statements of the ministries and the related inspections by the Court of Auditors and submitted to the National Council when the Minister for Finance has presented his/her opinion.

The Federal Statement of Accounts includes:

- the overall economic indication of the federal budgeting;
- the comparative budget forecast analysis, in which the actual disbursements and incomes are compared with the federal budget forecast;
- the annual status report as an asset balance statement;
- the annual profit and loss statement with an indication of expenditures and revenues;
- a report on the status of the federal debt and federal liabilities;
- the annual closing of accounts of the legal entities managed by the federation.

A rule applies with respect to the department budget that the Minister for Finance creates an annual statement of accounts. It is audited by the Court of Auditors and adopted into the Federal Statement of Accounts.

3.2. Internal audit

From the outset, it should be stated that the definition of the IIA in compliance with the 'International Standards for the Professional Practice of Internal Auditing 2011' does not include provisions on internal auditing as part of internal control. However, the contents of this message can be approved. The internal audit has not been developed as part of the PIC.

The capability of the minister to have an internal audit performed in the particular ministry is stated in the Federal Ministries Act. The Minister for Finance has issued two ordinances for his/

her department. The control organisation ordinance regulates the position of the internal audit in relation to the internal control system. The audit charter regulates the internal audit activities on the basis of the IIA standards. In both cases, all the department's employees are subject to the regulation.

The freedom of audit reporting is provided to the fullest extent. The audit reports are presented directly, with no intermediary stage, to the minister or his/her office. In his/her annual report, the head of the internal audit evaluates his/her organisational independence based on the IIA standard 1100 and the INTOSAI standard GOV 9140.

The audit charter, referred to as 'Audit Charter (Revisionsordnung)', was proposed by the head of the audit and then approved by the minister. It complies with the IIA standards.

Activities beyond the scope of the audit are not performed as part of the internal audit. Occasional consulting activities (outside an audit) are performed within the framework of the IIA standards.

Continuous professional training is provided on the basis of a general public management education scheme for university graduates and an additional basic education scheme for internal auditors. For example, a number of auditors acquire the 'Master of Business Administration (Public Auditing)' degree at the Vienna University of Economics and Business, others are 'certified corporate risk managers' or have a teaching assignment for internal project management at a university of applied sciences, etc.

Every four years, the internal audit itself is subject to an external quality assessment.

The audit reports are presented to the minister, the secretary-general, the head of the particular section, the managers involved at the ministry and the head of the audited unit.

The inspections of the internal audit go far beyond financial and regularity audits. They include operational audits and, in particular, management audits. Delinquency audits are provided by a specialised audit unit (Bureau of Internal Affairs).

In addition to the audits ordered by the Minister for Finance, joint certification audits are performed in the area of expenditure funding, together with the European Commission and the Directorate-General for the Budget.

The representatives of both the audited function and of the particular higher-level organisational units responsible for solving the problems identified or the potential issues are invited to the concluding discussions of an audit. The function directly responsible undertakes to provide for specific implementing measures within a fixed term of not longer than 12 months. Within the fixed term, this function is required to present a report to the internal audit. The implementation/failure to implement the approved measures is monitored and reported quarterly to the minister and the secretary-general.

If fraud and/or irregularities are identified during an audit, the Bureau for Internal Affairs of the Ministry of Finance is notified. This bureau initiates a separate investigation. The two investigation processes run in parallel and are coordinated.

A clear separation exists between a financial inspection and an internal audit. In the sense of a single audit concept, an internal audit is distinctly higher than an internal financial inspection. On the one hand, an internal audit takes into account the financial inspection results when creating the annual audit plan and when performing the individual audits. On the other hand it verifies the efficiency and effectiveness of a financial inspection (if undertaken by the bodies of the Ministry of Finance).

3.3. Internal audit relations with external audit

The internal audit department has its annual audit plan informally coordinated by the Court of Auditors, to which it presents its annual report. When the Court of Auditors inspects a topic already checked within an internal audit, the audit reports are presented. In such cases, the Court of Auditors holds an initial discussion with the internal auditors.

3.4. Audit boards and/or audit committees

Neither audit boards nor audit committees are established.

The following measures can be considered as focused in this particular direction:

- regular cross-checking of the Court of Auditors with respect to internal audits of the federation and its separate legal entities;
- (restricted) coordination activities by the Office of the Federal Chancellor for internal audits of the federation;
- regular external quality assessments (at the Ministry of Finance only).



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3.5. Coordination of public internal control

There is no particular centralised coordination or harmonisation function within the Ministry of Finance or within the federation. The control tasks are performed within the framework of a clearly defined comprehensive national control concept. Internal audit regularly assesses the functionality of the internal control systems. A general federal control is based on the Court of Auditors within the scope of the annual report and the cross-checking activities.

The EU funds are subject to the following.

Particular regulations ('sector regulations') apply to the implementation of the large European agricultural and structural policy programmes, together with the EU financial regulations. These regulations include also the involvement and responsibility of the Member States; according to them, the Member States are required to introduce certain implementing and control functions. In Austria, the required national legislation framework includes provisions implying that the EU expenditures, by means of the public budget, in particular the federal budget, are based on a defined process. The national budget law is applicable also in the area of EU budgeting. Furthermore, it must be ensured that the provisions contained in the EU sectoral regulations are applied in practice; if necessary, this is based on the enactment of particular national regulations. With respect to its participation function, Austria is subject to control by the European Commission; the European Commission is entitled to inspect the appropriate use of EU funds by the authorities as well as by the beneficiaries.

► *Agricultural policy*

The national implementation of the common agricultural policy is based on the Agrarmarkt Austria paying agency, with the exception of export refunds, which are processed by the Salzburg/Erstattungen customs office. The internal national processing of funding within the framework of rural development is provided by the federation (Federal Ministry of Agriculture, Forestry, Environment and Water Management) based on the Agrarmarkt Austria paying agency with the involvement of the state Chambers of Agriculture and the state governors, depending on the particular process. The federation is responsible for certification, control and paying functions (Federal Ministry of Agriculture, Forestry, Environment and Water Management or Federal Ministry of Finance).

► *Cohesion for growth and employment*

The national implementation of structural programmes is based on various functions of both the federation and the states, depending on the particular competence. The legal framework is based on the convention between the federation and the states in the matter of the administration and control system in Austria for the EU Structural Funds. Accordingly, programmes with regional targets, co-financed from the European Regional Development Fund (ERDF), are coordinated by the individual states. However, the administration of the programmes co-financed from the European Social Fund (ESF) and extending over the territories of several federal states is the responsibility of the federation (Federal Ministry of Labour, Social Affairs and Consumer Protection). An exception is Burgenland with its own programme co-financed from the ESF.

Certification, control and paying functions for both the ERDF and the ESF are the responsibility of the federation (in the case of the ERDF, the Office of the Federal Chancellor and the paying agency function for the ERP Fund; in the case of the ESF, the Federal Ministry of Labour, Social Affairs and Consumer Protection).

The basic competence for the affairs indicated in Articles 310 to 325 of the Treaty on the Functioning of the European Union rests with the Federal Ministry of Finance.

4. Financial inspection

The bodies intended for financial inspection are as follows.

- Court of Auditors.
- Federal Accounting Agency.
- Internal audit units at the Ministries.
- Additionally, at the Federal Ministry of Finance, the Bureau for Internal Affairs, which is responsible for delinquency inspections.
- Certification functions for EU funds.
- Inspection functions for EU funds.
- State inspection bodies.

In addition to the indicated bodies, the following prosecution institutions also exist:

- Federal Bureau of Anti-Corruption (from 2010);
- public prosecution services;
- Central Public Prosecution Service for Fighting against Corruption (from 2009);
- criminal courts.

No central institution responsible for financial inspection bodies and prosecution institutions has been established, and the establishment of such an institution is not envisaged. The inspection bodies standing closer to the inspected field, both technically and organisationally, are considered more efficient. Information on significant inspection results related to both national and European budget expenditures is presented to the Federal Ministry of Finance.

Inspection can be initiated by the following bodies in the following ways.

Court of Auditors	Parliament, minister, Court of Auditors
Accounting Agency	Operating inspections: per institution Subsequent inspections: per institution
Internal audits at the ministries	Particular minister
Delinquency audit	Particular minister, per institution
Certification functions for EU funds	Per institution
Inspection functions for EU funds	Per institution
State inspection bodies	In the same way as the federation
Federal Service for Prevention and Fighting against Corruption	Per institution
Public prosecution services	Per institution
Central Public Prosecution Service for Fighting against Corruption	Per institution
(Criminal courts)	(Principle of accusation)

These bodies can undertake both *ex ante* and *ex post* inspections with the exception of paying agency inspections and inspections in case of delinquency.

5. Ongoing and/or future reforms

The first (2009) and second (2013) stages of the budgetary reform have already been outlined in Section 1. The ongoing development of the control systems will be based on the context of this reform.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

When a new government came into power after the 1999 elections, one of its top priorities was modernising federal government. This soon came to be called the ‘Copernicus reform’. The underlying philosophy was that citizens were not there to serve the administration; rather the reverse, the administration should be there to serve the citizens. In fact, the reform comes down to the introduction and application of the principles of corporate governance in the public sector with the aim of improving public sector performance. The reform had four key pillars: a new organisational structure; a new human resources (HR) policy; new working methods; and a new system of control.

As regards the organisational structure, the old ministries were replaced by horizontal and vertical federal government services. In addition, several programmatic public sector services were set up. The new HR policy involved seeking to create appealing working conditions by such measures as ensuring that salaries were aligned with market levels and working out personal development plans. Organisational processes were redesigned in business process reengineering (BPR) projects, with a focus on simplification and improved service.

Finally, the intention was that greater accountability would form the key element of a new management culture. The emphasis would shift from *ex ante* control to *ex post* control. As part of this, the managers were also expected to improve their own internal control systems.

With a view to the introduction of sound governance, a legal framework was created in 2002 for both the introduction of an internal control system and the extension of internal audit activities. It also arranged for the installation of audit committees in all federal and programmatic public sector services. However the implementation of these regulations did not really get off the ground as there was insufficient engagement, both at the political level and within the civil service.

A new attempt was made in 2007. Three new royal decrees were drawn up to replace the existing legal framework. In addition to the introduction of an internal control system and the organisation of internal audit activities, a separate decree also arranged for the creation of a single Audit Committee for the Federal Government (Auditcomité voor de Federale Overheid — ACFO).

However the change to the legislation still did not lead to an increase in momentum in practice, as the Court of Auditors also noticed. Instead, the turning point was the appointment of a Government Commissioner for the implementation of internal audits in the federal government in mid 2009. His assignment consisted of the following tasks: making a proposal for the process of

⁽¹⁾ Contributed by the Federal Ministry of Finance on 4 March 2011.

introducing internal audits; preparing and starting this introduction under supervision of the audit committee that was due to be set up; drawing up a timetable for this; and finally supervising the transition from *ex ante* control to *ex post* control in consultation with the Inspectorate of Finance. The Government Commissioner resigned in July 2010 following the early elections the previous month. His powers were taken over temporarily by the retiring Minister for the Budget until the government commission was abolished entirely at the end of 2010.

Even so, it was thanks to the Government Commissioner that the Audit Committee for the Federal Government was installed in April 2010. The presence of an independent body of this nature led to an increased awareness among management regarding organisational control. One consequence of the creation of the committee was that every manager had to provide a report to it within six months of the appointment of its members. This report had to detail the existing structures and evaluation mechanisms for internal control within the manager's organisation as well as providing a plan for the organisation of his/her internal audit activities. Another consequence was that henceforth all managers would have to provide the ACFO with an annual report on the performance of their internal control system and the improvements they are planning to make.

2. Public internal control environment

2.1. Codes of conduct and ethics

The federal public service Budget en Beheerscontrole (FOD B & B, budget and management control) includes the Bureau voor Ambtelijke Ethiek en Deontologie (agency for ethics and codes of conduct within the civil service). The agency is responsible for the development of the federal preventative integrity policy. As part of this, it draws up policy recommendations for the responsible minister/government as well as providing a support service for other government institutions.

2.2. Human resources management

The federal government has a database, the so-called 'federal map', that provides federal staff, HR departments and citizens with an overview of all jobs and classes of jobs within the federal administrative public service. This ensures that all members of staff have a picture of their own job and also clarifies the specific career opportunities. The job descriptions give a picture of the different responsibilities and the expectations concerning performance and skills.

2.3. Tax fraud

For some years, the government has had a state secretary for the coordination of fraud prevention as part of efforts to combat tax fraud. The state secretary has two duties — firstly, to improve collaboration between all the services involved (administrative organisations, monitoring bodies, the police and the judiciary) in the effort to combat tax and social fraud in the areas of prevention, detection, control, prosecution and punishment, and secondly to ensure uniform application of tax and social legislation.

2.4. Public sector accounting

The act of 22 May 2003 reformed government accounting, by arranging for the introduction of general accounts alongside the budgetary accounts. The general accounts are based on the principles of double-entry bookkeeping. The act also arranged for the transition from budgetary accounts on a cash basis to budgetary accounts on a transaction basis. This means that income and expenditure are entered into the accounts when the right is established rather than when the cash is actually paid or received. However, it was not until 2009 that implementation of the act started.

The provisions of the act are now gradually coming into effect as part of the rollout of the Fed-com project (see below). The intention is that all federal public services and federal government institutions should apply the act in its entirety from the 2012 financial year.

2.5. New information system for the management of the accounts (Fedcom project)

The Fedcom project is a federal project that aims to modernise government accounting. By the time the project is complete, the federal state will have three kinds of accounts. Firstly, there will be budgetary accounts to allow monitoring of the implementation of the state budget. Secondly, there will be general accounts, to some extent comparable to those in the private sector, to allow monitoring of changes in the portfolio (balance sheet) and the federal results (income and expenditure account). Finally, there will be analytical accounts to allow analysis of expenditure per cost centre. Items will be entered into the accounts on a transaction basis in accordance with the ESA 95 rules. The implementation of Fedcom in the federal and programmatic public sector services is taking place in stages over the period 2009–11 (the so-called 'rollouts').

One of the advantages of Fedcom is that it offers an opportunity to build in internal control mechanisms and the segregation of duties. One of the consequences is that the *ex ante* controls by the Court of Auditors will no longer take place (abolition of prior approval from the Court of Auditors) and it will only carry out *ex post* audits (legality, regularity, efficiency analyses and reliability of the institutions' internal control systems).



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3. Concept of public internal control

3.1. Managerial accountability/responsibility

There has been some increase in management awareness in the federal government institutions concerning internal control and internal audit since the installation of the ACFO in April 2010. Even so, there is still a great deal of suspicion among management regarding these principles of public sector governance, and much work will need to be done to arouse interest among both management and operational staff.

For instance, the installation of the ACFO meant that Article 20 of the Royal Decree of 17 August 2007 on establishing the ACFO came into effect. This article states that every manager must submit a report to the ACFO within six months of the initial appointment of the ACFO members, and that this report should deal with the existing structures and evaluation mechanisms for internal control within the manager's organisation and a plan for the organisation of his/her internal audit activities.

Besides this, there is also the Royal Decree of 17 August 2007, dealing with the internal control system within some services of the federal executive, which seeks to increase the sense of responsibility among management and to set conditions for improved risk management.

The scope of both the abovementioned royal decrees is, however, limited to 22 institutions; they therefore do not cover the entire federal executive. The regulations only apply to all the federal and programmatic public services and the services depending on them (16), the Ministry of Defence and five 'category A' public utility institutions.

The Royal Decree of 17 August 2007 concerning internal control systems explicitly states that the reference framework is COSO/INTOSAI. It also stipulates that every member of staff should contribute to the proper performance of the internal control system in a manner appropriate to their job.

Regarding the determination of an acceptable level of risk, a distinction is made between risks at the political policy level and risks at the policy level within the civil service. The acceptable level of risk for risks associated with objectives at the political policy level is determined by the minister in consultation with the manager. The manager determines the acceptable level of risk for risks at the policy level within the civil service, and informs his minister.

All managers should submit a report to the ACFO on 15 February of each year dealing with the performance of their internal control systems. They should also include in the report the improvements they wish to make in the year ahead. Regulations stipulate that the following subjects should be covered as a minimum: the tasks, objectives and resources of the public sector service; acknowledgement by the manager of their responsibility for the proper performance of the internal control system; the application of the general objectives for internal control to the service; a description and evaluation of the internal control system in accordance with COSO/INTOSAI; comments made by those responsible for the internal audit activities and the

external control bodies and the response to these comments; and finally a description of those structures and procedures for monitoring and evaluation of the internal control system that the manager used to gain knowledge of the quality of their internal control systems.

3.2. Internal audit

The existence of internal audit activities is legally enshrined in the Royal Decree of 17 August 2007 on the internal audit activities within some services of the federal executive. Here, too, the scope is limited to the 22 institutions mentioned above.

The regulations allow internal audit activities to be carried out in three different ways. There is the option of a permanent dedicated audit service within the institution, or a permanent shared audit service for a number of institutions or an external service. This last option involves the internal audit activities being carried out by a private firm or by an existing audit service, which may or may not be shared, within other institutions. The minister must make a final choice within three months of being informed by the ACFO of its guidelines. Nevertheless, information provided by the then government commission shows that, by mid 2010, 10 of the 22 institutions had either an 'internal audit service' or had designated a responsible party for the internal audit activities, without any statement being made as to the necessary qualifications for auditors.

The royal decree stipulates the basic mission for the internal audit activities. For example, the internal audit activities should be carried out using an independent, objective, systematic and methodological approach. The evaluation of the internal control system should form the basis for a dialogue between the internal audit service and management, and should result in recommendations for improvements to the internal control system. Those responsible are obliged by law to take this into account.

The internal audit activities are also subject to IIA standards. They should be evaluated at least once every five years by a competent, independent evaluator or team consisting of individuals who do not work for the institution in question.

The regulations state that the internal audit activities should cover all the objectives of the internal control system. The internal audit service must draw up a work programme, based on a risk analysis, and this programme should be approved by the ACFO. It is only after this that the manager is informed of the programme.

No auditors may officially take on any tasks that are the responsibility of the manager concerning the internal control system.

The assignment of the internal auditors, their rights and obligations and their position within the service should be specified in a charter, to be drawn up in consultation with the manager and which must be approved by the ACFO. The charter should also make arrangements for reporting and lay down the rules for disputes and confidentiality. It must also include a commitment from management that they will respect the independence of the internal auditors and will not take retaliatory measures against individuals who cooperate with the internal audit activities being carried out within the service.

The job description and the competency profile of the individual in charge of the internal audit activities should be submitted to the ACFO for advice prior to the manager's proposal to the minister. The ACFO's opinion is binding. The individual in charge of the internal audit activities may hold the position within the same service for only 12 years. He/she is subject to an evaluation by a member of the ACFO, the manager and the relevant minister. In contrast, the auditors carry out their job for periods of six years and may be reappointed.

3.2.1. Relations between the internal audit and the external audit

There are currently no official protocols or agreements between the internal audit services and the Court of Auditors.

The regulations mention the single audit principle. Specifically, the royal decree dealing with the internal audit activities specifies that for processes containing procedures that are subject to an external audit, the internal audit service can — following favourable advice from the ACFO — draw up protocols formalising arrangements for the coordination of tasks and the exchange of information.

It is likely that talks with the Court of Auditors concerning the single audit principle will gather momentum now that the ACFO has been installed. This is after all an area in which lessons can be learned from the regional experience. That is because the Flemish government's internal audit service has drawn up a memorandum of agreements with the Court of Auditors based on the single audit principle with the aim of avoiding overlap and duplication in audits and investigations. The then Chairman of the Flemish Audit Committee in charge when this protocol was concluded is now the Chairman of the ACFO. He can, therefore, use his experience and network for the purpose of agreements between the internal audit services and the Court of Auditors on a single audit at the federal level.

3.2.2. Audit boards or audit committees

The Royal Decree of 17 August 2007 on establishing the Audit Committee for the Federal Government (ACFO) arranges for the creation of a single audit committee for the abovementioned 22 institutions. The members were appointed by the Royal Decree of 21 February 2010, discussed in the Council of Ministers. The ACFO was officially installed on 2 April 2010.

The ACFO consists of seven independent members — four Dutch-speaking and three French-speaking. Together, they should have sufficient expertise in the areas of public sector activities, the budget cycle, ICT, public sector management, public law, internal control, strategic management and risk management. The members are appointed for a period of six years. They can be reappointed for one more term of office. The members appoint a chair from their midst.

To ensure their independence, the vacancies, rules and conditions were publicised in November 2009 through the press, the Internet and publication in the Belgian official gazette. Candidates were not allowed to be working as civil servants for any of the institutions covered by the audit committee. After all, such civil servants are internal members of the organisation to be audited and therefore by definition not independent.

At the time, setting up the ACFO was a top priority for the Government Commissioner as it is key to the expansion of internal audit activities. It should safeguard the independence of the internal audit activities and ensure their effectiveness and quality: an audit is not possible if you cannot report to an independent body.

The ACFO meets at least once a quarter. At least five members need to be present for resolutions to be valid. The members receive an attendance fee per meeting. This fee is reduced drastically from the seventh meeting onwards. The head of the Inspectorate of Finance (cf. below) attends meetings by law. He/she has an advisory role and no voting rights. The members subscribe to the international professional standards of the IIA.

The ACFO is accountable to the government and its individual members. It draws up two reports for this purpose each year on 31 July. One of these reports is for the individual ministers and relates to the service the minister in question is responsible for, and the other report is for the Council of Ministers. The reports aim to give the ministers and the government an overview of the state of affairs of the internal control systems within the institutions in question. The ACFO can request all the information necessary to produce these reports from the managers or individuals in charge of the internal audit activities.

Incidentally, the role of the ACFO is bolstered by the fact that its general duties have explicitly been specified in legislation. For example, the ACFO must inform the government of the reliability of the internal control systems within the institutions for the purpose of achieving the government's objectives. It must also warn the government if it thinks that the institutions are supplying incorrect or unreliable information that could lead to the government taking decisions based on wrong information.

In addition, the ACFO is currently working out the details of an audit charter and rules of procedure. The audit charter should contain the following elements: a list of the members with the start and end dates of their terms of office; designation of the chair and the person responsible for the ACFO's secretarial services; a list of the ACFO's responsibilities; the reporting regulations; and the acceptance of the confidentiality principle for communication between the individuals in charge of the internal audit activities and the ACFO.



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3.3. Coordination of public internal control

Article 6 of the Royal Decree of 17 August 2007 concerning the internal control system specifies that the FOD B & B will ensure methodological support for the expansion of internal control within the services involved. The FOD B & B can set up thematic interdepartmental networks on its own initiative and take charge of their coordination. It can also carry out consultancy assignments on request of the services involved.

Specifically, the Management Support department within the FOD B & B is charged with this task. This department actually consisted of only 2.8 full-time equivalent (FTE) staff at the start of 2011, but efforts are currently being made to increase this to six or seven FTEs in the course of the year. However, the FOD B & B notes that it is very difficult to find people with the right profile. One possible reason is the higher salaries in the private sector.

The Management Support department currently facilitates the 'internal control' network, an informal body. This initiative was originally started up by the then Government Commissioner in spring 2010 but has been in the capable hands of Management Support since the start of this year. The meeting frequency is fairly high, with an average of one meeting every one to two months. This means care needs to be taken not to produce an overload of information, especially as the implementation of an effective, satisfactory internal control system within the federal government is generally still in its infancy.

That is why every member of the network was asked to give an overview of their five biggest problems during the January 2011 meeting. The most frequently cited concerns were: sharing best practices; the practical implementation of internal control; getting management interested and how to deal with resistance; the need for a maturity matrix; and the procedures for the annual reports on the performance of the internal control system, the so-called Article 7 reports. The agendas for the following network meetings will be determined on the basis of these concerns. There will also be meetings at regular intervals to which the chair of the ACFO will be invited, giving the members the opportunity to ask him/her specific questions. This will help to bridge the gap between the ACFO and the members specifically involved in internal control, which should in turn enable them to take better account of the priorities the ACFO wishes to make.

The Management Support department focuses specifically on internal control. Despite its limited capacity, it carries out consultancy assignments throughout the federal government. It provides training for civil servants in the form of an 'internal control' course and gives talks when requested dealing with the added value of internal control.

There was one network meeting on the subject of internal audits in 2010. The initiative was put on hold so that it would not interfere with the ACFO's viewpoint memorandum then being developed. It was clear that the existence of two parallel circuits would be disastrous for the development of internal audits within the federal government.

It was decided following discussions between Management Support and the ACFO that the 'internal audit' network would be started up through the ACFO secretarial office. This will prevent any conflicts of interest between internal control and internal audit. However, the secretarial office would only take on this task temporarily. After all, the auditors will have to facilitate the network themselves once the internal audit services are up and running.

4. Financial inspection ⁽²⁾

The federal supervisory authorities, in particular the Council of Ministers and the Ministers for the Budget and the Civil Service, as well as the communities and regions (Article 51 of the Special Act of 16 January 1989 concerning the funding of the communities and regions) can call on the financial inspectors to carry out administrative and budget control.

The Inspectorate of Finance reports directly to the ministers/governments (communities, regions and executives). The financial inspectors do not have any hierarchical relationship with the ministers they are assigned to, or with the departments where they carry out their controls. The

⁽²⁾ This section was written by the Inspectorate of Finance.

independence of the financial inspectors is explicitly endorsed in the Act of 22 May 2003 for the organisation of the budget and the accounts of the federal state, just as in the abovementioned special act.

The financial inspectors are the advisors on budgetary and financial matters for the ministers to whom they are assigned. In addition, they function as controllers on behalf of and at the expense of the ministers who are responsible for the budget or administration. Finally, in cases of direct assignment of authority they are responsible for checking all operations planned by the authorising officers with the exception of minor operations or operations that are defined in such a way that there is no room for subjective interpretation by the authorising officer. They may also be instructed by the minister to whom they are assigned to carry out investigations at public sector institutions or private institutions subsidised by the public sector. The Inspectorate of Finance is also charged with screening European funds. This task is becoming increasingly important as time goes on.

The *ex ante* control (our primary task) concerns the following aspects: the budget, regularity, efficiency, effectiveness, economy and desirability.

In addition to those cases (draft resolutions) where control by the Inspectorate of Finance is mandatory (see above), any individual minister, the Minister for the Budget, the Minister for the Civil Service and the Council of Ministers can instruct the Inspectorate of Finance to carry out specific assignments (audits, investigations, specific audits, etc. — often *ex post*).

Ex ante/ex post: see above. The thresholds above which *ex ante* controls of public sector orders and allowances apply can be amended by joint agreement of the line minister and the Minister for the Budget. These thresholds can be raised in order to improve performance of the internal control system. For example, at the Ministry of Defence an *ex post* control based on sampling is used for cases between the current thresholds and the higher thresholds.

Recent federal regulations state that protocols will be concluded between the Minister for the Budget/Civil Service and the Audit Committee on the one hand and those responsible for the internal audit activities and the Inspectorate of Finance on the other hand to agree on formal conditions for the coordination of tasks and sharing information for the analysis of processes regarding public sector orders, the allocation of discretionary allowances and the hiring of contractual staff. The head of the Inspectorate of Finance attends the meetings of the Audit Committee by law in an advisory capacity.

5. Ongoing and/or future reforms

At present, no major reforms are planned in public administration reform (PAR) and PIC. Even so, a significant step can be expected to be taken in government reform at the federal level as soon as the new government has been formed (this concerns PAR). The ACFO's viewpoint memorandum could also be a factor setting off a process of reform (PAR and PIC).

With regard to PAR and PIC, reference can be made to the Fedcom project (see also Section 2.5), which is based on the new Government Accounting Act (act of 23 May 2003). The main changes involved are: the division of the accounts for expenditure and non-tax income into three categories, namely the budgetary accounts, the general accounts and the analytical accounts (instead of the single budgetary accounts); a transition from accounts on a cash basis to accounts on a transaction basis; no more credit transfers as there will no longer be non-split credits; and finally centralisation of all payments, which will take place through the central accounting officer (with the exception of petty cash).

Fedcom uses an enterprise resource planning (ERP) application, namely SAP, as the IT system for this three-part accounts system. The application is based on three end-to-end processes.

- From established right to cash management: this process covers revenue and cash management.
- From budget to report: this covers entering and monitoring the budget, the periodic closing of the accounts and the fixed assets.



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- From order to payment: this process covers government orders (including local purchases), specific purchases (expenses claims), subsidies and staff costs.

Finally, it is worth noting that certain services that used to operate more or less independently are now collaborating more closely with Fedcom, and that all roles are being identified and the necessary authorisations assigned.

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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

In line with the country's commitments undertaken during negotiations on Chapter 28 of the accession agreement, on financial control, Bulgaria has established a comprehensive PIFC system. In the period 2005–06 the government, through the Ministry of Finance, undertook new initiatives and actions related to carrying out major reforms in the field of financial control, in order to ensure sound financial management of public funds. On 16 June 2005, the Council of Ministers adopted a strategy for the development of PIFC. The strategy set out priority areas and particular implementation measures. The main priorities related to updating the PIFC model were: more detailed legal regulations on managerial accountability in the public sector; forming independent internal audit units in public sector organisations (decentralised internal audit model); establishing central harmonisation units under the Minister for Finance which coordinate and harmonise the financial management and control system and the PIFC system; and separating internal audits from financial inspections.

In order to implement these priority measures, legislative changes and changes to the existing administrative structures were made to form decentralised internal audits and central harmonisation units at the Ministry of Finance and the Public Financial Inspection Agency and for them to operate at their full capacity. In March 2008, the Council of Ministers adopted a strategy for the development of financial management and control and internal audit in Bulgaria for the period 2008–10. The priorities on which the strategy focused were: strengthening managerial accountability in public sector organisations; ensuring quality internal audits; confirming the coordinating and harmonising role of the central harmonisation units at the Ministry of Finance; and the efficient implementation of EU funds and programmes.

Throughout this period, reform of PIC was accompanied by the development of policies on public administration and budget expenditure management. The relevant legislative instruments were also amended, the main ones being the Administration Act (last amended in December 2010), the Unified Classifier of the Positions within the Administration and the State Budget Procedures Act (last amended in 2008). A Council of Ministers decree of August 2009 set up the Administrative Reform Council as an advisory body to the Council of Ministers, which was to coordinate government policy regarding general public administration management. A plan for the implementation of measures for the optimisation of public administration was also adopted. All these measures can be seen as aiming at improving the public sector control environment, which is one of the elements of the management and control systems.

⁽¹⁾ Contributed by the Ministry of Finance of Bulgaria on 16 March 2011.

The Ministry of Finance was the main driver of this reform during the entire period. The Minister for Finance is responsible for the coordination and harmonisation of internal control and internal audits, and performs these functions with the Internal Control Directorate. The Minister for Finance also chairs the Administrative Reform Council. The Public Financial Inspection Agency, the Audit of EU Funds Executive Agency, the Budget Directorate, the Treasury Directorate and the State Expenditures Directorate also report to the Minister for Finance.

2. Public internal control environment

In 2006, the National Assembly adopted the Financial Management and Control in the Public Sector Act (FMCPSA), the Public Sector Internal Audit Act (PSIAA) and the Public Financial Inspection Act (PFIA) to implement the 2005 strategy for the development of PIFC in Bulgaria. These acts clearly set out and differentiate the control-related responsibilities of managers of public organisations, internal auditors and public financial inspectors. In accordance with the FMCPSA, managers of public organisations are responsible for fulfilling the organisations' objectives by managing public funds in a legal, economical, efficient and effective way. To this end, they have an obligation to introduce adequate and effective financial management and control systems and to ensure the internal audit function. Secondary legislation has been adopted and enforced, such as decrees and regulations of the Council of Ministers and the Minister for Finance, including the Decree of the Council of Ministers on setting up the Internal Control Directorate, the Regulation of 2006 on information provision under the FMCPSA, the Decree of the Council of Ministers of 2006 on the adoption of internal audit standards in the public sector, the Regulation of 2009 of the Minister for Finance on specific audit activities under EU funds and programmes, the Regulation of 2011 on making external evaluations to ensure audit quality and the Regulation of 2006 of the Minister for Finance on the certification of public internal auditors.

The spending units' basic responsibility to establish and operate financial management and control systems, as well as to update and report on their state, is also set out in other acts applicable to the public sector, such as the State Budget Procedures Act, the Municipal Budgets Act and the Bulgarian National Bank Act, according to which the state budget is executed on a cash basis. The budget procedure from 2007 onwards includes drawing up draft budgets in a programme format. This involves the formulation of policies, programmes, objectives and activities and forms part of the implementation of managerial responsibility to determine the objectives of public organisations.

The current system, which forms an environment for the development of PIC, also includes activities carried out by the Public Financial Inspection (described in Section 4 below), the Audit of EU Funds Executive Agency (AA) and the National Audit Office. The AA performs the role of an audit body for programmes co-financed by the Structural Funds, the Cohesion Fund and the European Fisheries Fund. The AA performs system audits and audits on a sample basis, and issues closure declarations with regard to projects under the Instrument for Structural Policies for Pre-Accession (the Cohesion Fund), the Schengen instrument, the European Return Fund, the External Borders Fund, the EEA financial mechanism and other EU programmes. The agency performs the role of a certifying authority for the yearly certification of accounts under the Sapard programme. It also performs functions related to the implementation of cross-border cooperation programmes.

The National Audit Office controls implementation of the budget and other public funds and activities in accordance with the National Audit Office Act and internationally recognised auditing standards. The main duty of the National Audit Office is to control the reliability and veracity of the financial statements from budget-funded organisations and the legality, efficiency, effectiveness and economical management of public funds and activities, as well as to provide the National Assembly with reliable information concerning these elements. The National Audit Office performs its operations independently and reports to the National Assembly.

3. The concept of public internal control

The Bulgarian legislation and financial management and control practices have implemented the five interrelated components set out in the INTOSAI guidelines.

3.1. Managerial accountability/responsibility

Managerial accountability/responsibility is the foundation of PIC. In accordance with the law, internal control is established as an integral process of an organisation's activities and is carried out by the organisation's management and employees. Internal control consists of five interrelated components — control environment, risk management, control activities, information and communication systems and monitoring according to the law. The internal audit is a managerial tool for monitoring. The managers of organisations have an obligation to ensure the conditions for carrying out internal audits, in compliance with legislation in force.

The law imposes on the managers of organisations managerial responsibilities to meet objectives and to manage public funds in a legal, economical, efficient and effective way. While carrying out their responsibilities, managers must establish and constantly improve the financial management and control systems at the relevant organisation in line with the provisions of the law, the Ministry of Finance methodology, the specifics of the activity and the results from monitoring. The systems include policies and procedures which are to provide reasonable assurance that the organisation's objectives are being met. Managerial responsibility for sound financial management covers all structures, programmes, activities and processes within an organisation, including organisations which are lower-level spending units.

One of the important mechanisms for achieving sound financial management is to exercise preliminary control in all processes within an organisation. It is common practice for persons in managerial positions, or other employees in relevant specialised units of an organisation, to exercise preliminary control of activities specific to that organisation through internal coordination procedures. Financial controllers are appointed to carry out preliminary control of financial activities, or accounting personnel perform this function in addition to their normal duties.

In order to ensure that the accounting principles and procedures are properly implemented and that financial discipline is observed, a double signature system is applied to conclude contracts, incur expenses and issue orders for hiring employees or for sending them on business trips, etc. In such cases, financial responsibility is assumed and/or payment is made after the person in charge of accounting records and the organisation's manager (or a person authorised to order payments on behalf of the organisation) affix their signatures.

Managerial responsibility is legally delegated to politically elected persons such as ministers, mayors or other managers. According to Bulgarian law, ministers and mayors have administrative and budget powers — they appoint employees, conclude contracts and dispose of public funds. In some structures, senior administrative managers such as the directors of agencies and heads of commissions bear managerial responsibility. Chief secretaries carry out administrative and managerial activities assigned to them by managers. On the other hand, managers at lower levels of the organisation also have managerial responsibilities (e.g. all other senior employees such as directors of directorates and heads of departments). They are obliged by law to report to their seniors on the internal control established in the units and structures they manage.

Top managers are allowed to delegate managerial responsibilities to subordinate managers. Any such delegation does not relieve top managers of the responsibility for implementing the powers delegated. Therefore, top managers request periodic reporting on the implementation of delegated powers via direct communication with subordinate persons in managerial positions and lower-level officers.

- The directors of financial directorates are an important link in the internal control system. Usually they or their subordinates engage in budget planning, sign as a second signatory, propose and apply accounting policies and exercise preliminary control. Here, the principle of division of responsibility is applied.
- One of the main responsibilities of the managers within their powers is to determine objectives together with the responsibility for identifying risks and establishing effective control systems. The drawing up of programme budgets includes a clear definition of the organisation's objectives and the criteria for meeting them.
- The objectives of the internal control system include achieving a reasonable assurance that the activities comply with the law, internal regulations and contracts (legality), as well as a reasonable assurance of the reliability and comprehensiveness of financial and operational



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information, effective, efficient and economical operations and the protection of assets and information.

- The reporting system is laid down in a regulation adopted by the Council of Ministers. The form, contents, rules and deadlines for the provision of information are standardised. As a rule, such information includes managers' evaluations of the general state of the management and control systems, measures undertaken to develop and improve them and the elements in need of development and improvement. Each year the Internal Control Directorate at the Ministry of Finance draws up/updates a questionnaire with reporting instructions, which is adopted by the minister and forwarded to the managers. The managers (ministers, mayors and managers of other organisations) provide information annually about the state of financial management and control, and the internal audit activities for the previous year, by answering the questionnaire and drawing up an annual report on the state of financial management and control. The report has an additional part where the internal audit unit gives its opinion on the information contained in the report. By signing this report, the managers ascertain and assume responsibility for the adequacy and efficiency of the systems set up in the organisations they manage. Moreover, they sign the annual financial statements in their capacity as first-level spending units. The Minister for Finance imposes fines for failure to meet this obligation for annual reporting within the set deadlines. The information obtained from the annual reports and the questionnaire is summarised in a consolidated report, which is then adopted by the Council of Ministers and submitted to the National Assembly.

3.2. Internal audit

The Public Sector Internal Audit Act (PSIAA) and internal audit standards in the public sector ('standards') regulate internal audit activity in the public sector. The PSIAA is in line with the International Standards for the Professional Practice of Internal Auditing of the Institute of Internal Auditors (the IIA), and the Committee of Sponsoring Organisations (COSO's) 'Internal Control — Integrated Framework' ('the COSO framework'). The standards correspond to the international standards for the professional practice of internal auditing as stipulated by the PSIAA.

The Bulgarian legal definition of public sector internal audit has adopted the IIA's internationally recognised definition. The internal audit tasks are defined in compliance with the main requirement for this activity — to help the organisation to accomplish its objectives. These tasks include the identification and evaluation of risks, the evaluation of the adequacy and efficiency of the financial management and control systems and issuing recommendations on the improvement of the organisation's operations. The law provides for the broadest possible scope of internal audit implementation. It covers all structures, programmes, activities and processes within an organisation. In order to ensure maximum audit coverage, the latest amendment to the PSIAA stipulates that the audit unit of an organisation shall also cover the trading companies of that organisation where no such audit unit has been formed independently. In performing their duties, internal auditors have the right of access to all the organisation's employees, assets and information.

The internal audit activity is carried out by an internal audit unit, which comprises a manager and internal auditors. These persons report directly to the manager of the organisation for which they work. The manager of the organisation bears the responsibility for ensuring the independence of the internal auditors when planning, carrying out and reporting on the internal audit results. The appointment or dismissal of the head of internal audit is carried out by sanction of the minister.

The internal audit unit reports directly to the manager of the organisation, which ensures the internal audit's functional and organisational independence. The law also sets out the minimum internal audit areas on which the internal audit unit is to report to the manager of the organisation and, if such exists, the audit committee.

The law and the standards set out a requirement whereby the internal audit manager draws up the statutes of the internal audit unit, which should be approved by the manager of the organisation and, if such exists, the audit committee. This document gives details of the objectives, pow-

ers and responsibilities of the internal audit. In drawing up the statutes, the internal auditors use 'the guidelines for drawing up statutes of the internal audit unit', which are part of the methodology for internal audit in the public sector adopted by the Minister for Finance.

In order to ensure the independence and objectivity of the internal auditors, the manager of the organisation may not assign them functions and duties that are beyond the scope of the internal audit. The internal auditors may not take audit assignments for assurance concerning activities and structures which they have consulted for or worked on over the past one-year period. The internal auditors are to notify the manager of the internal audit of any such circumstances. The auditors must also notify the manager of any actual or suspected conflict of interest or partiality.

Maintaining and developing professional knowledge and skills is a requirement laid down in legislation and further detailed in the methodology for internal audit. Each internal audit manager draws up an annual plan for the professional training and development of the auditors, in order to maintain audit personnel with sufficient knowledge, skills, experience and professional qualifications. The manager of the organisation approves the plan. The methodology for internal audit stresses the importance of the continuous training of auditors and the need to keep them informed about innovations and improvements in the ongoing development of this profession. The main problem in recent years has been insufficient financial resources to satisfy training needs. The Internal Audit Directorate (CHUIA and CHUFMC) at the Ministry of Finance coordinates and supports internal audit training. The directorates draw up an annual training programme for internal auditors in the public sector, conducted by employees of the directorate.

Only people holding a certificate for internal audit in the public sector issued by the Minister for Finance, or an internationally recognised certificate of internal auditing, can carry out internal audits in the public sector. The certificate is awarded after passing a written test. The tests have been conducted since 2006 and, to date, 1 226 people have obtained the national certificate. The Internal Audit Directorate is in charge of organising preparatory courses and conducting these tests. According to the law, internal audits are carried out through audit assignments for assurance and audit assignments for consultancy. Audit assignments for assurance account for the biggest share (in 2009, they accounted for 70 % of all assignments). The types of audits applied are traditionally regulated and recognised by international standards. The focus is on system audits. There is a more general methodology for carrying out performance audits, compliance audits and IT audits. The internal auditors also perform audit assignments for consultancy according to a developed methodology. The number of performed audit assignments for consultancy is growing constantly: in 2008 and 2009, they doubled in number. This indicates a greater trust by managers of public sector organisations in internal auditors.

The PSIAA, the standards and the methodology set out the provisions for follow-up activities related to monitoring the implementation of the recommendations given in the audit assignments. The approach and particular checks of the implementation of the recommendations are determined in the strategic and annual plans of the internal audit unit. The internal auditors assess the adequacy, efficiency and timeliness of the actions taken. The recommendations are followed up based on written information about the state of their implementation and by carrying out checks. It is done either as a part of another audit assignment or as a separate assignment. The methodology points out that obtaining written information is not enough to provide assurance that the actions taken have been effective. Assurance can only be provided through an organised audit assignment (either separately or as a part of another assignment).

The internal auditors are obliged to report immediately to the manager of the organisation whenever indications of fraud or irregularities are identified. They also make proposals for taking steps and notifying the competent authorities. If the manager of the organisation fails to take any steps within 14 days of notification, the internal audit unit notifies the competent authorities and, if such exists, the audit committee.

The PSIAA and the Public Financial Inspection Act were adopted in 2006, and institutionally and functionally separated the internal audit activities from the financial inspection activities. The financial inspection is structured as an agency under the Minister for Finance. It carries out checks when alerted or upon assignment by other public authorities, applies investigating methods and imposes sanctions. Its activities are outlined in more detail in Section 4.



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A cooperation agreement between the Minister for Finance and the head of the National Audit Office was signed in 2006. The main objectives of this agreement are to coordinate actions for improving the management of public funds and to combine efforts to establish adequate and effective internal control. Both institutions also work together by sharing professional experience, conducting training, drawing up and exchanging methodologies and providing information about scheduled audits of EU funds and programmes, and about identified problems of the financial management and control systems. The internal auditors and the auditors from the National Audit Office work together and exchange information when carrying out individual audits.

The PSIAA sets up the possibility for forming audit committees. The committee members need to meet certain education and professional experience criteria. The functions of the audit committee are to: support the internal audit unit by expressing an opinion on the internal audit unit's statute and its activity plans; review the annual report on the internal audit's activities; and express their opinion on it and on all significant internal audit-related issues. In practice, very few public sector organisations have formed an audit committee under the PSIAA. The reason for this is that internal audit is at an early stage of its development and managers do not fully appreciate the relevance of audit committees because of the numerous structures and units within public sector organisations (working groups, risk management committees, advisory councils, etc).

3.3. Coordination of public internal control

The Minister for Finance is responsible for the coordination and harmonisation of the financial management and control and the internal audit activities within public sector organisations. The execution of these duties started in 2004, when the Budget Control Methodology Department was established within the Treasury Directorate of the Ministry of Finance, as well as the Audit Activity Harmonisation and Methodology Directorate within the Public Financial Inspection Agency. In 2005, a decision was made to establish a special Internal Control Directorate in the Ministry of Finance, which was to report directly to the Minister for Finance. The directorate has two central harmonisation units — a financial management and control unit and an internal control unit. The directorate's main duty is to coordinate and harmonise the application of laws regulating financial management and control and internal audit in the public sector in line with applicable EU regulations and good practices in the field. The directorate is engaged in drawing up and updating a methodology for financial management and control and internal audit, monitoring the application of the legislation and methodology by ministries and municipalities, coordinating and summarising the internal audit units' plans for audit assignments under EU funds and programmes, supporting professional training in financial management and control and internal audit, organising examinations for obtaining the national internal audit certificate and maintaining a database of internal auditors.

As previously mentioned in Sections 3.1 and 3.2, the managers of public sector organisations submit to the Minister for Finance annual reports on the functioning, adequacy, efficiency and effectiveness of the financial management and control systems and the internal audit activities. The Internal Control Directorate analyses the information submitted and draws up draft annual reports on the state of financial management and control and internal audit. These reports are then included in the consolidated report on the internal audit in the public sector. The Minister for Finance is obliged by law to draw up these reports. The consolidated report is submitted to the Council of Ministers for approval and then forwarded to the National Assembly and the National Audit Office. The report is also published on the Ministry of Finance's website.

The part of the consolidated report containing conclusions and guidelines for the development of financial management and control and internal audit allows for legislative initiatives to be made by members of the parliament and the Council of Ministers. The information contained in the report is used by the managers of organisations and of internal audit units in the public sector to improve their financial management and control systems and internal audit activities. The Central Harmonisation Unit of Internal Control and the Central Harmonisation Unit of Financial Management and Control use the summarised data to develop the methodology, as well as to prepare comments and clarifications on particular issues, to make the training programmes, etc.

4. Financial inspection

The Public Financial Inspection Act regulates public financial inspection. It is carried out by the Public Financial Inspection Agency (PFIA), which is an administration body under the Minister for Finance — a legal entity funded by the budget. The main duty of public financial inspection is to protect public financial interests by:

- carrying out *ex post* financial inspections on the compliance with the regulations on budget, financial, economic or reporting activities of spending units, commercial companies partly owned by the state and other entities;
- identifying violations of the regulations on budget, financial, economic or reporting activities and indications of fraud;
- identifying violations of the regulations on public procurements;
- detecting damage caused;
- identifying fraud/irregularities affecting the interests of the European Communities;
- seeking administrative-penal and financial liability from guilty parties in cases stipulated by law.

The PFIA also checks public procurement contracting authorities which are not subject to financial inspection. The PFIA presents an annual report on its activity, which the Minister for Finance submits to the Council of Ministers. Since 2008, the PFIA has assumed the important duty of giving assistance to Commission inspectors in carrying out on-the-spot checks and inspections pursuant to Council Regulation (Euratom, EC) No 2185/96 in cases where a person under inspection resists granting access to their premises and/or allowing documents to be inspected.

The PFIA interacts and exchanges information with the prosecuting authorities, the Ministry of the Interior, the National Audit Office, the Public Procurement Agency and other public authorities, based on signed agreements. Public financial inspection is carried out in: budget organisations; commercial companies partly owned by the state or municipality which has a blocking minority; other legal entities in which the state or municipality has a direct or indirect share; and state aid beneficiary entities financed by the state budget or municipal budgets, extra-budgetary accounts or funds under international agreements or EU programmes.

The activities of the PFIA are not scheduled. Financial inspections are carried out: upon requests, complaints or reports of violations from public authorities, individuals or legal entities; to inspect procedures for the award and execution of public procurements based on information from the public procurement register, the Public Procurement Agency and the National Audit Office; to verify the disbursement of state aid and targeted grants awarded to Bulgaria under the State Budget Act in the relevant year; upon request from the Council of Ministers or the Minister for Finance; upon request from the prosecuting authorities under the Judicial System Act; and upon reports of irregularities affecting the financial interests of the European Communities identified by the AFCOS Directorate at the Ministry of Interior. Following the recommendations made in the European Commission's report of July 2010 on strengthening the follow-up control of the implementation of public procurement regulations exercised by the PFIA, the PFIA will be amended to introduce system control based on risk assessment, in order to improve the efficiency of the protection of public financial interests.

5. Ongoing and/or future reforms

A national reform programme for the period 2010–13 implementing the Europe 2020 strategy has been adopted. The programme addresses priority issues by rendering an account of the current, immediate needs and challenges facing the economy. To speed up recovery from the economic crisis, the government is focusing on redirecting policy towards increasing competitiveness. The national reform programme has set priority areas for economic policy, such as improving the business environment and infrastructure to attract investment and increasing trust in public institutions. The economic policy measures envisaged in these priority areas are aimed at overcoming existing impediments to economic growth by: improving the efficiency of public spending and allocating public funds to activities that increase the economy's growth



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potential; providing for a functional and stable financial sector; improving administrative effectiveness, including improvement of administrative regulation and decreasing administrative burden, increasing the efficiency of administrative service and reinforcing administrative capacity; and using the delegated budget instrument in the education system, strengthening managerial responsibility of the managers in that field.

At the beginning of 2010, the Administrative Reform Council, chaired by the Deputy Prime Minister and the Minister for Finance, decided to start an initiative to establish an up-to-date public administration by modernising its organisation, improving access to it, increasing public service quality and optimising public spending. As a result, in July 2010, the Council of Ministers adopted a plan for the implementation of measures to optimise public administration. The plan envisages particular measures in three areas: optimising operations; improving the effectiveness and efficiency of administrative structures; and reducing administrative structures. Administrative structures have already been optimised and their number reduced by 7.8 %. The number of employees has been reduced by 12.6 % and costs have been cut. The medium-term plan is to intensify the modernisation and reform process taking place in the administration, along with the improvement of the management and control systems.

Internal control reform, which started in 2005, requires constant efforts to ensure its effective functioning. The priorities and particular measures to achieve this objective are set out in a strategy for the development of financial management and control and internal audit. Such a strategy for the period 2008–10 has already been adopted by the Council of Ministers and reported on. A new strategy will be drawn up to include the undertaking of new measures for reinforcing managerial responsibility/accountability, increasing the quality of internal audit in the public sector and strengthening the position of central harmonisation units. These measures should more actively engage the managers of organisations with risk management and thus it is necessary for them to deepen their knowledge of the financial management and control systems. As regards internal audit, one of the measures envisages carrying out external assessment for quality assurance, something which is new to internal audit in the public sector. As regards the central harmonisation units, actions will be imposed to ensure efficient coordination between external and internal audits, to draw up an additional methodology for financial management and control and internal audit and to include new and more practical training modules.



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Public internal control (1)

1. Brief history of the public internal control (PIC) system

The financial control system of the public sector comprises two layers of controls: external controls which are carried out by the National Audit Office and internal controls which are mainly carried out by line ministries, the treasury and the Internal Audit Service.

The budget is prepared by the Ministry of Finance on an annual basis and becomes law once it is approved by the parliament. The development budget used to be prepared and monitored by the Planning Bureau until 2007; however following a reform of the national procedures, which was initiated by the Minister for Finance, the whole budget process (including both development and operational expenditure) is now carried out under the responsibility of the Ministry of Finance. In addition, since 2009 the budget has been prepared on a three-year basis.

The responsibility for managing and supervising all financial operations in respect of money paid or received lies with the Accountant General (head of the treasury). The Accountant General and the Deputy Accountant General are appointed by the President of the republic and their role in terms of managing and supervising all accounting operations stems from the constitution. All treasury staff are hired by the Public Service Commission and thereafter the treasury assumes responsibility for their training and professional development. The operation of the accounting function is explained in detail in Section 3.1. It is worth noting, however, that the Republic of Cyprus, which was established in 1960, 'inherited' quite a robust accounting system from the UK, which was subsequently further developed and built on. The existing 'Law for the management of revenues and expenditure and of the accounting system of the republic and other related matters' was established in 2002, and in 2004 the treasury set in operation an automated financial reporting system, following an initiative of the Accountant General. In the context of this initiative to modernise and automate the work of the treasury, all accounting and financial procedures and instructions were reviewed at the time.

Internal auditing is carried out by the Internal Audit Service. This is headed by the Commissioner of Internal Audit, who is an independent state official. The internal audit function was a separate directorate within the treasury until 2003. At that time, and following the enhanced role that the directorate had to assume due to the accession of Cyprus to the EU, it was decided that it should become an independent office.

There are 11 line ministries, each of which is organised in departments and/or directorates in accordance with its objectives and needs and sets out procedures and controls (other than financial controls, which as mentioned above are set out by the treasury on a horizontal basis) to serve the public and carry out its day-to-day activities. All public servants except police, army and educa-

(1) Contributed by the treasury of the Republic of Cyprus on 14 June 2011.

tion staff are hired by the Public Service Commission, based on the approved organisation chart of each ministry appearing in the budget law. Ministries assume the responsibility to adequately train their staff in accordance with their needs.

Cyprus operates an academy of public administration which aims to assist in the development of the managerial capacity and the modernisation of the public sector by offering training seminars to public servants.

2. Public internal control environment

The PIC environment in Cyprus is characterised by a tightly controlled centralised approach. The key player in the PIC system is the treasury, the other actors being the Ministry of Finance, the Internal Audit Service and the 'controlling officers' who are located at each ministry/department.

The treasury is responsible for ensuring rational financial administration, paying all obligations of the republic, maintaining a sound financial management framework, servicing the public debt, providing the regulatory framework for public procurement across the government and delivering timely and accurate financial information. The Ministry of Finance mainly assumes the responsibility for preparing the annual budget, handling domestic and international economic affairs and taxation issues and managing the national debt. The Internal Audit Service operates independently of the line ministries and reports to the Internal Audit Board.

It is worth mentioning that the National Audit Office is responsible for auditing financial transactions and procedures on an *ex post* basis.

The national budget is prepared on an annual basis on a line-by-line basis by the Ministry of Finance. At the same time an indicative budget for each of the two following years is prepared. The budgetary process is based upon historical data, the level of current spending and each year's financial targets. The development budget is prepared on the basis of the existing and any new mature projects.

The budget is submitted to the Council of Ministers by the Minister for Finance and when approved it is submitted to the parliament. The parliament can vote for the budget, in which case it becomes law. The parliament may reduce or vote against certain budget items but it cannot increase the budget for any line.

Once the budget is approved by the parliament it becomes law and it stipulates the categories and lines of expenditure and the amounts that each ministry/department is allowed to spend for the next financial year. The budget for the two years following the next financial year is indicative. In accordance with the budget law, certain specified officials, the 'controlling officers' (permanent secretaries or directors of departments) are responsible for authorising the expenditure of each ministry/department. The approved budget is entered into the accounting system and no payments can be made in excess of the budget, unless an additional budget is approved by the parliament or a transfer between items is approved by the Minister for Finance. It is noted that every payment/transaction must be approved by the responsible 'controlling officer' or his/her authorised representative before it is processed and posted to the accounting system.

In order to secure and control the accounting activities and to provide timely and accurate financial information within a financially sound environment, the treasury operates various electronic systems covering the whole spectrum of its activities such as payroll and servicing of public debt. All transactions are recorded in a centralised reporting system which is administered by the treasury as far as access levels and user profiles are concerned.

It is noted that all accounting staff are appointed by the Accountant General and given access to the accounting system accordingly. All transactions are recorded on a cash basis, in a two-step process i.e. first submitting and then finalising accounting entries. All staff involved in the processes of paying or receiving money on behalf of the government follow binding instructions which are issued by the Accountant General in the form of circulars.

The Internal Audit Service prepares and implements an annual audit plan. All findings and suggested corrective actions are communicated and discussed with the auditees and agreed action

plans are usually set up and monitored. More details about the Internal Audit Service are explained in Section 3.

External audit is carried out by the Auditor General, an independent official appointed by the President. Audit activities cover both the financial and the operational activities of the government. Audit findings are communicated to all the auditees (ministries and departments) for their comments and implementation of the relevant suggestions. An audit report covering all ministries is compiled on an annual basis and submitted to the President.

3. The concept of public internal control

3.1. Managerial accountability/responsibility

Managerial accountability refers to the totality of operations of a ministry/department and is not restricted to the role of financial services. It is an integral part of the wider scope of internal governance.

The control environment is characterised by strict procedures for the approval and execution of expenditure in accordance with the annual national budget. The budget cannot be overspent without prior approval by the parliament. The procedures for public procurement, approval and payment of expenditure are uniform across the whole government and are governed by relevant laws, regulations and instructions which are issued by the treasury. It is noted that the treasury is the competent authority for both public procurement and financial management (handled by separate directorates) and all accounting departments within the government are headed by treasury staff.

Control activities in relation to approving and executing payments are standardised across the government and are overviewed by accounting staff. Standardised forms, electronic and manual, are used for documenting and processing the approval and execution of all payments. Staff who authorise and execute payments are well aware of the relevant regulations and procedures and the treasury delivers training seminars based on a needs assessment to ensure and enhance awareness and efficiency of implementation.

Public procurement procedures are governed by national laws (harmonised with the EU directives) and detailed regulations issued by the treasury. Training seminars are provided from time to time to staff involved in procurement and an electronic system has been operating since 2009, providing for electronic submission, appraisal and evaluation of tenders.

Control activities relating to other aspects of public administration are established and initiated by each ministry/department in accordance with their daily operations. The level of such controls varies from department to department and depends on the management of each department.

As far as risk management and assessment is concerned, there is no unified methodology or guidelines. Assessments are performed at the level and at the initiative of each ministry/department. The degree of detail and the quality of risk assessments varies within the various departments.

Day-to-day communication with the public and other ministries/departments is performed in a uniform way, as prescribed by national rules applicable to the whole government. There are also detailed rules for processing and archiving incoming and outgoing mail. Each ministry issues an annual report within three months of the year end, presenting activities performed and targets achieved during the previous year. Annual reports are submitted to the Council of Ministers.

An annual financial report is issued by the Accountant General presenting the financial results for the year on a cash basis and the implementation of the budget as at the year end. The report is submitted to the Council of Ministers and the parliament and is available to the public. The treasury is currently reviewing the contents and presentation of the annual report with a view to providing financial information to potential users in accordance with international public sector accounting standards.



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There is no national legislation providing for internal control units at ministerial or departmental level. However, certain ministries have created such control units on their own initiative. The nature, extent and detail of the control activities performed by these units varies from ministry to ministry and is governed by internal rules and procedures.

As noted above, all guidance, procedures and controls relating to financial, accounting and procurement aspects of public administration are provided for by the treasury, whereas other internal controls relating to the performance of day-to-day work of the line ministries fall under the responsibility of their top administrative managers. Decisions relating to policy development are taken by the Council of Ministers and each minister is responsible for implementing the policy at ministerial level.

The decision power as far as authorising expenditure lies with the 'controlling officers' (top administrative managers) who are appointed by the annual budget law. Controlling officers are personally responsible for approving all transactions relating to their ministry/department. Responsibility can be delegated, and it usually is, to senior officials within the same organisation. The top management of each ministry/department is responsible, though supported by accounting staff, for the preparation of the budget within the constraints set out by the Ministry of Finance. The annual budget is negotiated and approved by the Ministry of Finance before being submitted to the Council of Ministers. Ministers are responsible for the effectiveness and results of the policies adopted.

3.2. Internal audit

The Internal Audit Service (IAS), an independent service headed by the Commissioner of Internal Audit, assumes the responsibility for carrying out assurance and consulting activities. The activities of this service are governed by the Law on Internal Audit of 2003. It is noted that before 2003, internal audit activities were carried out by a separate section of the treasury headed by the Accountant General. However, due to independence issues arising from the role of the Internal Audit Service in relation to the administration of the programmes co-financed by the EU Structural Funds, as well as the need for the development of internal audit as an essential component of a system of budgetary control, it was decided to form a new independent IAS in order to undertake the audit of European funds in Cyprus (the facilitator of the European Commission) and the operation of internal audit in the public service under the control of the republic (the consultant of the public sector).

It is noted that certain ministries or departments have established internal audit/control functions which operate independently from the Internal Audit Service and report to the ministry/department top managers. These services do not have a uniform structure or methodology.

The Commissioner of Internal Audit is appointed by the Council of Ministers for a period of six years and reports to the Internal Audit Board. The Commissioner is responsible in accordance with the provisions of the relevant law for:

- examining and evaluating the adequacy and effectiveness of internal control systems;
- examining and evaluating the systems that have been set to ensure compliance with policies, procedures, legal obligations and regulations;
- examining and evaluating the measures taken for the management of liabilities and safeguarding of assets and the verification of their existence;
- examining and evaluating the economy, efficiency and effectiveness of the various activities and procedures;
- examining the operation of programmes, plans and activities to ensure that their results are in accordance with the targets set and the operations are executed as planned;
- evaluating the adequacy of management and control systems;
- providing advice on the appropriateness of internal control systems and on other accounting and operational issues;
- evaluating the credibility, relativity and integrity of the financial and operational information;

- conducting special investigations and audits on any subject that affects the integrity, loss of revenue, interests and operational effectiveness of the public service;
- evaluating the quality of decision-making processes and of the information environment; and
- performing any other task within the scope of internal audit.

Upon the completion of each audit, an audit report is prepared which includes details of audit findings and recommendations covering measures to be taken by the auditee to address weaknesses identified. Once the contents of the report have been discussed and agreed with the auditee, an agreed action plan is prepared which includes details of recommendations as well as an implementation timetable. Based on these timetables, follow-up audits are carried out, thereby monitoring the implementation of corrective measures, and their results are communicated to the Internal Audit Board.

The officers employed at the IAS are members of the civil service and are appointed by the Public Service Commission (in accordance with the Public Service Law). The IAS staff possess many specialisations and qualifications and include professional accountants who, as far as training is concerned, comply with the requirements of the international and national institutes of which they are members. Recently, the IAS has been staffed with officers with qualifications in mechanical, civil and electrical engineering.

3.2.1. Internal audit relations with external audit

The Internal Audit Service operates independently from the Audit Office, which is headed by the Auditor General. Internal Audit reports are always communicated to the National Audit Office. The findings of the audit service are taken into account when preparing the annual audit plan and there may be an exchange of views in certain cases, however there is no other interaction with the audit function.

3.2.2. Internal Audit Board

The Internal Audit Board, to which the Commissioner of Internal Audit is accountable, is appointed by the Council of Ministers for a term of three years and its responsibilities are set out by the Law on Internal Audit of 2003. It is chaired by the Minister for Finance and is made up of two other ministers, the Accountant General and an experienced professional from the private sector. The Commissioner of Internal Audit is obliged to submit an annual report within six months of each year end to the Internal Audit Board, describing the activities performed by the service during the year.

The board is responsible for:

- safeguarding the independence of the Internal Audit Service;
- observing the results of the Internal Audit Service and informing the Council of Ministers accordingly;
- suggesting measures to the Council of Ministers for the strengthening of the internal audit function in the public sector;
- monitoring the quality of the work of the Internal Audit Service and making suggestions for its improvement;
- getting information on the response of the management of the audited organisations to the issues raised by the Internal Audit Service;
- requesting the management of the audited organisations to provide explanations if they do not respond to their obligations towards the Internal Audit Service;
- receiving the annual internal audit plan and the strategic plan of the Internal Audit Service; and
- deciding on the distribution of the annual internal audit report.



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3.3. Coordination of public internal control

As far as financial management is concerned, harmonisation and coordination of procedures is achieved through the guidelines and circulars issued by the treasury, being the competent authority, as explained above.

Internal audit activities are performed by the Internal Audit Service across the whole government and there is no need for coordination with any other body.

Ad hoc assessments and peer reviews may be carried out on the initiative of certain departments/ministries by professional (sometimes international) organisations and their findings are submitted to the top management of the ministry/department for adoption of relevant corrective action.

4. Financial inspection

There is no dedicated office responsible for financial inspections as such. The Council of Ministers and top managers of ministries/departments can appoint 'investigating officers' for specific suspected cases of fraud or mismanagement and based on the outcome of the investigation may pursue disciplinary action. Such investigations may also be carried out by the Auditor General on his/her own initiative, or by order of the President.

In a broader context, certain investigations concerning the functioning of public services are carried out by the Commissioner of Administration (Ombudsman) on his/her own initiative, following complaints submitted by individual citizens.

5. Ongoing and/or future reforms

The treasury is currently in the process of reviewing the existing law relating to the management of revenues and expenditure and the accounting and financial instructions with a view to modernising them and providing more relevant and targeted guidance to the users.

In addition, the treasury is in the process of purchasing an enterprise resource planning (ERP) system to replace the existing accounting software. It is also contemplating, although in a longer-term horizon, a move from cash-based to accruals-based accounting.

A new unit was recently created (in 2011) within the treasury to assume responsibility, among other functions, for reviewing and refining staff training and professional development, accounting procedures and methodology.

The Ministry of Finance is considering the adoption of a programme-based approach for preparing the budget, although no final decisions have yet been made.



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Public internal control (1)

1. Brief history of the public internal control (PIC) system

The basic government policy document for developing PIC is the 2005 concept paper on financial control systems ('government concept'). This policy is based on the conclusions of Chapter 28 of the accession negotiations on financial control and on other chapters. It takes into account the recommendations of SIGMA in 2003 that the government should further develop the three pillars of PIFC, providing assurance that the administration of public funds is adequate and trustworthy. These elements are a financial management and control (FMC) system, a system of internal audit (IA) and the central harmonisation/coordination of both these systems.

These pillars, which were implemented and maintained in accordance with internationally accepted standards ('standards') and proven good practice in Europe ('good practice'), should lead to economy, efficiency and effectiveness in the use of public resources. At the same time, these pillars should help prevent errors and irregularities and as a consequence also avoid extra costs to the public budget.

The legal framework of PIC in the Czech Republic is to be found in the key procedures for the authorities and public sector organisations in dealing with public budgets, accounting and the internal control systems. After the Czech accession to the EU, legal instruments of the European Commission that are directly applicable have become part of this framework — in particular, the requirements of Article 280 of the Treaty establishing the European Community, the requirements of the Financial Regulation applicable to the European Community and the relevant recommendations of the European Court of Auditors.

PIC is institutionally organised by central, provincial and municipal authorities and other public organisations on the basis of the Financial Control Act. The information in this report is limited to PIC in key ministries such as the key state budget chapter administrators ('chapter administrators'). The Ministry of Finance is the central administrative body responsible for PIC coordination.

2. Public internal control environment

One of the government's main objectives is a rigorous implementation to consolidate the public budgets in order to achieve a general government deficit limited to 3 % of GDP by 2013. To meet this objective, it established measures of a legal, organisational and operational nature to be implemented.

(1) Contributed by the Ministry of Finance on 31 May 2011.

Unlike before, multiannual expenditure projections have been introduced as the binding method for budgeting in government spending. They are the key instrument for financial management.

The main characteristic determining the PIC environment is the established system of state accounting. In 2007, an accounting reform took place during which the government approved re-defined basic principles of state accounting. One of the first outputs (according to the conceptual framework) is to change the current method of accounting and the compilation of an accounts sheet and a financial report. A package of legal, technical and other tools now determines the central system of state accounting information. Its purpose is to provide timely, complete and accurate information on the financial and asset situation in each entity (the authorities and organisations in the public sector). This means that aggregated and consolidated information on the state economic situation as a whole will be available, not only on a cash basis, but also on an accrual basis in a proper combination. Ongoing monitoring and surveillance of progress within the accounting entities and at state level — with regard to each phase of financial reform — should therefore be the fundamental condition for the successful management of all new obligations and rules. The recently introduced accrual accounting principle is crucial for managing the state budget as well as for PIFC and for financial policy.

External audit (EA) is another key element of good governance. Its main task is to provide independent and objective assurance on the reliability of the accounts, on the legality and regularity of financial transactions and on following conventions of sound financial management, especially by the chapter administrators and accounting entities under the responsibility of these administrators and the state as a whole. The supreme audit institution (SAI) fulfils this task. The SAI acts on the basis of international standards of auditing when verifying the completeness and accuracy of state budget chapters' accounts, the state closing account and in other audit activities. The current national legislation doesn't regulate these questions associated with the external auditor. However, the SAI is preparing to extend its scope to municipal authorities and their budget management in parallel with extending its work force.

The present weaknesses in the PIC system, which are identified in the government PIFC concept, should be gradually eliminated in accordance with the national strategy to protect the financial interests of the republic and to prevent errors, irregularities, fraud and corruption, facilitate their detection and return unduly paid public funds.

According to this PIC concept, the Czech public administration is generally perceived as an area where there is a large scope for corruption. Generally, corruption aims especially at areas where decisions are being taken on public finances and where public services are provided to citizens. The Czech situation is complicated by the large number of decentralised and often overlapping control activities across an equally large number of government entities with complex links and different control outputs.

Reports on the status of the current systems that form the PIC environment, together with the currently stressed status of public finance, lead to the conclusion that system changes and new procedures for FMC and IA are needed. These changes, which should be based on international standards and good practice, must ensure that public funds will be used not only for their agreed purposes, but also in an economical and effective way, ensuring at the same time adequate protection of state funds and assets.

3. The concept of public internal control

A well-structured and functional model of PIFC is instrumental to an adequate internal control environment in the public administration. This model consists of a set of recommendations based on the standards and European good practice developed by the European Commission to support Member State governments in their efforts to update and modernise PIC in these countries. The Czech system provides the characteristics of PIFC, i.e. the FMC system, a system of IA and coordination of both these controls of PIC.

The main purpose of the government concept, as mentioned before, is to create an appropriate legal framework that will pave the way for a dynamic development of PIC in institutions and organisations at all levels of public administration. The framework foresees that the revision of guidelines for the implementation of these systems be based on the COSO standards. At the

same time it should create conditions for: eliminating the weaknesses of the current PIC system; introducing the same system of protection of public funds whether from foreign or national sources; avoiding duplication and excessive overlap of the activities of various control bodies; and avoiding excessive control or audit activities in auditees.

The changes needed in the development of the FMC and IA systems are being implemented gradually at various levels of the public sector. This process is meeting, however, with occasional resistance to improving the conditions for coordinating PIC in the application of key principles and tools as laid out in the government's strategy on the fight against corruption (2006–11).

The government's draft amendment to the Financial Control Act No 320/2001 Coll. was sent to the parliament in 2006 (one of the key steps for the government to perform the necessary changes in the PIFC legal framework). The Control Committee of the Chamber of Deputies, however, refused this draft and accepted another amendment to the Financial Control Act that deleted the provision on the need for a central harmonisation unit (CHU) for PIC coordination in the Ministry of Finance.

This second amendment to the Financial Control Act included an audit of FMC systems for operational programs co-financed by EU funds into the *ex ante*, ongoing and *ex post* financial control in the public sector. The vast majority of the chapter administrators kept its organisation or created a new competent section, so that in practice both financial control (including the investigation of third party complaints and stimuli to negative behavior) and internal audit are ensured.

3.1. The FMC system

The principles of good governance in the public sector require management authorities to be responsible for the implementation of PIC and for adhering to the principle requirements of:

- depolitisation, professionalisation and stability of the public administration;
- separation of functions between the management authorities, senior management and IA of chapter administrators;
- providing central coordination of FMC for the entire public sector.

The management authority of a chapter administrator has overall responsibility for ensuring the discharge of public services throughout its scope of competence, for the relevant structured and measurable activities and for creating conditions to prevent incidents and practices that may endanger or prevent objectives and policies.

The top manager is responsible for meeting the objectives and for implementing the policies set by the management authority of a chapter administrator, who can be a minister at the level of ministries. Ministers are politically nominated.

The hazy boundaries between political and administrative responsibility are a potential risk to maintaining continuity in the approaches of executives not only in the field of developing an adequate PIC by the chapter administrator, but also in its implementation. Adequacy is the ability to fulfill the basic objectives of this system, i.e. ensuring economy, efficiency and effectiveness of operations, reliability of the accounts and financial and accounting records, compliance with the law and the protection of public funds.

The minister or the executive is entrusted with public resources for meeting the objectives and implementation of policies. He/she is responsible for the safety of these resources and must put in place effective controls to mitigate and prevent any risks of fraud, corruption and irregularities, including measures to avoid conflicts of interest. One of the persistent issues today is that managers of chapter administrators attach different levels of importance to the new concepts of control. The traditional inspection/revision schemes continue to exist and in some cases managerial responsibility for establishing and maintaining the new internal control has been given to internal audit. The effort to establish an overall internal control system has led to shifting human resources depending on the choice of which kind of control is preferred. Such an approach is weakening both the FMC and the IA systems.



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3.2. The internal audit system

Internal audit (IA) serves as a critical and independent observer of the governance process of the chapter administrators. IA should provide the management authority of the chapter administrator with an analytical perspective on issues related to the methodical approach to risk management, control processes and governance. The internal auditor does so on the basis of its exceptional status, legally enshrined in Part 4, Chapter III of the Financial Control Act.

IA assesses the identification of strategic, operational and financial risks faced by chapter administrators and reviews the adequacy and effectiveness of the management and control mechanisms established under the responsibility of top management to reduce and manage these risks in a dynamic way.

The IA findings therefore have cardinal importance for the management of the chapter administrator. They draw attention to the weaknesses of the FMC system and provide recommendations as to where the system needs to be improved (added value). IA activity must not be subject to managerial instructions, but must follow a set of rules as contained in the internationally accepted professional practice of IA. Its audit reports must be completely independent of the opinions of top management, thereby making it clear that the IA system is not part of the administrative and financial services of a chapter administrator, but reports directly to the management authority.

IA regularly ensures that the chapter administrator abides by all the relevant legislation, that it has established effective management and control mechanisms and that it takes measures to avoid conflicts of interest, fraud and corruption. It also regularly reports on the implementation of self-regulatory mechanisms through which the professional practice of IA is managed. Performance measurement and IA quality assurance follow from standards, ethical principles and best practices.

Efforts to maintain the status and monitoring function of IA in accordance with the Financial Control Act in a range of chapter administrators have in some cases been compromised by replacing internal audit services with external (private sector) suppliers of audit services. Some chapter administrators also plan to replace the IA functions with the financial control of the accounting entities within their sector or municipal scope (carried out according to traditional inspection/revision schemes). The hiring of external private audit capacities is often based on the criticism that public internal audit does not fulfill the monitoring function. Some chapter administrators also refuse to use the audit findings or implement the recommendations of external audit firms, thereby increasing the costs to the national budget.

There is a high risk of not meeting the objective internal audit standards when management depends or unconditionally relies on the wisdom of external private audit firms. Worse still is when management specifically interferes with the objectivity of the services provided or even predefines the outcome of the so-called 'fully independent external audit firm recommendations.' In extreme cases this risk can grow when the audit is only to be focused on a targeted search of errors or investigation of internal and third-party complaints.

When internal audit reporting is restricted to stating a list of errors, which does not give due regard to the identification of the real causes, this may lead to a general perception by the public of an untrustworthy management of chapter administrators and of an unsatisfactory handling of public resources.

The considerable complexity of the current control structures in the Czech public sector is complicated by the implementation structures involving shared responsibility of the country and the European Commission for the proper administration and management of EU funds. Different criteria for national and EU legislation create different objective conditions for the implementation of different management and control regimes for national and external public resources. This means that the coordination of these systems is much harder than in the case of the 'single audit'.

Overall, taking into account the risks and issues mentioned above, the present status of internal audit and the proper development of the internal audit function in the public sector are not considered satisfactory.

3.2.1. IA and EA relations

The supreme audit institution (SAI) is the external auditor of the chapter administrators. Its main purpose is to report and give an independent assurance of the accuracy of the public accounts, financial reports and account sheets ('financial audit'), the legality of operations ('audit of compliance with the legislation') and adherence to the principle of sound financial management in the administration (performance audit).

The SAI's audit findings and recommendations confirm the existence of long-term persistent shortcomings in the governance of the administration chapters and can be found in the summary report on the financial control results in the public administration (the Ministry of Finance submits this report to the government every year).

In terms of annual audit plans, the SAI coordinates its audit activities with those of the chapter administrators.



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3.2.2. Audit committees and audit boards

Audit committees and/or audit boards did not find support in the Czech public sector as the new concept of internal audit is perceived (with some exceptions) as another bureaucratic and economic burden without an apparent benefit to the public sector.

3.2.3. Central coordination of PIC

An effective methodological support and central coordination contributes to the correct development of a PIC system. The parliamentary amendment of the Financial Control Act (mentioned below) prevented the CHU for PIFC from reporting directly to the Minister for Finance from 1 January 2008. The CHU was split into two departments under the competence of the Deputy Minister for Finance responsible for the financial, audit and operational section.

Regular assessments of the FMC and IA systems in the public sector and regular reports/periodic surveys about the status of these systems are contained in the annual report on the results of financial controls, which the Minister for Finance submits to the government (according to the Financial Control Act). A copy of this report is submitted to the SAI. The report is published on the website of the Ministry of Finance after having been discussed in the cabinet.

4. Financial inspection

The fight against irregularities, fraud, corruption and other illegal activities ('irregularities and frauds') that have a negative impact on the financial interests of the state, municipal authorities and EU must be effective. Therefore it is necessary to clearly define the limits of responsibility of all actors involved in the ongoing management and control process in providing public services and management of public funds whether local, national or international.

Financial inspection is the responsibility to ensure prevention, detection, reporting (or notification) and investigation of irregularities and frauds. Financial inspection may take corrective actions, especially in cases relating to the use of public funds without authorisation (financial corrections) and imposing sanctions wherever it is needed to restore the financial discipline of institutions and public sector organisations and all other providers and beneficiaries of financial support from public sources.

The primary responsibility for risk assessment and risk management is with the management of the chapter administrator. Top management must formulate a strategy to lower the risks, a plan to identify fraud/corruption that explains the procedures for reporting and a continuous programme of raising staff awareness.

According to COSO ERM standards, internal auditors are not responsible for the detection and investigation of fraud/corruption. On the contrary, they are required to provide independent assurance on the effectiveness of procedures established by top management to assess and manage risks associated with the threat of fraud or corruption. All other activities carried out by IA should be consistent and not in conflict with this primary task. Internal auditors should of course have sufficient knowledge to be able to identify indicators of fraud/corruption. The role of the

IA is not reduced, but focused on the assessment of control mechanisms, in this case — financial inspection — as established and maintained by the top manager.

5. Ongoing and/or future reforms

The basic policy document for further development of PIC remains the government concept mentioned in Section 1 above, based on the comprehensive PIFC model as developed by the European Commission to support the governments of EU Member States. The Czech government is aware of the need for changes in its PIC system and adopted (in 2008) its action plan to address the priorities and objectives of the national strategy to protect the financial interests of the Commission in the country. The government is committed to drafting a new law to replace the current, already obsolete 2001 Financial Control Act.

At the same time, the government provided clear criteria for a regulation of PIC systems, in compliance with the requirements set out in Section 1 above. These criteria were subject to extensive debate with experts from all levels of public administration, from the Czech Institute of Internal Auditors and from academia. The draft law (according to the government submission) is consistent with the views of the World Bank and the Directorate-General for the Budget of the European Commission on the basic conditions for PIC in developed democracies. However, the government, after adopting its anti-corruption strategy, took the decision to replace the legal initiative of the Minister for Finance by asking for a simple technical amendment to the existing Financial Control Act. This technical amendment is in the stage of inter-service consultation.

This amendment should create the conditions that will correspond to developments in the building of a comprehensive PIC, in compliance with standards and good practice.



DENMARK

DENMARK

Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The Danish PIC system has evolved into its present form over several decades. The following events, in particular, have marked the development of our current internal control set-up:

- the establishment of an independent National Audit Office (NAO) led by the Auditor General;
- the development of objectives and performance management;
- the introduction of accrual accounting principles;
- the establishment of administrative service centres.

In 1975, the audit departments were merged as a result of the Auditor General Act, whereupon the NAO was established as an institution under the control of the Ministry of Economic Affairs. In 1991, the NAO was moved from the control of the Ministry of Economic Affairs to the parliament, making the NAO a fully independent audit authority.

In addition, Denmark is placing an ever-increasing focus on objectives and performance management in order to discharge our responsibilities efficiently and implement our policy objectives. This is being achieved by awarding and monitoring performance contracts with ministerial agencies, which has strengthened the use of internal control and monitoring.

The introduction of accrual principles for accounts and budgets has changed the rules and management perspectives. Similarly, the establishment of administrative service centres has changed the allocation of basic economic administrative duties, leading to an increased focus on business processes and controls in relation to external reporting.

2. Public internal control environment

The state budget provides the basis for state activities during a financial year and is adopted as a Finance Act by the parliament, which has authorising authority and also controls the allocation of appropriations. The Minister for Finance is responsible for coordinating the planning of the state budget. Budgeting is carried out using a top-down approach based on policy objectives. The framework is set at the top and then implemented in the institutions.

⁽¹⁾ Contributed by the Ministry of Finance on 7 April 2011.

The ministries and other state institutions may, in the course of a financial year, incur costs and collect revenues in accordance with the appropriations allocated. With regard to the appropriations available, checks need to be carried out that these are consistent with the general and special conditions under which the appropriations have been granted and in accordance with other provisions, such as acts of parliament, orders, circulars and internal instructions.

The allocation and accounting principle for the operational area is based on a full accruals approach, while allocation and accounting principles for infrastructure, defence, various grants and other types of expenditure are mainly based on an 'acquisition approach' (modified accrual accounting). The state presents its public accounts and an annual report for each state activity.

The public accounts are prepared in accordance with the same principles as the Finance Act. The detailed rules for the public accounts are laid down in the Danish Public Accounting Act and the Public Accounting Order issued pursuant to that act. The public accounts provide the basis for subsequent checks by the parliament of the administration's use of appropriations, including checks that no expenditure is incurred without reference to a particular appropriation.

All state-owned enterprises must present an annual report, containing a report on the enterprise and its key figures, performance report, accounts, endorsement and appendices. The annual report is the medium through which the individual state enterprise reports on its professional and financial performance during the year. In its annual report, the enterprise must provide an income statement and a balance sheet for the operational areas it manages, report on the objectives agreed or set by a party other than the enterprise itself and illustrate the scope of the grant schemes it manages, etc.

With few exceptions, state institutions use Navision Stat as their local financial system. Accounting records are collected centrally in the State Group System (Statens Koncern System or SKS), and are used for preparing the public accounts, amongst other purposes. The accounts are approved in the SKS.

The public accounts are audited by state auditors (appointed by the parliament), in cooperation with the Auditor General and the NAO. When auditing the public accounts and in order to prepare a report on the audit of the public accounts, the NAO examines the annual reports of enterprises. It also examines reports by individual ministries on the need for greater or lesser use of appropriations granted through allocation acts, also known as accounting statements. The state auditors make political recommendations and criticisms based on reports from the Auditor General and action plans from ministries.

3. The concept of public internal control

The structure of the Danish state administration's PIC system is dealt with below. Our main focus has been the introduction of measures which place accountability/responsibility and the resulting need for follow-up on local managers with regard to financial reporting, objectives, performance management and monitoring the use of appropriations. We have also examined the use of internal audit by state institutions and the relationship between the internal and external audit.

3.1. Managerial accountability/responsibility

The Danish state has not set out a PIC framework in a separate document or in a set of rules. However, based on the existing regulations (e.g. the Public Accounting Order) and prescriptive guidelines ('Responsibility for management — guidance on management, from group to institution'), there is a clear framework for the responsibilities allocated to state institutions in order to ensure appropriate internal controls and management of the institution.

Accountability is placed, to some extent, on the local institution, in particular through requirements for objectives and performance management, appropriation management and procedures for the approval of accounts. For this reason, internal control and accountability are closely linked.

The Danish public sector is divided into ministerial portfolios, whereby each portfolio has a department with subordinate agencies and institutions, which together constitute a portfolio group. The minister bears the ultimate political responsibility for his/her portfolio. Powers of allocation and inspection have been delegated to the administrative level.

As far as audit is concerned, there is a link between the political and administrative levels in relation to state auditors and the NAO. The Auditor General is appointed by the speaker of the parliament at the recommendation of state auditors, and the NAO is a fully independent audit authority which reports on appropriations and accounts to the parliament. State auditors are appointed by the parliament. State auditors are the only people who can request that the NAO investigate a particular area. In addition, state auditors are entitled to criticise ministers and agencies on the basis of the NAO's reports and memoranda. The section below explains the management and inspection responsibilities of departments and agencies, respectively.

A department has the overall management and supervisory responsibility for a ministerial portfolio. This management responsibility includes establishing and managing the overall financial framework for the ministerial portfolio — appropriation management and continuous monitoring of spending, utilisation of credit facilities, etc. Moreover, group management covers the professional management of institutions and ensuring continuous efficiency improvements across the group. This enables an individual ministry to determine for itself the process and mechanisms for meeting management requirements for continued efficiency improvements. The department is entitled to set priorities and monitor the operations of its institutions and thus ensure safe and efficient operation of the entire group. Group management covers:

- appropriation management and monitoring of the overall financial framework;
- management and supervision by accountants and departments;
- payroll management;
- risk management;
- objectives and performance management;
- procurement management and tendering;
- digitisation;
- group responsibility for interaction with administrative service centres.

3.1.1. Management and supervision by accountants and departments

The Public Accounting Order specifies departments' overall responsibility for management, accounting and financial monitoring. The Public Accounting Order states that departments shall:

- organise the accounting system within a ministry;
- monitor compliance with accounting rules; and
- ensure the provision of necessary information for the continuous monitoring of internal accounting, periodic reporting and the annual preparation of the public accounts and annual reports.

Departments have a responsibility to provide the necessary control systems in the subordinate institutions of the ministerial portfolio. At the same time, the department must itself monitor compliance with the rules on financial reporting and ensure the provision of necessary information for financial management, including the monitoring of appropriations, in the ministerial portfolio. In order to discharge its inspection and supervisory responsibilities, the department must, as a minimum, do the following.

- Ensure that formal systems for internal control, including instructions and financial reporting, are in place in its institutions; this is documented in ministerial instructions, and the department must approve the instructions to enterprises.



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- Ensure that the IT use of accounting data takes place appropriately, reliably and securely; this includes supervision of administrative business processes and controls, where responsibilities and tasks are not transferred to a service centre.
- Ensure that institutions check and approve their quarterly accounts; the department approves the ministry's overall accounts and the institution's annual reports, and it is responsible for transfers, corrections, extensions, etc. concerning the transfer of appropriations in the ministerial portfolio.
- Actively seek relevant information from institutions, for example in the form of quarterly figures for financial, staff or pay conditions, as well as other information which can demonstrate whether an institution's administration and management are functioning appropriately.
- Intervene in and address any problems which they become aware of within institutions.

In discharging its inspection and supervisory role, the department has a number of different tools and options to safeguard the standard of the work and inspection procedures within its institutions. These include the creation of departmental controller units. However, it is up to each department to determine how the required supervision and management responsibilities should be exercised.

3.1.2. Management and supervisory responsibilities of central government institutions

In order to ensure effective institutions which deliver results in keeping with policy objectives, state institutions must, as a minimum, set objectives for their work and monitor the results in their annual report. This is an essential element in the prioritisation and monitoring of appropriation use.

Objectives and performance requirements are set on the basis of a dialogue between the institution's management and the department and within the framework of the ministerial portfolio's basic management conditions, applicable law and legal requirements and budget and appropriation rules.

In principle, risk management of the institution's core activities, that is evaluation and management of uncertainties and potential deviations from planned operations and activities, is part of the institution's own financial management and its managerial responsibility. The Danish state is self-insured, which means that institutions must carry out risk management of their assets. The department has a responsibility to ensure that particularly vulnerable institutions, which are at high risk of significant losses, are taken into account in the budgetary process and that the relevant institutions work on managing these risks.

3.1.3. Management responsibility in central government institutions

The institution's management must ensure optimum resource utilisation in relation to the institution's objectives. Financial management covers the management of the institution's financial resources, activities, resources and results. The basic requirements for the institution include budget contributions, appropriation management and budget control, as well as accounting and annual reports.

The department creates a framework for objectives and the performance management process, including the management tools that should be used. It may contain a timetable, and possibly procedures for negotiating on the determination of objectives and reporting, monitoring and evaluation of performance and fulfilment of objectives.

For institutions, there are four basic requirements which must be met in order to satisfy the department's overall objectives and performance management.

- The institution must set objectives for its core tasks.
- The institution must establish HR policy quality objectives. These may be included in the institution's performance or directors' contracts or made public in some other way.

- In its annual report, the institution must report on all external objectives, i.e. objectives set out in the Finance Act or otherwise agreed between the relevant department and the institution.
- The institution and the department must review the institution's objectives and results at least once a year.

As a minimum, institutions must report on objectives in their annual reports. In this regard, the department is required to review and evaluate the institution's progress, even if this is sometimes done before the annual report is prepared.

The head of department may enter into a performance-based salary contract with an agency or institution director which includes a variable pay clause in addition to the fixed salary. This practice is aimed at clarifying the objectives and direction for the institution's development and giving the director a financial incentive to ensure the control and management of the institution with a focus on results and impact.



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3.1.4. Reporting and approval

Reporting and approval is based on a hierarchy which basically consists of central government agencies and departments. Reports are approved on a monthly, quarterly and annual basis in the SKS. Reporting institutions approve for enterprises, which approve for departments, which in turn approve for the Danish Agency for Governmental Management and the NAO.

The monthly approval is technical (reconciliation between systems), whereas the quarterly and annual approvals are substantial and take place through the SKS. The quarterly approval includes verifying:

1. the consistency between data recorded in the budget accounts and data recorded in the local financial system;
2. the consistency between recorded appropriations and appropriation acts, etc.;
3. that the use of appropriations is reasonable, while taking into account the activities of the previous period;
4. the accounting reconciliation between assets and liabilities;
5. that assets and liabilities are at a reasonable level;
6. that the names of the main accounts and sub-accounts used are correct; and
7. that the accounts contain all funds which the individual institution, enterprise and ministerial portfolio is responsible for.

With regard to points 3 and 5, in particular, the management must take active responsibility for deciding whether the circumstances are reasonable. This requires the establishment of business procedures and internal controls which can provide feedback to the management and an assurance of the fairness of the arrangements and reliability of the accounts.

The annual approval involves the same requirements as the quarterly approval, but it also needs to ensure debtors, prepaid and accrued amounts, etc. are recorded in the accounts so that this gives an accurate picture of income and spending, as well as of assets and liabilities at the end of the financial year. In addition, departments must approve ministry accounts by submitting an accounting statement to the Danish Agency for Governmental Management and the NAO, containing the following information:

- whether any changes have been made to accounting principles which might be relevant to the evaluation of the relevant year's accounts;
- whether the accounts contain all funds that the ministerial portfolio is responsible for;
- whether appropriations are being correctly used;
- whether assets and liabilities have been calculated correctly.

Moreover, in its accounting statement, the department has to confirm that, in connection with financial reporting, business procedures and internal controls have been set up which ensure, as far as possible, that the arrangements covered by financial reporting are consistent with the appropriations granted, acts and other regulations, as well as with the contracts entered into and customary practice. Departments must also approve the annual appropriation transfers in connection with the end of the year.

The state institution's annual report is endorsed by the enterprise management and the relevant ministry's department. The endorsement affirms that:

- the annual report is accurate, that is that it is free of material misstatements or omissions and that objectives in the annual report have been set and reported on in a satisfactory manner;
- the arrangements covered by financial reporting are consistent with the appropriations granted, acts and other regulations, as well as with the contracts entered into and customary practice;
- business procedures which ensure financially appropriate management of resources have been set up in the institutions covered by the annual report.

For each reporting institution, 'accounting instructions' which describe how accounting management in the form of business procedures is structured within the institution must be prepared. There is no requirement for accounting instructions to be approved by a higher authority, but accounting instructions must be prepared in accordance with the guidelines in the relevant enterprise's instructions.

3.2. Internal audit

An internal audit unit may be organised by agreement between the minister concerned and the Auditor General (Section 9 of the Auditor General Act, hence commonly known as a 'Section 9 agreement') for individual institutions, or for institutional or management areas. Cooperation between the NAO and internal audit is organised through regular meetings. Like the NAO, internal auditors must carry out their duties in accordance with the principles of good public auditing practice, as provided for by Section 3 of the Auditor General Act. The specific content of the audit has evolved in line with the practice developed by the NAO, through its cooperation with ministries on the preparation of audit instructions and through its cooperation with other auditors who audit the public accounts.

The NAO has drawn up a standard Section 9 agreement in order to ensure that the agreements entered into are generally consistent.

Internal audit extends to several ministerial remits at different levels, including the following:

- the Ministry of Finance (MoF);
- the Ministry of Defence;
- the Ministry of Food, Agriculture and Fisheries;
- the Ministry of Taxation;
- the Ministry of Justice;
- the Ministry of Transport.

The duties which internal auditors carry out and the part of the group concerned which is covered by the audit differ from ministry to ministry. In the MoF internal auditors audit all the group's agencies, whereas in some other ministries internal audits are more focused both in terms of the areas audited and the project portfolio. The following section is primarily based on how internal audits are carried out in the MoF.

3.2.1. The nature of functional independence

The cornerstone of the internal audit is the agreement entered into with the NAO under Section 9 of the Auditor General Act. Within the framework of the agreement, an internal audit must be independent of management in terms of planning, prioritisation, organisation and implemen-

tation. Internal auditors must have access to all information which is, in their view, necessary for discharging their duties, and internal audit must, at the earliest possible opportunity, be incorporated into planning and modification of accounting systems and organisation of business processes. Internal auditors have the opportunity to assist and advise institutional management on an ongoing basis.

Normally, internal audit will be part of the organisation as an independent staff function, reporting directly to the head of the institution. There is no requirement that an internal audit body must be a part of the organisation — it may also be an external auditor or audit firm which carries out the task, although this is primarily the case in subsidised non-profit institutions, e.g. schools, and public enterprises which are mainly financed by the state and are subject to an audit by the NAO.

In the MoF, the head of department is entitled to propose focus areas for audit, but he/she cannot determine the audit results. In addition, group-based audits are focused on the independence of the individual agencies being audited, which means that the internal audit body can highlight issues but the solution has to be decided by the agency itself. The principle of not making decisions also applies where group audits form part of working groups, in which case this is clearly delineated. If the internal audit identifies any potential problems concerning independence in the interface between the consulting and audit bodies, then the NAO is asked to investigate the matter.

Internal audit reports and provides free recommendations to management within the framework of the Section 9 agreement and good public auditing practice. Internal auditors rarely undertake tasks outside the scope of internal audit, but there are times when they are relied upon as a sounding board in the dialogue between the audited institution and the NAO.

The head of internal audit at the MoF is COR certified. COR, the Certification Scheme for Public Auditing, is a supplementary training and certification course for auditors whose job it is to audit public enterprises. The scheme is also aimed at auditors whose job it is to audit enterprises where the public sector provides grants or is otherwise a stakeholder.

Certification consists of theoretical training, practical experience and exams. The training requirements for obtaining certification are a five-year master's course and a continuing education programme consisting of a series of theory courses which provide the auditor with a thorough grounding in the public sector and auditing as a profession. The theoretical training course can be run concurrently for auditors who obtain a minimum of three years' practical experience in auditing public accounts. Before they can be certified, course participants must demonstrate their theoretical and practical skills and must subsequently pass a practical examination in public auditing.

Internal audit staff must do a course in public auditing, which is offered jointly by the NAO and the Copenhagen Business School. The head auditor is also a member of the Institute of Internal Auditors (IIA). The group audit staff is participating in some of the IIA's courses.

3.2.2. Internal audit reporting

Internal auditors report to the head of department, NAO and top management of the agency being audited. Internal auditors endorse the accounts and produce the auditors' statement, notes on the audit and any management letters. On concluding the annual audit, internal auditors produce a written report on the work they have done and conclusions which may be drawn from the report for the institution's management and the head of department.

3.2.3. Types of audits performed

Internal auditors are required to carry out their audit duties in accordance with the principles of good public auditing practice. Internal auditors may also carry out management audits and provide a certain amount of consultancy. Group auditors therefore act as advisors and as a sounding board for the head of department and other group management, and their duties include the following:

- checking compliance with legislation, regulations, etc. in connection with accounting and management, as well as compliance with internal policies and guidelines;



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- review and critical assessment of internal control systems, business processes, IT systems, procedures, etc. from an accounting and reporting perspective;
- managerial consultancy on IT systems, internal controls, etc. from an accounting and reporting perspective;
- IT security, ongoing review, critical assessment and consultancy concerning the group's procedures, etc. in order to ensure compliance with DS 484 (the Danish information security standard).

Duties are carried out in close liaison with departmental management and staff and the agencies under the MoF, as well as with external consultants, for example in connection with IT audits.

It should also be noted that internal auditors do not audit the department, which is however audited by the NAO.

Internal auditors carry out the following types of audit.

- Financial audit: the audit verifies that the accounts are correct.
- Compliance audit: the audit verifies that the arrangements covered by the financial reporting are consistent with the appropriations granted, laws and other regulations, agreements entered into and customary practice.
- Management audit: the audit assesses whether due financial consideration has been taken of the management of funds and operations of enterprises covered by the accounts. Requiring enterprises to take 'due financial consideration' means that their financial management must ensure economy, efficiency and effectiveness in the performance of their tasks.

The different types of audit are carried out to a varying extent, depending on the type of institution being audited.

3.2.4. Formal follow-up procedure for managers with regard to internal audit reports

A fixed element in an agency's performance contract is that any comments made by group auditors must be implemented within three months of submission, unless agreed otherwise.

3.2.5. How duties between internal audit and the financial inspection are separated

Not applicable — the Danish state does not currently have a central controller unit.

3.3. Internal audit relations with external audit

In general, cooperation is based on internal auditors carrying out most of the audit, with the NAO overseeing auditors' work and carrying out an additional audit, as needed. The NAO retains overall responsibility for the performance of the audit.

Financial auditing is the main task of internal auditors, while the NAO confines itself to supervision and, if necessary, an additional audit. In principle, internal audit should also carry out the management audit, at least in the form of a continuous management audit, which can often be carried out in the same operation as the financial audit.

Major investigations normally fall outside the remit of internal auditors. However, it makes sense that internal auditors should assist the NAO in connection with an investigation of the institutional area concerned, but that is not always the case.

Cooperation between internal audit and the NAO is organised through quarterly meetings. The NAO's supervision of internal auditors and practical cooperation takes place through ongoing dialogue.

3.3.1. Audit boards or audit committees

The Danish state has no audit boards or audit committees. This is probably due to the fact that internal audits within ministries and agencies are limited. Another fact that should be taken into account is that the NAO assesses agreements by establishing internal audit groups and assessing the work of internal auditors and that it has responsibility for the overall audit.

3.3.2. Coordination of public internal control

The Danish state has no central coordination units established to harmonise internal controls across the state or assess the functionality of internal control systems or internal audits across the state.

4. Financial inspection

Not applicable, see above.

5. Ongoing and future reforms

With regard to PAR (public administration reform) and PIC, there are no ongoing reforms, nor have any been planned for the future. With regard to PEM (public expenditure management), we are seeking to strengthen this area through new initiatives aimed at both overall expenditure management and financial management in individual institutions.

► *Legal basis of public internal control*

The following regulations form the core of the Danish PIC system:

- the Danish Constitution;
- the Danish Public Accounting Act and related regulations;
- the Danish Auditor General Act and related regulations;
- the budget guide; and
- Responsibility for management — guidance on management, from group to institution (a framework for accountable governance).



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

1.1. Development of internal control systems and the internal audit function

On 21 March 2000, the government of the republic (hereafter ‘the government’) appointed the Ministry of Finance (MoF) to be in charge of public sector internal control and internal audit. On 14 February 2000, a Financial Control Department (FCD) was established in the Ministry of Finance whose duties included coordination and analysing of the internal control system, organisation of internal audit in the authorities of executive power (AEP) and making proposals to improve them.

On 7 June 2000, the parliament adopted the Government Act and the State Public Servants Official Titles and Salary Scale Act setting down the responsibility of the heads of the AEP to ensure application of an internal control system and organisation of internal audit activities. Governmental and state authorities were required to appoint a person responsible for internal audit and, if necessary, establish an appropriate structural unit to perform internal audit by 1 January 2001. From then on, the public internal audit system has continuously functioned. The general rules for internal audit for governmental and state authorities were adopted by Government Regulation 329 of 18 October 2000, also giving additional requirements for internal auditors upon their employment.

Until 2005, the responsibility for performing internal audit development coordination (the central harmonisation unit — CHU) was with an official who worked under the head of the FCD and who was responsible for the harmonisation of internal audit methods, advising internal auditors and coordination of the development and implementation of the financial control system. On 16 March 2005, an internal audit coordination unit was established within the FCD, responsible for proposals to amend laws regulating the internal control system and organisation of internal audit, development of methodical instruction for organising the work of internal auditors and for assessing internal control systems, preparing a strategic plan and a consolidated internal audit work plan, organising internal audit reporting and exchange of information and harmonising internal audit methods.

On 25 May 2006, the government approved ‘The internal audit concept for AEP’. The concept covered:

- the role of the Ministry of Finance in the public internal audit system;
- government participation in internal audit-related issues;

⁽¹⁾ Contributed by the Ministry of Finance on 15 March 2011.

- reorganisation of the internal audit function within the government;
- improving the quality of internal audit;
- performing the duties of an audit body during the European Union budget period of 2007–13.

In July 2006, the government asked the Minister for Finance to develop additional competence requirements and activity quality criteria for internal auditors. Strategic goals and performance indicators for the development of the internal auditor profession were established in the national budget strategy. The Ministry of Finance was to ensure:

- a transfer from national good practices to international internal audit standards in the professional practice of internal auditors;
- improved quality of the internal audit function to comply with national and international requirements; and
- the designing of a system for internal auditor professional certification and quality monitoring, and the building of the legislative framework for implementation of the system.

Developing the internal auditor profession concept creates a methodical continuity in professional training and practices of public internal auditors and establishes the basic principles for developing and assessing the quality of internal audit activity.

By the end of 2009, the system for professional certification and quality monitoring was developed and the legal framework for implementation prepared. The system is based on the recommendations of the International Institute of Internal Auditors (IIA) and on the International Professional Practices Framework (IPPF).

The Authorised Public Accountants Act (APAA), adopted in January 2010, specifies inter alia the requirements for internal auditors, the legal basis for the activity of internal auditors, the internal auditors' right to professional practices and the basic principles for monitoring the quality of internal audit. The APAA covers the activity of internal auditors in the public sector and in companies and private sector entities that are classified as public. The act introduces compulsory guidelines of the IPPF principles (definition of internal auditing, code of ethics, international standards for professional practices of internal auditing) into Estonian legislation.

On 5 April 2010, the Minister for Finance established the Professional Qualifications Committee for Auditors as an advisory committee to address issues relating to professional internal audit practice and quality monitoring. The objective of the committee is to help develop the professional activity of internal auditors and its quality.

Those who wish to obtain the international certificate Certified Government Auditing Professional (CGAP) will be provided with an opportunity to take an examination in Estonian from the autumn of 2011, which will be prepared in cooperation with the IIA branch of Estonia.

1.2. Development of financial management and control

In June 1999, the parliament adopted the State Budget Act (SBA), which mainly regulates the area of financial management. The act was significantly amended in 2002 and 2003.

On 1 January 2004 the General Rules for Public Sector Accounting came into force. A major change was that the accounting rules were brought in line with the basic accounting principles of IPSAS (International Public Sector Accounting Standards) and that the requirements for preparing consolidated statements and common accounting principles and rules for submitting statements to the MoF were based on the common chart of accounts. In January 2004 the transfer to accrual accounting was fully completed.

In 2004, comprehensive instructions for public procurement were designed, which served as a tool for persons organising public procurements. A new public procurement register was launched at the beginning of 2004. In 2005, a government regulation for reconditioning of the state's strategic planning was approved. It regulates the system of strategic planning for the AEP and gives a major role to the strategic development plans in the state budget preparation.

In 2005, for the first time, the consolidated 2004 annual state report was prepared on the basis of accounting principles similar to those applied in the private sector. For the first time, the consolidated 2004 annual state report provided a consolidated activity report, which informed the parliament and the public about the most significant activities undertaken and achieved by the state. In 2005, local government subsidiaries were included in the consolidated state financial statements. As of 2005 the consolidated state annual report included the entire public sector. In 2006, the state budget strategy for 2007–10 was completed together with a comprehensive financial framework, including as well the strategy and implementation plans of the EU Structural Funds for 2007–13.

The initial concept of developing the state financial management was formulated by the MoF by the end of 2007, suggesting:

- the implementation of performance-based budgeting;
- a transfer from cash-based budgeting to accrual-based budgeting;
- more systematic use of reporting when adopting management decisions and planning;
- the strengthening of financial discipline; and
- improving the efficiency of internal control systems.

In 2009, two long-term nationwide development projects were initiated: the support services consolidation project and the project for performance management, the latter of which covers the issue of a linking of the state's strategic planning and financial management functions. A detailed analysis was carried out in 2009 to consolidate the public sector support services and financial, personnel and payroll accounting transfer to common software. The respective time schedule and action plan were prepared for 2010–13.

A new Authorised Public Accountants Act came into force in March 2010, laying down the legal basis for the professional practice of authorised public accountants, defining the legal basis for sworn auditors and sworn audit firms as well as the responsibility and legal basis for the activity of internal audit in the public sector.

2. Public internal control environment

The MoF has the responsibility to coordinate the planning and implementation of budget policy and to organise the state accounting function.

2.1. State budget preparation

The legal basis for preparing the state budget is found in the constitution, the Government Act, the SBA(s) ⁽²⁾, and tax acts. The actual basis for collecting revenues and expenditure is the state budget strategy and its ministerial development plans. A development plan is approved by the relevant minister after discussion with the prime minister and other relevant ministers. Development plans are submitted to the MoF by 1 March after which the Ministry of Finance will prepare the state budget strategy for the following four years.

The state budget strategy is the basis for preparing a draft annual state budget. Draft budgets for constitutional institutions and ministries are submitted to the MoF. The MoF will prepare a draft state budget and submit it along with an explanatory memorandum to the government. The government will submit the draft state budget and the explanatory memorandum, together with an overview of the country's economic situation and the primary objectives of the government, to the parliament, which will then adopt the annual SBA.

The state budget is prepared and its implementation is monitored on a cash basis, whereas accounting and reporting on the balance of the government sector is performed on an accrual basis. As the public sector accounting is fully accrual based, but receipts and transfers are recorded on a cash basis, double accounting currently exists in the financial management system. Thus, it is not possible to link the volumes of state budget revenues and expenses directly to the accrual-based public sector balance.

⁽²⁾ State Budget Act and Annual State Budget Act.



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The SBA prescribes a detailed classification of budget revenues, expenses and financial transactions. For the purpose of monitoring state budget expenditure, state budget classification codes will be introduced to accompany payment orders.

2.2. State accounting

State accounting is regulated by the Accounting Act, as well as the General Rules of State Accounting and guidelines in accordance with the International Public Sector Accounting Standards (IPSAS), except for the double accounting issue mentioned above.

Management of all central government cash flows and settlements, including investing state reserves, is done centrally via the state treasury. To organise the implementation of the state budget, an electronic state treasury system has been introduced. The electronic state treasury system is an Internet application enabling clients to communicate with the state treasury.

2.3. Registries

A number of information systems and registers have been established:

- the State Budget Information System for planning the state budget strategy, state budget and state budget classification, etc;
- databases for reporting execution of state budget payments (years 2003–08 and from 2009), i.e. the electronic state treasury;
- trial balances — accrual-based balances of account combinations that are used to prepare accrual-based financial statements;
- State Budget Analysis System, that is a further development of the State Budget Information System enabling the progress of budget implementation to be analysed as well as budget applications to be submitted;
- Public Procurement Register;
- electronic public procurement environment designed for persons organising procurements and bidders intended for organising electronic public procurements;
- register of state aid and aid of minor importance;
- State Real Estate Register; and
- SAP accounting system.

2.4. Competence

The large majority of the public sector officials must adhere to the Public Servants Act and other relevant acts, codes and rules. The recruitment and evaluation of personnel are regulated by the government regulations 'Approval of evaluation requirements for the primary groups of positions' (also defines minimum requirements necessary for serving as a higher level public servant) and 'Organising competitions and evaluations'. Furthermore, personnel recruitment policy and practices are regulated by the internal human resources department's work rules and guidelines.

2.5. Tone at the top

The MoF cannot dictate to line ministries what they have to do and how. The ministry, however, is responsible for the preparation of the state budget and for ensuring the full implementation and prudent use of the taxpayer's money. Also, the MoF can and must demand that budgetary fund users undertake careful planning as well as correct and transparent implementation. The MoF cannot demand that others fulfil the above if it does not set examples of economy, efficiency and effectiveness.

2.6. External control components

Each defined state accounting entity prepares an annual report and submits it to the National Audit Office (NAO). The financial statements prepared in 2011 and thereafter are audited by the NAO. Each entity will submit an annual report, together with the audit report of the NAO, to the MoF. The MoF submits annual reports of the ministries and the state chancellery, together with the audit reports of the NAO, to the government. The government will decide upon approving these annual reports.

The MoF prepares a consolidated state annual report which the NAO will audit; the NAO will also check whether the transactions have been lawful. The MoF submits the consolidated state annual report together with the NAO audit report to the government for approval, and publishes them on its homepage. The government submits the approved consolidated state annual report to the parliament for approval. The audit report of the NAO will be attached to the report.



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3. The concept of public internal control

► *Control environment*

In legal terms the control environment is formed by various legislative acts already mentioned above and other pieces of law, regulations, rules, manuals, etc. Various IT systems, such as registers, databases and electronic environments, play an important role in the organisation of state administration and the creation of the control environment.

► *Risk assessment*

The government regulation ‘Types of strategic development plans and rules for their preparing, amending, implementing, assessing and reporting’ stipulates that any state authority will submit a summary of risk analysis and an analysis of the activity environment (the organisation’s current situation, readiness to achieve the set objectives, a description of the significant risks in relation to the implementation of the development plan and activities to manage these risks). There are no other laws dealing with risk assessment. The head of a state accounting entity will indicate in its annual report whether a risk assessment was carried out during the reporting period. The 2009 internal audit reports indicate that in most cases a risk assessment was carried out. The intention is to update the risk assessment guidelines by the MoF in 2011.

► *Control activities*

Many control activities are laid down by law and internal rules regulating the work in various sectors. For example, according to the general rules for state accounting, an entity’s accounting principles and procedures have to establish requirements for preparing and checking source documents, entering data into an accounting information system, assessing accounting journals and ledgers and preserving documents. The general rules include also due-date requirements for submitting documents and reports.

The responsibilities of the employees of an accounting entity are determined by the job descriptions. The requirements for document checks are established by the entity’s accounting principles and procedures, which also define who is responsible for ensuring that:

- a specific document fairly reflects a respective business transaction;
- the amounts, prices and other conditions on a document are in compliance with previously made contracts;
- a transaction is legal and necessary;
- a transaction is in compliance with the budget;
- the terms and conditions of a transaction are similar to the terms and conditions of similar transactions; and
- the economy principle is applied when concluding agreements.

The employees of the accounting unit shall ensure that the following information is checked and that the information is accurately entered into the accounting information system when checking documents and preparing transfer (payment) documents:

- a transaction is in compliance with the principles of monitoring budget implementation;
- the accounts, transaction partner, field of activity, source, cash flow and budget classification codes are accurate;
- the term of payment;
- the accrual period;
- information regarding the recipient, including when VAT is shown on the purchase document, performing checks to confirm whether the supplier is registered as a person liable to VAT and whether the invoice is prepared in compliance with the VAT Act;
- whether the particular good, service or other benefit has been paid for before; and
- whether the purchase transaction was checked according to the requirements set for document checks and was approved by the person(s) authorised to do so.

The requirements for document checks must ensure that the authorised person (signatory) and the employee of the accounting unit are not the same. The head of the authority will appoint the authorised person(s) within the scope of his/her competence. Every source document must be signed by both the authorised person and the employee of the accounting unit.

If possible, two persons (four-eye principle) are involved in the money transfer process. Where electronic transfers are made, the rights are assigned so that one person cannot perform a money transfer alone. In order to fulfil this requirement, the person entering a transfer must be other than the person accepting the transfer. Another person besides the cashier approves the cash payment orders.

The above ensures that the responsibilities are separate when transactions are made — approving rights are assigned, four-eye principle is applied — and that the information systems have automatic checks over resources and data access in place, data is made compatible and supervision is exercised.

The control measures for information systems are automatic and usually continuous. For example, the following checks will be run on a payment order entered into the electronic state treasury system:

- the payment order is compiled in the required format;
- the authority has free state budget funds, or in case of state foundations the balance of the electronic state treasury revenue account is checked;
- the minimum amount of payment to the recipient via a bank transfer in the Republic of Estonia is EUR 0.05 and to a foreign country EUR 1.90.

Due to the rapid development of the information systems, the control measures are updated constantly.

The performance of officials is evaluated at least once a year during the employee's evaluation interview with his/her superior. Superiors constantly supervise the work performed by their subordinates. As it is extremely important that the officials who have to apply a range of internal controls, when performing their duties, are aware of the existing control measures and appreciate the importance of applying these measures, there is regularly organised training, information days, meetings, etc. (on department, organisation, area of government (hereafter 'remit'), state authority level).

► *Management of the information and communication process*

The most critical aspect of the information and communication process is timely notification of the right persons. In order to ensure the defining, recording and forwarding of important information, in such a format and at such a time that would enable employees to perform their duties accurately, all legislative acts are available in the electronic state gazette

(*Riigi Teataja*) (<https://www.riigiteataja.ee/>). Guides, manuals and other necessary information are published on the home page of the MoF. Networks have been established for the purpose of information and experience exchange (information circles, registers). The state budget planning information is available in the State Budget Information System (REIS) and the current progress of budget implementation (cash-based) by the budgetary state authorities and by the economic substance is available in the electronic State Treasury System.

► **Monitoring**

Managers are the first persons to perform initial monitoring, the monitoring links reporting to the planning activities. In the budgeting contexts, the duty of the MoF is to coordinate the state's budget strategy, preparation and negotiations of the state budget, to assess the efficiency of using state resources and implementation of strategic development plans and activity plans and to prepare budgetary policy decisions. As the state budget is an annual plan of the state budget strategy, annual reports should be the basis for monitoring the implementation of the state budget strategy. The work rules for 'The state budget strategy and preparing, implementing and monitoring of the state budget' were approved on 21 September 2009 by the directive of the secretary-general of the MoF.

The working rules for the state budget monitoring and reporting specify the following activities: reports on the state budget implementation from the state treasury; analysis of other governmental sector budget positions; analysis of state budget implementation; overview of revenue receipts, reserves and debt; preparation of a monthly overview on the economic situation, receipt of state budget revenues and use of state budget funds; analysis of the reports on the activity plan implementation; analysis of the reports on the state budget implementation; analysis of public sector financial indicators, etc.

3.1. Managerial accountability and responsibility

The final managerial responsibility in the public sector is assigned to the head of the respective authority by law (who is politically appointed at ministry level). As a rule, the sole management principle is usually applied in governmental authorities. The chain of responsibility is such that the lower-level manager is accountable to a higher-level manager. There is no distinct separation of political and administrative power (especially at ministry level). Moreover, the roles of a chief executive officer and a financial executive officer are not described by law. The delegation of responsibilities and liability and granting officials the rights necessary for them to perform their work duties is decided upon by the head of the organisation.

Within the context of the state budget, the responsible person is the Minister for Finance, to whom other ministers are accountable. The Minister for Finance is accountable to the government; the next level is the parliament. The state budget preparation process is based on the state budget strategy on the basis of which an annual SBA is prepared. This, together with the annual activity plans of the development plans of the ministries' areas of government, forms the application document of the state budget strategy. Consequently, according to the legislation, the state budget strategy and the annual state budget are the central governance instruments and policy tools for the government in power.

According to the Government Act, the responsibility for creating and applying the internal control system lies with the head of a governmental authority or an authority under its administration. The Government Act provides that the ministries and the state chancellery are accountable to the government. The heads of sub-offices are accountable to the relevant minister or the state secretary. The governmental authorities use state budget funds and prepare reports about using them as specified by law.

The Government Act stipulates the competence of a minister as head of the ministry, according to which the minister must:

- make proposals to the government concerning the draft annual budget of expenditure and revenue and, where necessary, concerning the draft supplementary budget of the ministry, decide on the use of budget funds and monitor the accurate and purposeful implementation of the budget and the purposeful use of the funds, aid and grants allocated by the European Union, along with other foreign aid;



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- approve the budgets of state authorities within the remit of the ministry on the basis of the state budget, and monitor their implementation and, where necessary, issue precepts for the use of budget funds;
- specify the structure, operations and administration of state authorities within the remit of the ministry, unless this is provided for by legislation with a higher authority than a regulation of the minister;
- approve the staff of governmental authorities within the remit of the ministry, unless it is stipulated otherwise;
- report to the government on the activities of the ministry;
- ensure implementation of the internal control system and the organisation of internal audit in the ministry, the governmental authorities within the remit of the ministry and the state authorities administered by such governmental authorities.

When drawing up the state budget, the final responsibility for the state budget principles, the preparation of an annual budget and reporting on its implementation to the government is on the Minister for Finance as provided for by law.

The introduction of performance budgeting, together with the possible introduction of accrual-based accounting principles for budget preparation, would increase the responsibility of the heads of state authorities for ensuring efficient planning and effective use of resources. This would entail a need to supplement the liability mechanisms for the violation of budgetary discipline, which are currently quite insufficient.

According to the Government Act, an internal control system is a comprehensive set of measures implemented in the directing of governmental authorities and state authorities administered by governmental authorities in order to achieve lawfulness and purposefulness and to ensure:

- compliance with legislation;
- protection of property from damage caused by squandering, non-purposeful use, incompetent management and other similar damage;
- the purposefulness of the activities of the authorities in the performance of their duties;
- collection, storage and publication of truthful, updated and reliable information concerning the activities of the authorities.

The head of a governmental authority and a state authority (administered by governmental authorities) must implement the internal control system in the authority and is liable for the efficiency of this system. According to the SBA and the Accounting Act, every state accounting entity is required to prepare an annual report which consists of the annual accounts and the activity reports. The annual accounts also contain a report on the state budget implementation. According to the Accounting Act, the activity report included in the annual report of a state accounting entity must contain the assessment of the internal control system by the head of the authority⁽³⁾ and an overview of activities undertaken by the state accounting entity in organising the internal audit function. The activity report also includes an overview of the implementation of the action plans prepared pursuant to the SBA.

The objective of the relevant consolidated reports is to give the *Riigikogu* and the public information about the most important activities carried out by the state authorities in the previous budget year. This means that an additional report similar to that for the planning process is provided with the consolidated report on the budget implementation.

Although the reporting system is formally in place, the content of the activity report in its current form is very uninformative and the quality of the data submitted is at times poor. It is hoped that by developing the concept of the state's financial management it will be possible to eliminate these weaknesses.

⁽³⁾ In 2009, the ministers and the State Secretary considered the major part of the internal control systems to be efficient. This means that the internal control system is actually functioning, complies with the requirements set in the procedure rules and ensures the lawfulness and economy of the entity's activity and the protection of resources.

3.2. Internal audit

Public internal audit was established in 2001. Due to the development of this function, the legal framework has constantly been updated. The most important legislative acts are the following.

1. The Government Act provides:

- the concept of the internal control system, the responsibility of the head of an authority to ensure efficient implementation of the internal control system in governmental authorities and state authorities under the administration of governmental authorities and organisation of internal auditor professional practice in the authority;
- the competence of a minister in organising internal auditor professional activity in the ministry and its remit;
- the competence of the MoF in coordinating the implementation of the internal control system and organisation of internal auditor professional practices;
- responsibility for applying requirements as set down by the Authorised Public Accountants Act (APAA) in organising professional practices of internal auditors.

The Government Act also specifies the responsibility of the head of a ministry's internal audit, as the consolidating entity, to evaluate the implementation of the internal control system and its efficiency and to submit a report on the matter to the minister or the State Secretary before approving the annual report for the fiscal year. The purpose of this provision is to give systematic feedback, as regards the use of public sector funds, to those responsible for governance, about whether risks are managed and decisions are followed.

2. The APAA specifies inter alia the legal basis for internal auditors' activity in the public sector and public interest entities. It enables the checking of the competence of those who are active in the internal auditor profession, primarily their knowledge of professional standards. For this purpose, for example, someone that wishes to reach the level of professional internal auditor of a public sector entity must pass professional examinations on the special domain of public law and on an appropriate sub-area (CGAP). In order to ensure the high quality of the professional work performed by internal auditors as regards necessary education, the law sets down requirements concerning education (at least a bachelor's degree or a higher education diploma) and two years of practical work under the supervision of an acknowledged (certified) internal auditor. The law also supports the introduction of a system that enables the updating of the knowledge and skills of internal auditors on a continuous basis and ensures that the competence and high quality of internal auditors are maintained.

We intend to adopt legislation which will establish a requirement that the internal auditor of a public sector entity has to have a national certification from 1 January 2013.

3. Based on the APAA and according to the Ministry of Finance regulation 'Adoption of internal auditor professional practice standards', the important internal audit framework principles are adopted as positive law that the internal auditors are required to follow when managing the internal audit function, planning professional activity, performing work and reporting on work results. The above and other implementing legislation based on the APAA are planned to be adopted during 2011.
4. The General rules for internal auditing of the authorities of executive power (a regulation to be adopted pursuant to the Government of the Republic Act, currently in preparation) regulates the general principles for the professional activity of internal auditors and rules for reporting in an AEP. The general regulation includes:
- the principles for organising the professional activity of internal auditors in the AEPs;
 - coordination of the internal audit function within the remit of the ministry;
 - preparing a quality programme for the internal audit function and requirements set for the organisation of quality assessment;
 - reporting on the quality programme results.



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Internal audit departments have been established in all ministries (11) and a person responsible for internal audit has been appointed in the state chancellery. The internal audit function is centralised at ministry level in the governing areas of four ministries. Thirty-seven authorities have established a separate internal audit function (a person responsible for internal audit has been appointed or a relevant structural unit has been established) as of 31 December 2010.

The internal audit function is directly subordinated to the head of an authority, ensuring functional independence from other activities of the authority, necessary work conditions, access to important data, employees and physical assets necessary for the performance of work and direct contact with the head of the authority.

Internal audit departments function pursuant to the department statutes, which are approved by the head of the authority. The internal auditors who work alone work on the basis of their job descriptions, which must also include rights, responsibilities and liability pursuant to standards and must be approved by the head of the authority.

Internal audit activity is allocated in terms of activities giving assurance and advice as follows: in 2009 the percentage of assurance-related activities was 79 % and providing advice accounted for 11 %, whereas in 2010 assurance activities accounted for 72 % and advising 11 %.

Internal audit reports directly to the head of the authority, although the head of internal audit function has the right to forward audit outcomes to other persons to ensure implementation of recommendations made during an audit. According to the standards, the head of internal audit has to design and implement a monitoring system for monitoring implementation of recommendations submitted to the management. The principles, documents, etc. of monitoring are set down in the procedures of internal audit function.

When fraud is discovered during an audit, the internal auditor has to inform the head of the authority first. The principles for taking action in case of fraud and corruption are laid down in the Anti-corruption Act.

The portion of activities, beyond the duties of an internal auditor profession, performed by the internal audit units has reduced over the years. The most frequent duties beyond the duties of internal auditors are performing the duties of the keeper of declarations of economic interests, participating in working parties, conducting internal investigations, supervisory control and disciplinary procedures and, in a few cases, participating in assessment of the quality management system as a quality management system internal auditor. Such activities account for 15 % of the internal audit tasks on average.

Training for internal auditors is in part organised centrally, but a significant part of training stems from the specific needs of their unit or of internal auditors. In 2010, internal auditors of AEPs participated in training for a total of 842 man-days, which is 7.9 training days per one internal auditor on average. Centrally organised refresher training is justified when the internal auditors are assigned new duties or in case of significant topics that concern a large target group to ensure a similar understanding and application of adopted requirements. During the period from June 2006 to November 2010, the MoF organised 11 large training courses for internal auditors.

In 2010, the MoF started to develop a network of internal training providers consisting of internal auditors, through which 15 internal auditors active in the public sector will be trained and will conduct training for other public sector internal auditors in the near future.

The heads of internal audit of the state accounting entities assessed the fairness of annual reports and legality of transactions of the fiscal years 2004–10 as regards the audit of the use of funds. The NAO assessed the fairness of the consolidated annual report of the state, during which the NAO was allowed to base its work on the work performed by the internal audit units of the state accounting entities. In order to increase the degree of independence of assessments given on the fairness of annual reports and lawfulness of the transactions of the state accounting entities, the competence to assess the fairness of annual reports (of 2011 and the following fiscal years) and lawfulness of transactions has been given to the NAO.

According to the Government Act, the heads of internal audit of ministries and the state chancellery give an opinion on the implementation of the authority's internal control system and its efficiency (starting from fiscal year 2011). For the first time, the said opinion, concerning 2011, must be made and submitted to the minister or the State Secretary before the annual report for the fiscal year is approved.

3.2.1. Internal audit cooperation with external audit

The cooperation with the NAO is organised on two levels: on the level of the MoF and of the ministries' internal audit units. In internal audit-related cooperation, the MoF will involve the NAO:

- in the process of preparing draft legislation;
- as the participant and/or comment provider in projects concerned with the preparation of methodological guides;
- as the participant and training provider in internal audit training programmes;
- in the exchange of information with internal auditors (the auditors of the NAO have access to the internal auditors' extranet, they can read the information paper intended for the internal auditors, if they wish they can participate in the meetings of the heads of internal audit, etc.).

The internal audit units of ministries and the state chancellery partner up with the NAO in auditing the annual reports of the state accounting entities. The NAO may rely upon the work of internal audit when assessing the fairness of the consolidated annual report of the state and the lawfulness of transactions. To ensure the above, the scope of work will be agreed upon to avoid double work and to exchange working papers. The annual work schedules are also discussed to minimise the amount of double work.

3.2.2. Audit committees

The APAA stipulates the nature of an audit committee and the basic establishing principles, according to which an audit committee is an advisory body in the area of accounting, audit, risk management, internal control and auditing, exercising supervision and preparing the budget and ensuring lawful activity. The ministries do not have a duty to establish an audit committee, but when a committee has been established in a ministry, its duties include the ministry's entire remit and the members of the committee will be nominated and dismissed by the minister.

An audit committee shall have at least two members, of which at least two members must be experts in the field of accounting, finance or law. A member of an audit committee can be elected on his/her written consent. A member of an audit committee shall not be an internal auditor, a member of the management board or a procurator, an assistant minister or a secretary-general or a person performing audits.

3.3. Coordination of public internal control

According to the Government Act, coordination of implementation of the internal control system and organisation of internal auditing in the government sector are included in the remit of the MoF. For this purpose, the MoF carries out the following actions.

- Prepares draft legal acts that regulate the area of internal audit.
- Prepares general guides in the area of internal audit and internal control.
- Undertakes assessments to confirm compliance with the international standards for professional internal auditing.
- In cooperation with the heads of internal audits of ministries, prepares general development objectives for four-year periods. According to the current development objectives, all ministries must perform an internal quality assessment by the end of 2011, at the latest, and an external assessment by the end of 2012.
- Organises training to improve the professional skills of internal auditors.



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- Collects and analyses annual reports on the internal audit function. The heads of internal audit annually submit a summary about the organisation of the internal audit function in the authority to the FCD. Every year the head of the authority submits his/her assessment of the internal control system and an overview of the activities undertaken by the state accounting entity when organising the internal audit function as a part of the activity report included in the annual report of the state accounting entity.
- Analyses the results of the audits conducted on the annual reports of the state accounting entities and makes proposals to the government for eliminating the detected deficiencies. The heads of internal audit of state accounting entities form their opinion on the fairness of annual reports and lawfulness of transactions as of 2004 (until 2010). Every year the MoF analyses the deficiencies detected during the audits and prepares a summary of the detected problems for the government and makes proposals to the ministers for eliminating these problems. The proposals made by the MoF are discussed by the government while approving the annual reports of state accounting entities.
- Organises regular meetings for the heads of internal audit of ministries (usually three times a year) and periodic bilateral meetings with the heads of internal audit of ministries (every other year).
- Maintains a database of internal auditors which includes the contact details of all the internal auditors working in the public sector, information on their work experience, education, speciality, refresher training completed, certificates and language skills.
- Administrates the information environment 'Internal auditors extranet', with restricted access, on which are available legislation covering the area, guides, contact details of internal auditors, materials from organised training, work schedules, summaries of reports and feedback, etc.
- Publishes the quarterly informative paper *Internal auditor* for internal auditors.
- Advises and consults internal auditors.

From 2000 to 2009, the coordination of implementation of the internal control system and organisation of internal audit of governmental and state authorities, as well as analysing and making proposals to improve their efficiency, was the task of the FCD in the MoF. As of 2010, these tasks are distributed. Creating the policy concerning the professional activity of internal auditors and legislative drafting, including coordination of organisation of internal auditors' professional activity, is the task of the Business and Accounting Policy Department.

The task of the FCD is coordination of implementation of the internal control system and analysing and carrying out assessment of the professional activity of internal auditors or its organisation, including carrying out external quality assessment. To sum up, the tasks of the MoF in implementing the organisation's internal control system and coordinating the organisation of professional practices of internal auditors are the following.

1. When coordinating and analysing the implementation of the internal control system, the MoF shall:
 - give methodical instructions for implementation of and assessing the internal control system;
 - where necessary, organise a comparative analysis of the internal control systems established in authorities and make proposals for improving their efficiency;
 - collect and analyse information on the implementation of the internal control system of the authorities and its efficiency.
2. When coordinating the organisation of professional practices of internal auditors, the MoF shall:
 - provide interpretation of the internal auditor professional practices standard or part thereof;
 - assess and analyse the influence of regulations for organising the professional practices of internal auditors and make proposals to improve them;

- collect and analyse information on the organisation of the professional practices of internal auditors.
3. To organise the assessment of the professional activity of internal auditors or its organisation, the MoF shall:
- where necessary, advise authorities during internal quality assessment conducted pursuant to the internal auditor professional practices standards;
 - undertake external quality assessment of the internal audit function pursuant to the internal auditor professional practices standards.



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4. Financial inspection

In Estonia, there is no central governmental financial inspection authority. The Ministry of Finance has a central role as the local partner of OLAF in terms of processing violations relating to the use of EU funds, but the detecting of corruption and fraud as regards other state budget funds is conducted by other authorities and at other levels. The internal audit is instrumental in detecting violations and corruption within an organisation and it must assess the likelihood of fraud during audits and, upon detecting violations, notify the head of the authority and, if necessary, law enforcement authorities thereof. The NAO also deals with possible violations relating to state budget funds with the objective of giving the parliament and the public assurance through an economic audit that the public sector funds are used legally and efficiently. The NAO is an integral part of the public sector audit system as it audits externally the activities of, legal adherence of and use of funds by the public sector authorities.

Potential fraud and irregularities are prevented primarily by updating the organisation's control measures of the internal control system, regular risk assessment and establishment of the internal audit function. Some internal audit units conduct internal investigations and perform supervisory control. The principles of official supervision are set down in the Government Act.

There are general restrictions that apply to all employees in the public sector and specific restrictions that apply only to officials and are regulated by the Anti-corruption Act.

There are no direct sanctions in case of violation of the SBA. The principles of action, in case of a suspected case of corruption and fraud, are set down in the Anti-corruption Act. Investigation of cases of fraud and corruption is the competence of investigation bodies. Wherever there is a reasonable suspicion that an official has violated the law, behaved in a wrongful manner as regards state assets, misused powers or performed other corruption-related transactions or actions, the following authorities must be notified thereof in person or by submitting an application:

- the nearest police prefecture in the event it is related to officials working for local governments and state authorities and private companies/non-profit associations;
- the Security Police Board in the event higher state public servants are involved (the President, a member of the parliament, the Auditor General, the Chancellor of Justice, a judge, a prosecutor or a higher official of a governmental authority, the Chancellery of the Parliament, the Office of the President, the Office of the Chancellor of Justice, the NAO or a court);
- the Public Prosecutor's Office in the event officials employed in law enforcement authorities are involved (e.g. police officer).

5. Ongoing and future reforms

5.1. Centralisation of support services at state authorities (financial accounting and accounting, personnel recording and payroll accounting, records management to administer e-invoices and documents created in support functions).

The project aims at better management of information, at making such information more readily available and at reducing costs relating to the organisation of financial management, personnel management and administration activities. The reorganisation will make these activities more transparent, providing an operational overview. Rearrangement of support services enables a more expedient introduction of e-invoices and e-documents and

a web-based reporting system. The ministries will join the project in stages and all 242 authorities will be introducing a common system by 1 January 2013 at the latest.

5.2. Development of a strategic planning and financial management framework.

- Integration of strategic planning and budgeting frameworks to improve monitoring of government spending and policy performance and for prioritising objectives in limited-resource situations.
- Developing a sustainable method for setting performance indicators and objectives for use in performance-based budgeting and strategic planning.
- A better integration of performance information into management and budgeting processes through introduction of programme-based performance budgeting.
- Applying accrual-based budgeting principles. Offering the decision-makers accrual-based budget information besides the information that is currently available from the cash-based budget.
- Developing a method for budgeting programme expenses (cost) for the public sector.

5.3. Updating the legal framework for financial reporting (initiated) — devising principles for preparing and submitting electronic (XBRL-based) annual reports that are based on international financial reporting standards (IFRS).

5.4. Development of the information system STEP — the objective of creating an information system of strategic management and state budget planning is to enable efficient and operational integration of state strategic planning, budgeting, reporting and related tasks and activities into a comprehensive system. This system will ensure the availability of the information necessary for making strategic decisions in time, helping to improve the quality of data, supporting the complete process of state financial management and reducing, among other things, the amount of and the time spent on manual work. The development of this system is currently in the procurement planning stage.

5.5. Application of accounting-related audit activity, including professional certification of internal auditors and implementation of a quality monitoring system, within the scope of the law — the application period from 2011 to 2015 of the APAA includes development and adoption of all implementation acts, launching the professional examinations system and the monitoring system of the auditor activity and the complete introduction of the auditor activity register and maintenance thereof. The development of an accounting terminology dictionary will be started, while research papers and a master's study accounting project will be given support.

5.6. Implementation of an internal control system and organisation of the internal audit function in local governments — to implement the anti-corruption strategy the Local Government Organisation Act will be amended and is expected to come into force in January 2013, according to which:

- the council shall ensure implementation of the internal control system and organisation of the professional activity of the internal auditor in the local government;
- the rural municipality or town government shall implement the internal control system and be responsible for its performance;
- the local government unit has a right to establish an appropriate position or structural unit for performing internal audit;
- when organising the internal audit, the provisions set down in the APAA shall be applied in the local government;
- if an appropriate position or structural unit has been established in the local government for performing internal audit, the respective official or the head of the structural unit will submit the internal auditor's report to the rural municipality or town government before approving the annual report.

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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

Since the 1990s, internal control of central government finances, and related legislation in particular, has undergone significant reform and development. The concepts of internal control and, to some degree, principles concerning internal control, have been reformed during this period. Budget statutes define and enact internal control to be carried out under the responsibility of top management. Nowadays internal control is an integral element of management and related risk management following the principles of good governance, and as such an essential element of the performance management and accountability systems.

At the beginning of the 2000s, basic requirements for internal control had been included in budget statutes. However, there were still deficiencies in the steering of internal control and in uniform operating policies. In practice, internal control had not yet been sufficiently integrated in management systems and procedures as part of performance management. In addition, no uniform system existed at the level of government and central government finances as a whole to ensure the sufficiency of internal control. For this reason, the Ministry of Finance set up a working group on 18 December 2001 to examine the development of the procedures of drawing up the final central government accounts and to present proposals on necessary legislative changes. The working group cooperated closely with a working group on the reporting process, established by the parliament's Speaker's Council.

The importance of internal control was further emphasised in the accountability reform and related amendments to budget statutes which took place in 2003. These changes included the following:

- the basic criteria for accountability and performance were redefined in legislation;
- the government's financial status report and the state's financial statement and report were merged into a new report on the final central government accounts, presented to parliament;
- the structure of financial reporting by government agencies and ministries was specified with regard to accountability and performance, and in particular with regard to preparation of performance reports regarding the achievement of set performance targets;
- an obligatory declaration assessing the functionality of internal control and risk management was included in financial reporting by government agencies and ministries;
- the responsibility of the ministries in steering their administrative domains and policy sectors and implementing the performance liability was emphasised by requiring annual

⁽¹⁾ Contributed by the Government Financial Controller, Ministry of Finance on 1 April 2011.

evaluation and comment by the ministries on the final accounts and audit reports of their subordinate units which are required to prepare their own accounts;

- a joint government controller function was established at the Ministry of Finance for the preparation of the report on the final central government accounts; to ensure that a true and fair report is given; for internal control of the state of central government finances and utilisation of reporting and evaluation; and for the development of the control and reporting system on central government finances and operations;
- an advisory board for internal control and risk management was set up for the development of internal control and the planning of cross-sector cooperation and preparatory measures, with representation from all ministries and certain other bodies key to internal control;
- an internal audit division was established for coordinating and developing internal auditing, with representation from internal auditing functions at all ministries.

2. Public internal control environment

2.1. Principles of budget preparation

After possible changes, parliament approves the budget presented by the government and possible supplementary budgets. The budget is prepared for one financial year at a time. A financial year is equal to a calendar year. The estimates of annual revenue and the appropriations for annual expenditure are entered in the budget as gross amounts, deducting neither expenditure from revenue nor revenue from expenditure (gross budgeting). Provisions can be laid down by law that, in the case of certain revenue and expenditure, only the estimated revenues or appropriations equalling the balance between them may be entered in the budget (net budgeting).

The budget may contain three types of appropriations.

1. A fixed appropriation, which cannot be exceeded or transferred to a later financial year.
2. An estimated appropriation, which cannot be transferred to a later financial year. Permission to exceed an estimated appropriation may be granted if the excess is based on a statutory need, or a comparable need, or some other compelling unforeseen need or a need that is difficult to estimate.
3. Transferable appropriations, which cannot be exceeded. A transferable appropriation may, in accordance with what is decided in the budget, be carried over for use during a period not exceeding two financial years following the financial year in question.

In the budget, items of revenue or expenditure are allocated to the financial year to which they are applicable. Allocation is primarily made on the basis of the delivery of a product or service or the receipt of a production factor. For instance, procurement expenditure is budgeted for the calendar year when the purchased product or service is received. Expenditure is not carried forward in the budget.

2.2. Principles of central government accounting and preparation of final central government accounts

The state has an accounting obligation for its budget economy. The budget economy is divided into accounting units, which comprise ministries, government agencies and public bodies. Accounting data from the accounting units is compiled into the state's consolidated accounts for the preparation of the final central government accounts. The state treasury collects the accounting data and manages the consolidated accounting.

The accounting units are responsible for their payment transactions and accounting and, as government agencies and public bodies, prepare their annual accounts and reports on their operations.

Central government accounting comprises budget accounts and general accounts. The accounting must comply with good accounting practices. Budget accounting monitors the implementation of the budget and the general accounts show income and expenditure as well as the financial position regarding assets and liabilities.

Government agencies and public bodies must provide true and fair information on their compliance with the budget, their revenues and expenditure, their financial position and their operative performance in their annual accounts and in the report on their operations, compiled in order to implement accountability.

For each financial year, the government submits the report on the final central government accounts to the parliament. The report includes the final central government accounts and other necessary information on central government's financial management and compliance with the budget, as well as information on the most important aspects with regard to the societal effectiveness of central government activities and development of performance. The report also includes key information on the development of societal effectiveness and performance in the ministries' administrative sectors.

The final central government accounts include:

1. a budget implementation statement on the implementation of the budget, specified by budget section or sector and by chapter and item;
2. an income and expenditure statement on revenue and expenditure;
3. a balance sheet illustrating the financial position on the final day of the financial year;
4. a cash flow statement illustrating cash flows;
5. notes that are required to provide true and fair information.

2.3. External audit

The National Audit Office of Finland is an independent body operating within the parliament (supreme audit institution). The National Audit Office is tasked with auditing national financial administration in order to ensure that it is appropriate and is carried out in compliance with legislation and the budget.

By the end of September each year, the National Audit Office submits a report to parliament on its operations, and special reports when necessary.

3. Public internal control

3.1. Managerial accountability and responsibility

Internal control in central government is defined as follows: internal control refers to procedures included in the agency's guidance and operating processes, organisational solutions and operating methods that can be used to obtain reasonable assurance of:

- the legality of operations;
- the security of funds;
- operational performance; and
- the production of true and fair information on finances and performance.

According to Section 24 b of the Budget Act, government agencies and public bodies must ensure that internal control is appropriately arranged in their own operations and in activities for which they are responsible.

Risk management identifies, evaluates and manages factors that threaten to hinder the attainment of objectives included in the four categories mentioned above. Risk management has the same goals as internal control. Ideally, internal control and risk management procedures are integrated into the agency's usual planning, management and operating processes. Typical examples of such procedures include:

- the planning of objectives and operations and identifying and evaluating risks that threaten to hinder the attainment of objectives;
- management of information required in operations using information systems;



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- technical control and reporting procedures for exceptional situations, included in information systems;
- differentiation of tasks.

According to Section 24 b of the Budget Act, the management of each agency is responsible for the arrangement of internal control, as well as its appropriateness and adequacy.

The top management of an agency bears the primary responsibility for the arrangement and management of internal control, in the same way as it is responsible for meeting the organisation's targets and arrangement of related activities. The management carries out the measures necessitated by this responsibility by delegating tasks to various levels of the organisation in accordance with their management system. With regard to internal control, delegation often means allocating tasks and responsibilities to subunits so that the subunits are responsible for their operations and the identification, management and reporting of related risks.

Pursuant to Section 65 of the State Budget Decree, the report on operations, included in the final accounts of an accounting office, must include an assessment of the appropriateness and adequacy of internal control and related risk management, as well as a statement on the status of internal control and key development targets, drawn up on the basis of the assessment (assessment and statement of assurance of internal control).

The assessment should be:

- genuine — not apparent;
- systematic — it should be based on comparing the present state to accepted criteria in the framework;
- sufficiently extensive — it should cover all relevant operational and support processes in activities the agency is responsible for;
- documented — it should cover all relevant operational and support processes in activities the agency is responsible for;
- approved by the management — enabling the evaluation of internal control, which is the management's responsibility.

In 2005, the advisory board for internal control and risk management, established by the government, prepared a recommendation for government agencies and public bodies on approaches to internal control and risk management and on the assessment of their functionality. The recommendation is intended as a tool to support government agencies, public bodies and funds as they evaluate and develop their own internal control and risk management processes. Efficient internal control and risk management enhance the operating unit's performance and are an essential element of good governance. In 2008, a more concise version of the recommendation was issued, which can be used as an alternative to the more extensive framework, for instance in smaller agencies.

When applying the evaluation frameworks, the functionality of internal control and risk management is assessed by examining the following aspects that influence it:

- the agency's operating environment;
- setting of objectives;
- identification, evaluation and management of risks;
- controls (control measures);
- communication and flow of information; and
- monitoring of internal control and risk management performance.

Government agencies and public bodies can also utilise other commonly approved evaluation frameworks (for instance, COSO, COSO-ERM, CoCo) in evaluating the functionality of internal control and risk management. Using a generally approved framework supports systematic, documented evaluation of internal control. The evaluation framework should always be adjusted to correspond to the agency's needs.

The internal control assessment can be implemented in different ways. It can be carried out through self-assessment by the management group, through decentralised self-assessment, through assessment supported by internal audit or through information gathering and assessment with assistance from an external specialist. Responsibility for the evaluation of the various aspects can be assigned in a variety of ways.

Information obtained in the assessment must be utilised in the planning and execution of the agency's operations. Based on the assessment results, the agency can prepare the assessment and statement of assurance of internal control, to be included in the report on operations.

The assessment and statement of assurance of internal control included in a government agency's report on operations should, in short, contain the following elements:

- statement on managerial responsibility;
- method of assessment implementation (reference to the framework, for instance);
- conclusions on the state of internal control; and
- possible development targets.

3.2. Internal audit

Internal audit supports the efficiency of internal control and risk management at ministries and government agencies. Management at ministries and agencies are responsible for the due implementation of internal control and risk management processes.

There is variation between ministries and government agencies in how internal audit is arranged. Many of the smaller agencies in particular do not carry out separate internal audits. Also, the Ministry of Finance has no internal audit unit or internal auditor. In many agencies, internal auditing is a function carried out by one person.

As laid down in Section 70 of the State Budget Decree, internal audit is arranged at the discretion of the ministry's and agency's management. In their consideration, the management should evaluate the need for an internal audit in relation to internal control needs and requirements of European Union Law.

The ministry's and agency's management must arrange an internal audit if there is justified need for an audit on the basis of internal control procedures. The purpose of an internal audit is to determine the adequacy and sufficiency of internal control for the management, and to perform the auditing duties prescribed by the management.

Common standards and recommendations concerning internal auditing must be taken into account when arranging the internal audit.

The rules on internal auditing procedures and the status of internal audit in the organisation of the government agency or public body are provided in the rules of procedure on internal auditing, which are confirmed by the government agency or public body itself. The rules of procedure on internal auditing must be submitted for the information of the ministry concerned and the National Audit Office.

A model of the rules of procedure has been drawn up with a view to an internal audit organised independently by an agency. Government agencies and public bodies must critically evaluate the model's applicability to their own operations and, where necessary, add, remove or adapt its content to better suit their own operations. The model can also be utilised in the preparation of rules of procedure on an internal audit that is carried out as an outsourced service, provided that the applicability of the rules of procedure to the agency's operations is ensured.

The agency's management decides on the organisational status of the possible internal auditing unit. Most commonly, internal audit is directly subordinate to a ministry or the senior officials of an agency. In this case, internal audit reports directly to top management and gets its powers from the top management.



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3.3. Coordination of internal control

Since 2004, the Government Financial Controller's function has operated within the Ministry of Finance.

The Government Financial Controller's function is the government's joint supervisor of performance and finances. He/she serves as an advisor to the government and top management at ministries, as an administrative controller and as an independent supervisory authority in ensuring and developing the quality of the control and reporting system on central government finances and in ensuring financial accountability.

The Government Financial Controller's function is responsible for ensuring that the report on the final central government accounts provides true and fair information on central government finances and performance. It steers, coordinates and develops the reporting and assessment of central government finances and financial performance. The function's scope of duties covers the assessment of performance and finances, strategic accounting and steering and developing the assessment of the financial implications of legislation. The function also manages the guidance, coordination and development of internal control and related risk management, as well as arranging government-level activities and reporting related to the control and prevention of misuse of EU funds that the state is liable for.

In carrying out its duties, the Government Financial Controller's function takes advantage of expertise possessed by the Ministry of Finance and other ministries and authorities.

The advisory board for internal control and risk management operates within the Ministry of Finance. The advisory board is tasked with:

- monitoring and evaluating the state and procedures of internal control and related risk management within central government and its methods and general development, as well as the functionality and utilisation of internal control procedures in the guidance and management of finances and operations;
- taking initiatives to develop internal control and related risk management;
- coordinating the procedures of various authorities and government agencies and public bodies in internal control and administrative monitoring of financial management, and preparing the required measures;
- monitoring and evaluating the state of internal audit arrangements, the quality and performance of internal audit, its utilisation in management and guidance, as well as the procedures and general development of internal audit and making initiatives to improve internal audit and its utilisation;
- arranging cooperation between internal audit functions at different government agencies and public bodies and coordinating the internal audit operations and the utilisation of results in different agencies;
- monitoring and evaluating the control and audit of EU funds in Finland, as well as related reporting, and coordinating and developing the related measures and procedures of various authorities, government agencies and public bodies, while preparing measures required for coordination and development;
- preliminary handling of Finland's reply to the Commission of the European Communities for the Court of Auditors' annual report, as referred to in Article 143(6) of the Council Regulation (EC, Euratom) No 1605/2002 on the Financial Regulation applicable to the general budget of the European Union;
- monitoring and evaluating the situation of misuse or crime committed in the operations of government agencies and public bodies, or targeted at the state's funds or assets, or funds or assets the state is responsible for, and coordinating and developing the operations and procedures of various authorities and government agencies, as well as reporting concerning misuse and errors;
- preliminary handling of the information on Finland, compiled for the report, as referred to in Article 280(5) of the Treaty establishing the European Union; and

- arranging training and cooperation and compiling and disseminating good practice, as well as preparing proposals for recommendations and issuing statements on matters within the board's sector.

The advisory board for internal control and risk management is chaired by the Government Controller General, with the Government Deputy Controller General acting as deputy chair. The government appoints the advisory board and its members and their deputy members for three years at a time, so that the advisory board includes a representative from each ministry, as well as representatives from key cooperation partners in the sector if necessary.

The advisory board has an internal audit division for the assessment and development of internal audit, with representation from all ministries and the state treasury. The division develops internal audit procedures by preparing common recommendations and good practices for internal auditing. It does not, however, have authority over the internal audit units within ministries and government agencies.



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4. Financial inspection

No such body exists in Finland.

5. Ongoing and future reforms

Changes regarding internal control and risk management may be made in budget statutes. Particularly with regard to the tasks of the government financial controller's function and the advisory board for internal control and risk management, there have been discussions regarding the identification of a clearer focus for the operations.

With regard to internal audit, it has been debated at length whether ministries and government agencies should be obligated to arrange internal audits and how internal audit should be arranged.

Regarding the arrangement of internal audit, there has been debate on, for instance, centralising sector-specific internal audit in ministries, for example, centralising internal audit at the government level, creating an internal audit service centre and cooperating more closely at the administrative sector level and coordinating internal auditing.

With regard to an internal control framework, the current recommended model is based on the COSO-ERM model. Recently, debate has been initiated on whether ministries and government agencies should be supported in the possible implementation of the ISO 31000 risk management standard and related standards.

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Public internal control ⁽¹⁾⁽²⁾

Introduction

The French public administration has a long tradition of public affairs control, notably based on the principles of the Declaration of Human Rights ⁽³⁾ and enshrined in the Constitution ⁽⁴⁾, which is also reflected in the legal rules set out, for instance, in general ⁽⁵⁾ and specific civil service regulations and in the Public Procurement Contracts Code.

In 2006, the entry into force of the Constitutional by-law on budget acts (*La loi organique relative aux lois de finances* — LOLF) provided an opportunity to rethink the management of public expenditure and was accompanied by an evolution in the role of the main players involved in the control and management of the state's public finance. An objective-based public policy management, a results-oriented budget, a new system of responsibility, strengthened accountability and a new accounting system constitute the key features of the reform implemented in the French public administration.

Against the background of an accounting and financial organisation of the French state structured around a centralised accounting network, which guarantees the financial uniformity of the French administration and the separation of the functions and tasks assigned to the authorising officer and the accounting officer, the French public administration relies on a robust internal control environment (1 and 2).

Within this environment, an internal control system was developed based on the accounting and financial functions. The certification of the state's accounts required by LOLF served as a catalyst for the development and implementation of an effective internal control and audit system that

⁽¹⁾ Contributed by the General Inspectorate of Finance (Inspection Générale des Finances) on 27 April 2011.

⁽²⁾ This contribution on the PIC system of the French administration is based on the two main regulatory texts currently in force in the field, namely:

- Decree No 62-1587 of 29 December 1962 establishing the general regulation on public accounting (*Décret N°62-1587 du 29 décembre 1962 portant règlement général sur la comptabilité publique*);
- Constitutional by-law on budget acts (*La loi organique relative aux lois de finances — la LOLF*) of 1 August 2001. Moreover, the contribution takes up elements from the Report of the General Inspectorate of Finance on the organisation of state internal control and audit policy, published in October 2009, and from the Decisions of the 4th Council for the modernisation of public policies (4^{ème} conseil de modernisation des politiques publiques) of June 2010.

⁽³⁾ Declaration of the rights of man and of the citizen (*Déclaration des droits de l'Homme et du citoyen*) of 1789, Article 15 — 'Society has the right to require of every public agent an account of his administration.'

⁽⁴⁾ French Constitution of 4 October 1958.

⁽⁵⁾ Title I: Law No 83-634 of 13 July 1983 establishing the rights and obligations of civil servants (*Loi No 83-634 du 13 juillet 1983 portant droits et obligations des fonctionnaires*); Title II: Law No 84-16 of 11 January 1984 establishing statutory provisions on the national civil service (*Loi No 84-16 du 11 janvier 1984 portant dispositions statutaires relative à la fonction publique de l'État*); Title III: Law No 84-53 of 26 January 1984 establishing statutory provisions on the local civil service (*Loi No 84-53 du 26 janvier 1984 portant disposition statutaires relatives à la fonction publique territoriale*); Title IV: Law No 86-33 of 9 January 1986 establishing provisions on the hospital civil service (*Loi No 86-33 du 9 janvier 1986 portant dispositions relatives à la fonction publique hospitalière*).

focuses on accounting and aims at guaranteeing the quality of the state's accounts. Gradually, the internal control system was extended to the budgetary area (3).

The state administration is currently implementing a reform intended to control the risks related to the management of public policies under the responsibility of the ministries. This reform is designed to extend the scope of internal control to all 'businesses' and functions within all ministries and to establish an effective internal audit policy in the state administration (4).

1. Brief history of the public internal control (PIC) system

1.1. An accounting and financial organisation of the state structured around a centralised and unified accounting network

The accounting and financial organisation applicable to the state and to national public institutions, to local communities and to the public institutions attached thereto ('public entities') is set out by a decree ⁽⁶⁾ establishing the general regulation on public accounting. This piece of legislation regulates the separation of functions. In fact, financial and accounting operations resulting from budget implementation or from the statements of estimated revenue and expenditure of public entities devolve upon authorising officers and public accounting officers. Such operations regard the revenue, the expenditure, the treasury and the assets of public entities.

The authorising officer ('manager') function and the public accounting officer function are incompatible and are organised as follows.

- Authorising officers decide on the execution of revenue and expenditure. For this purpose, they certify the rights of public entities, settle the revenues, commit and settle the expenditure. Authorising officers are responsible for the certifications they issue.
- Public accounting officers are solely responsible for: taking over and collecting demands for payments remitted by the authorising officers, claims resulting from contracts, title deeds or other titles within their keeping, as well as for collecting fees in cash and any type of revenue that public entities are authorised to collect; paying the expenditure based on orders delivered by accredited authorising officers, on titles presented by creditors or on their own initiative, as well as following up complaints and other notifications; keeping and preserving monies and assets belonging or entrusted to the public entities; handling monies and moving cash accounts; keeping supporting documents and accounting records for the operations; keeping accounts according to the accounting position they hold.
- Public accounting officers are appointed by the Minister for Finance or with the minister's approval. They submit the accounts at least once a year. Under the conditions established by finance laws, public accounting officers are personally and financially responsible for the operations they perform and for regularly carrying out the controls set out in the decree mentioned above.
- Public accounting officers are organised in a network placed under the authority of the Directorate-General for Public Finance (Direction générale des Finances publiques — DGFIP).

DGFIP, a directorate of the Ministry of Finance, stands at the centre of public financial operations (cf. *infra*). Within its range of competences (execution of revenue and expenditure, book-keeping for local communities and their public institutions, economic and financial expertise services, field management, etc.), DGFIP is responsible for the payment of state expenditures and for state accounting. As such, DGFIP is the state's accounting and financial operator. In fact, DGFIP leads the state's accounting function through its network of public accountants (cf. *supra*). This organisation in an accounting network confers a significant degree of unity to the accounting and financial functioning and practice, which is a characteristic of the French administrative organisation.

⁽⁶⁾ Decree No 62-1587 of 29 December 1962 establishing the general regulation on public accounting (*Décret N°62-1587 du 29 décembre 1962 portant règlement général sur la comptabilité publique — RGCP*).

1.2. A budgetary and accounting reference framework profoundly reviewed in 2001

At the end of the 1990s, the French parliament initiated a reflection on the effectiveness of public expenditure and the role of the assemblies in budgetary matters and gave rise to a political consensus on the need to update the rules of budgetary and accounting management. LOLF was voted for unanimously in August 2001, thus establishing a new reference framework for the budgetary and accounting rules applicable to public administration.

Before LOLF, the powers of the government and of the parliament as regards the preparation, voting and implementation of the state budget were regulated by the Organic Order of 2 January 1959. That was a fundamental piece of legislation that provided a global framework for the budgetary procedure in the context of the rationalised parliamentarism of the Fifth Republic.

LOLF resulted from a bill of the National Assembly submitted in June 2000, which capitalised on a political agreement with the Senate and a consensus with the government. The text of LOLF was discussed between 7 February and 28 June 2001 and was validated by the Constitutional Council on 25 July 2001. LOLF was adopted on 1 August 2001 and fully entered into force on 1 January 2006. LOLF establishes the framework of the 'new financial Constitution of the state'. The finance law for 2006 was the first law that was fully prepared, adopted and implemented in accordance with the new budgetary framework.



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The key principles of LOLF:

► *A new structure of the state budget: budget planning according to public policies*

Under LOLF, the budget is no longer presented according to the nature of the expenditure (operating, investment, intervention, etc.), but according to public policies (security, culture, health, justice, etc.). The parliament and the citizen are therefore able to assess the overall resources employed in order to implement each state policy.

► *A new approach to public management: objective-oriented management*

One of the major issues of the public management reform was to make the state pass from a means-based culture to a results-based culture, so that each euro spent could be more useful and more effective. Thus, performance, i.e. the ability to achieve the expected results, lies at the centre of the new budgetary framework. Consequently, parliamentary debates both on the budget and on the budget implementation analysis no longer refer only to the appropriations and their justification, but also to the strategies and objectives of public policies. A chain of responsibilities was thereby established in the administration, in which public authorising officers play a major part.

► *A new view on state accounts: the general account of the state*

LOLF introduced a major reform of accounts, which are established henceforth according to the new accounting standards, which draw to a large extent on the practice of private companies. Starting from 2006, a major step was taken in the modernisation of state accounting. Accounts are more comprehensive and clear; they offer a better evaluation of the assets and allow the state to render a better account of its actions.

2. A stabilised internal control environment

2.1. A budgetary and accounting system based on transparency

2.1.1. A general budget structured on three levels: mission, programme, action

Major state policies are transposed into missions. The parliament votes the budget per mission. A mission is established at the government's initiative and can be ministerial or interministerial. The mission contains programmes. The parliament can alter the expenditure distribution among programmes within the same mission.

The programmes or the allocations define the implementation framework of public policies: the programme is the unit for parliamentary authorisation. It constitutes a global and restrictive appropriation arrangement. It issues from a single ministry and includes a coherent group of actions. It is assigned to a manager, appointed by the relevant minister. Each programme is associated with specific objectives and expected results. An indicative component of the programme, the action provides details on the intended destination of the budget allocations.

The voting procedure, distinguishing between commitment authorisations and payment appropriations, allows following up and covering of the liabilities of the state. All the appropriations, irrespective of the nature of the expenditure concerned, are voted on, on the one hand, as commitment authorisations (capacity to engage the state into legally binding commitments) and, on the other hand, as payment appropriations (cash volume needed during the year to cover the commitments made or the commitments that are to be made). This distinction between commitment authorisations (CA) and payment appropriations (PA) supports a multiannual view of the expenditure (payments made by PAs resulting from past commitments, initiation of CAs that do not involve immediate payments, etc.).

In order to identify the use of public funds, each programme displays a double presentation of its credits: by destination (actions) and by type of expenditure (staff, operating, investment, intervention, etc.).

2.1.2. Budget planning according to public policy objective

Each programme has a corresponding strategy, objectives and quantified performance indicators. These elements are included in the annual performance plans (APP) annexed to the draft finance law. Under the authority of the respective minister, the manager undertakes to meet these requirements. He/she will report the results obtained to the parliament at the time of the analysis of the law on the settlement of accounts and management report, in the annual performance report (APR). The state operators ('public agencies'), which implement certain sections of public policies, are included in the APP in order to have their contribution assessed.

The introduction in the same document of financial elements and of performance assessment encourages the permanent improvement of public expenditure effectiveness. The relevance, reliability and truthfulness of the indicators are evaluated by the Interministerial Committee for Programme Audit (Comité interministériel d'audit des programmes — CIAP) and by the Court of Auditors (Cour des Comptes) (cf. *infra*).

Therefore, in order to allow the members of the parliament and the citizens to have a clear and documented perspective on public expenditure, the budget presentation is based on the following.

- Justifying expenditure from the first euro: the administrations explain in their APP how they plan to use the appropriations and staff available, from the first euro. They explain the actual implementation in their APR at the end of the year.
- Analysing the cost of public policies: it consists of submitting to the parliament complementary information on the resources actually used within the programme in order to fulfil its objectives.

The assessment of the overall expenditure required for the implementation of public policies is presented *ex ante* for the appropriations in the APP and *ex post* in the APR for the expenditure incurred. In order to render a faithful image on the state's financial situation, the total costs (relying on the expenditure data from the general accounting) are subsequently evaluated and analysed in the APR.

2.1.3. A three-tier state accounting system

LOLF introduces a three-tier accounting system for the state ⁽⁷⁾.

- The general accounting of operations relying on the principles of accrual-based accounting.

⁽⁷⁾ Article 27 of LOLF: 'The state keeps an accounting of the budgetary revenue and expenditure and a general accounting of its operations. Moreover, it implements an accounting system that analyses the costs of the various actions initiated within the programmes.'

- The budgetary accounting, on an annual basis, which allows following up and returning expenditure at the time it is paid and revenue at the time it is collected. This offers a ‘cash register’ perspective.
- The accounting that analyses the costs of the actions that are part of the programmes, which completes the view on the budget.

The financial statements established in the general accounting and presented in the state’s general account offer a global perspective on the assets, the financial and property situation of the state. Thoroughly retracing the expenditure corresponding to a financial year, they offer knowledge of the costs of public policies.



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2.1.4. The financial statements of the state

According to the provisions of LOLF, the state’s general account (SGA) is established based on accounting standards that draw to a large extent on the practices of private companies and on international public standards (IFRS, IPSAS), but also takes into consideration the specificities of the state. Its format allows a clear and concise consultation of state accounts. SGA comprises four financial statements: the balance sheet, the profit and loss statement, the cash flow table and the annex.

Consequently:

- SGA lists and records the value of all the assets controlled by the state (real assets, roads, stocks, etc.) and all the amounts it has to or may have to pay in the future for current obligations. Providing an overall vision of state assets and commitments of expenditure, SGA represents an essential tool for the operational management of public finance, offering a higher added value as compared to budgetary accounting, destined for the parliament, the ministries and the citizens.
- The state accounts, supplemented especially as regards the commitments outside the balance sheet, the assets and the liabilities, support the strengthening of accounting internal control (cf. *infra*) and enable the performance of risk analysis within the ministries. SGA also leads to the improvement of governance within the state and to the encouragement of parliamentary control on public accounts.
- Due especially to the census of real state properties and stocks, SGA offers a better knowledge of the assets and encourages the development of a more effective management. By introducing the concepts of provisions and accruals, SGA gives authorising officers a sense of responsibility for the medium-term costs and risks associated with their actions. SGA therefore helps to improve public management.

2.1.5. An integrated financial information system

Chorus, the IT system (integrated management software package, based on SAP technology), is the financial information system of the state. It manages expenditure, non-tax revenue and the state’s accounting. It has been implemented in all central and decentralised state administrations since the end of 2010. Chorus is an accounting centralisation system and a steering system.

This IT system is shared by all the financial players of the state’s central and decentralised services: authorising officers, financial controllers, accounting officers, prefects, etc. Chorus is used for the management of the national budget, whose implementation is provided by the state services: the general budget programmes, the special accounts programmes (earmarked accounts, financial assistance accounts, business accounts, monetary transactions accounts, etc.) and the programmes of additional budgets.

2.2. The effective governance of public management

2.2.1. An organisation based on managerial responsibility

The programme manager (ProgM) is the central link of public management, integrating political and managerial responsibility. Under the minister's authority, the programme manager is involved in the elaboration of the strategic objectives of the programme under his/her responsibility; he/she guarantees its operational implementation and undertakes to fulfil the objectives associated therewith. The minister and the programme manager become accountable for the objectives and indicators specified in the APP. These national objectives are adapted, if necessary, for each government service. The programme manager delegates the management of the programme by establishing operational programme budgets (BOP), placed under the authority of appointed managers (MOBP).

The directors of financial affairs departments (DFAD) prepare, together with the programme managers and the directors of human resources departments, the decisions and the arbitrations in the budgetary field. They establish a framework for the ministerial management doctrines and for the decisions on the use of resources (e.g. purchase policies, building policy). They conduct the cost analysis within ministries, coordinate and strengthen the programme managers' implementation reporting requirements and coordinate the accounting and budgetary internal control tools. They have consulting, expertise and assistance competences. They are the official contacts of the financial control authorities and of the ministerial accounting departments.

2.2.2. Internal coordination authorities

The secretaries-general of the ministries are involved in the implementation of LOLF and in the setting up of the new public management systems. They play a major part in the organisation of the ministries and their role is to encourage the implementation of an accounting internal control system.

The budgetary and accounting control service is a single service providing a global view of the ministerial expenditure process. In each ministry, the budgetary controller and ministerial accounting officer (CBCM) ⁽⁸⁾ is placed under the authority of the Minister for the Budget in order to ensure a global view of the ministry's expenditure processes and its assets with a view to improving security and reliability. The CBCM:

- is in charge of financial control within the ministry;
- is the public accounting officer;
- coordinates the decentralised authorities responsible for financial control;
- submits to the budgetary authorities and to the authorising officer an annual report on the implementation of the budget and an analysis of the ministry's financial situation.

2.2.3. Horizontal harmonisation authorities

The Directorate for the Budget (La Direction du Budget — DB) is responsible, under the authority of the Minister for the Budget and Public Accounts, for establishing the framework for public finance and preparing the national budget. DB is also responsible for the implementation of LOLF concepts, being accountable in this respect to the ministries and parliament, as well as for the preparation of and compliance with budgetary standards: performance-based management, drawing up of annual performance projects and annual performance reports, justification to the last euro, development of cost-analysis accounting, budgeting and management rules, follow-up on staff costs, etc.

The Directorate for the Budget is also responsible for the evolution of budgetary and financial control. As such, it is in charge of training and running the network of budgetary and financial

⁽⁸⁾ Decree No 2005-1429 of 18 November 2005 on the organisation and management positions of ministerial budgetary and accounting control services (*Décret No 2005-1429 du 18 novembre 2005 relatif à l'organisation et aux emplois de direction des services du contrôle budgétaire et comptable ministériel — CBCM*).

control players within the central administration and in decentralised departments: budgetary controllers and ministerial accounting officers (CBCM) and financial controllers.

The Directorate-General for Public Finance (La Direction Générale des Finances Publiques — DGFIP), set up by the merger of the two major directorates in the Ministry for the Budget (Directorate-General for Taxes and Directorate-General for Public Accounting), takes practical actions at central and local level. After the establishment in the summer of 2008 of a unified central administration, DGFIP has undertaken to create, within each department, a single local — or regional — Directorate of Public Finance. These unified local directorates will be fully operational throughout French territory in 2012. DGFIP performs a series of taxation-related tasks (drawing up laws and rules on taxation, on the land registry and title registration, on the tax base, the control of tax returns, the collection of revenues, etc.) and public management tasks. DGFIP manages the state's centralised accounting function (cf. *supra*) and is a key actor in the implementation of the new public accounting and of the certification process.

The Interministerial Committee for Programme Audit (Le Comité interministériel d'audit des programmes — CIAP) is an interministerial audit structure within public administration. It has a double mission: on the one hand, to assess, for each programme, the correct application of the principles stipulated in the LOLF and, on the other hand, to ensure the relevance and reliability of the information annexed to the draft finance laws that supports the debates and the parliament's vote.

CIAP is therefore competent to assess, for each programme audited:

- the area of the programme and the allocation of appropriations per actions;
- the performance system (objectives and indicators) associated with the programme;
- the operational diversification of the programme and the managerial dialogue;
- the justification of appropriations from the first euro;
- the cost analysis accounting per action.

CIAP draws up an activity programme every year and depends on the means of general ministerial inspections for carrying out its missions. The parliament and the Court of Auditors receive the audit reports, the responses of the ministries and CIAP's opinion, by virtue of their communication right. Moreover, CIAP publishes an annual progress report, which presents the main lessons learnt from its audit campaigns and its suggestions on the methods that should be implemented in order to improve service management under LOLF and the quality of the information submitted in support of financial draft laws.

2.2.4. The parliament's role

The parliament decides on all appropriations. Each mission is subject to vote. The members of the parliament can take the initiative to increase the appropriations of a programme, provided that the total amount of the mission to which the programme belongs does not increase. They can also create, eliminate or modify a programme.

Parliamentary control also has several other leverages:

- control on the movements of appropriations under management;
- investigatory powers of the finance committees⁽⁹⁾, which allows them to carry out any types of investigations on specific items and on the spot and to organise any hearings deemed necessary;
- precise definition of the mission to assist the parliament entrusted to the Court of Auditors⁽¹⁰⁾.

Parliamentary control is frequent, especially as exercised by the finance committees. The finance committee of the National Assembly established a fact-finding mission on the Organic Law re-

⁽⁹⁾ Article 57 of LOLF.

⁽¹⁰⁾ Article 58 of LOLF.



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garding finance laws (*mission d'information sur la loi organique relative aux lois de finances — MILolf*). Since 1999, it has performed several 'evaluation and control missions' every year. The objective of an 'evaluation and control mission' is to ensure the effectiveness of public expenditure. Within the Senate, the special rapporteurs of the finance committee, belonging to the majority and to the opposition, publish an increasing number of control reports.

Moreover, the Court of Auditors, in its assistance mission (cf. *infra*), contributes to the parliamentary control on the implementation of finance laws, i.e. to the control of the compliance with the budget authorisation voted by the two assemblies. As such, it submits to the parliament:

- a preliminary report on the implementation results from the previous year, for the public finance guidance debate;
- a report on the results of the previous financial year and on the budget management, annexed to the bill on accounts settlement and management report;
- an explanatory report to the parliament when the government performs movements of appropriations, which must be ratified by the following finance law (advance decree).

Since 2002, the Court of Auditors has been bound to answer any assistance requests from the president and the rapporteur general of the finance committees of each assembly. Moreover, it has the obligation to carry out, on their request, any investigation on the management of services and to present its findings within eight months.

2.2.5. The role of the Court of Auditors

The Court of Auditors checks the accounts of public accounting officers and reports on the adequate implementation of public expenditure. It verifies the regularity and the effectiveness of expenditure. For this purpose, it establishes a working plan independent from the government and the parliament.

The assistance mission to the parliament and the government on the implementation of finance laws and of laws on social security financing is set out in the Constitution ⁽¹¹⁾ and formalised in the LOLF ⁽¹²⁾.

The Court of Auditors is responsible for certifying the regularity, the truthfulness and the faithfulness of state accounts, of the accounts of national entities within the general scheme, of the mixed accounts of branches and of collection operations within the general social security scheme. This mission was assigned to the Court of Auditors by LOLF in 2001 — as regards the state — and by the Organic Law regarding social security financing laws (*Loi organique relative aux lois de financement de la Sécurité sociale — LolfSS*) in 2005 as regards social security.

2.3. The systematic control of legality within the state administration and the fight against fraud and financial irregularities

The decree establishing the general regulation on public accounting (cf. *supra*) sets out the control methods of budgetary resources. In fact, there is a systematic control on the authorising officers' management and on the public accounting officers' management. The authorising officers' management is controlled, according to the rules specific to each 'public body', by the parliament, qualified legislative bodies, competent audit bodies and committees and the Minister for Finance. The public accounting officers' management is controlled, according to the rules specific to each category of accounting officers, by the Minister for Finance, hierarchical superiors and the competent control bodies. The Minister for Finance performs the controls mentioned above through the General Inspectorate of Finance and other bodies or agents authorised for this purpose by specific legislation.

The general inspection services or the inspection services specific to each ministry are responsible in particular, within the public administration, for the fight against fraud and/or irregularities by means of financial inspections. The general inspection services or administration inspection

⁽¹¹⁾ Article 47 of the Constitution.

⁽¹²⁾ Article 58 of LOLF and Article 1-VIII of the Organic Law regarding social security financing laws (*Loi organique relative aux lois de financement de la Sécurité sociale*) of 2 August 2005.

services have variable scopes of competence: a central administration directorate and its network, a whole ministry and, in several cases, an interministerial competence area. According to the intervention area, these services are assigned to the highest level of the organisation (minister or General Managing Director). The typical missions of the administration services in the field of financial inspections are performed in case of the occurrence of an undesirable event, leading to disciplinary sanctions or criminal penalties. Financial inspection missions target primarily the rectification of major irregularities or dysfunctions.

3. A public internal control system implemented on the accounting and financial functions

Any risk management approach only makes sense in relation to the objectives of the entity. The entry into force of LOLF in 2006 enabled for the first time the systematic formalisation of the objectives of the administration. LOLF directs the legislator to adopt each year, by means of finance laws, the strategic objectives assigned to the government as a whole and, within the government, to each ministry. The programme managers then assign the objectives to the manager of each BOP.

The accountability requirement presupposes that the programme managers, the ministers and the government are able to verify the fulfilment of the objectives set out in the finance law, to justify the discrepancies found and to suggest corrective measures or the reconsideration of certain performance objectives.

Until recently, the administrative culture and the management framework favoured external control actions: on the one hand, the external control during the operations, such as the control traditionally performed by public accounting officers or financial controllers (cf. *infra*); on the other hand, the inspection activity, which consists in carrying out isolated, usually unexpected external controls, in order to analyse, rectify and, if necessary, sanction major irregularities or dysfunctions. The administration also has to ensure the strict application of the legal rules issuing, for instance, from general and special civil service regulations or from the Government Procurement Code. Additionally, automatic controls are performed for large IT systems and procedural rules specific to public entities or public practices are applied.

The set of rules and control measures that govern state administration are not related to a global internal control system yet, and the inspection function is not directly equivalent to that of internal audit. In fact, as part of the public management reform, the development and the implementation of an accounting and financial internal control system has been widely encouraged.

3.1. An internal control system based on the accounting and financial processes in view of the certification of state accounts

In order to ensure that state accounts can be certified with minimum reserves, the government encouraged the implementation of an accounting and financial internal control system and of the internal audit function associated thereto. In order to ensure the quality of the accounts presented by the state to its external auditor (the Court of Auditors), internal auditors evaluate, according to the professional rules governing the practice of internal audit⁽¹³⁾, the existing accounting and financial internal control system or assist, by means of consulting assignments, the manager in developing their accounting and financial internal control system. Within this certification process, the work relationships between external and internal auditors are regulated by standard ISA 610⁽¹⁴⁾.

Therefore, the current internal control system is centred on the accounting and financial function, at the initiative of the Directorate-General for Public Finance as a part of its responsibilities related to the keeping of state accounts. As such, it is subject to the verification of the Court of Auditors, which has the responsibility to certify that the state's accounts are legitimate, truthful and reflect accurately its financial situation. DGFIP services are present throughout the public



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⁽¹³⁾ International standards on internal audit of the Institute of Internal Auditors.

⁽¹⁴⁾ International Standard on Auditing (ISA) 610: 'Using the work of internal auditors'.

administration: in the central services of the ministries, as ministerial accounting and budgetary control (MABC) services, which are also functionally attached to the Directorate for the Budget as regards their competence as financial controllers, and at decentralised level, throughout the treasury network, which is being gradually integrated into the new unified network of the DG-FiP ⁽¹⁵⁾.

By means of its network, DGFIP leads and organises the accounting and financial internal control system throughout the state administration. In partnership with the Secretaries-General and the Directors of Financial Affairs, MABC services implement control measures in the ministries assuring the accounting quality of the operations and financial transactions.

The accounting and financial internal control system is formalised into reference documents that apply to the work process throughout the entire chain of expenditure and revenue. In all ministries, these reference documents are supported by a mapping of accounting and financial risks, updated regularly by the relevant managers. The application of these reference documents is subject to internal audit assignments conducted by the national audit department of DG-FiP ⁽¹⁶⁾, often carried out jointly with the internal auditors of the relevant ministries.

On the whole, the accounting and financial functions are the only functions subject to an internal control system in all ministries. This situation results from the interministerial responsibilities of DGFIP: as a partner of the Court of Auditors, with relays in all ministries, it was able to lead the establishment of the accounting and financial internal control system at interministerial level and to assist all ministries in its implementation.

3.2. The extension of accounting and financial internal control to the budgetary area during the financial control reform

The means of exercising financial control ⁽¹⁷⁾, hereinafter ‘budgetary’, must observe the balance between the manager’s responsibility and the control of his or her actions. Its objectives focus on the identification and prevention of budgetary risks by ensuring that the state and its representatives responsible for expenditure make commitments within the limits and conditions sustainable by the budget, now and for the future, in compliance with parliament’s authorisation. The controller:

- guarantees a priori that budgetary planning is consistent and sustainable at its different levels, i.e. the programme and the BOP, and that it falls within the limits of parliament’s authorisation;
- secures budget implementation by ensuring an accounting follow-up of the ministry’s commitments and a priori or a posteriori control of the main documents and procedures leading to expenditure commitments;
- informs, based on analyses, all the stakeholders, namely the minister responsible for the expenditure, the Minister for the Budget and parliament, on the levels and determinants of expenditure and, if necessary, participates in regulating it;
- serves as an adviser to the budget manager by offering clarifications and guidance in the framework of the control dialogue.

The financial control reform was conceived with the aim of developing an internal budgetary control system. Instead of a control performed systematically during the operations, which may slow down the implementation of expenditure and, consequently, affect the efficiency and the effectiveness of public action, financial control encourages the authorising officers to equip themselves with tools and methods in order to control their operations. Under the supervision of the financial controller, they perform the controls themselves, on the basis of a risk analysis of budgetary sustainability.

⁽¹⁵⁾ Within its own structure, DGFIP also created two complementary systems of internal audit and risk control, regulated by two circulars of the Director-General of 30 July 2009.

⁽¹⁶⁾ DGFIP’s national audit department, under the authority of the Director-General for Public Finance and supervised by an audit committee, brings together the national and the local audit network (at regional and departmental levels).

⁽¹⁷⁾ Decree No 2005-54 of 27 January 2005 on financial control in state administrations.

The budgetary function is thus subject to a process similar to the accounting function. The Directorate for the Budget plans the implementation of a budgetary internal control system in all ministries. A budgetary audit and internal control service (MACIB), placed under the functional authority of the budget director, is charged with preparing future budgetary internal control standards and with drawing up the risk management system for the state budget. Like the accounting internal control system, the CBCM services, which play for every ministry the role of financial controller on behalf of the Directorate for the Budget, guide its implementation. The budgetary internal control system is intended to complement the accounting internal control system in order to ensure operational control all along the expenditure chain, from planning to payment.



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4. An ongoing reform designed to extend the risk management approach to all public policies

Therefore, internal audit activity was first developed in relation to the accounting and financial functions, and afterwards was extended to the budgetary area. In June 2010 the fourth Council for the modernisation of public policies (*Le quatrième conseil de modernisation des politiques publiques — CMPP*), chaired by the President of the Republic, validated a reform intended to extend the scope of the internal control approach to all the functions and ‘businesses’ within the ministries and to ensure a relevant and consistent development of the state’s internal control and internal audit policies by means of better risk management.

4.1. Controlling risks, henceforth an essential issue of public management

The implementation of LOLF, as well as the need to control risks in all public action sectors, requires the deployment of an effective internal control and internal audit system. For this purpose, each ministry must implement a relevant internal control and audit system, adequate for its organisation and objectives, aiming at ensuring the control of risks related to the management of the public policies under its responsibility.

4.2. The implementation, within the state administration, of an internal audit system in compliance with international standards

The reform initiated aims at ensuring the development and implementation of the state’s internal audit policy, according to three major objectives.

- Strengthening the internal control system in each ministry under the coordination of the secretaries-general; the system must be adequate for the organisation and objectives of the respective ministry and is meant to ensure the control of risks related to the management of the public policies under the ministry’s responsibility.
- Setting up a ministerial internal audit system by creating, within each ministry, an internal audit committee guaranteeing the function’s independence, as well as a ministerial internal audit function, responsible for ensuring the coordination of the internal audit policy for all the functions and ‘businesses’ within the ministry.
- Creating an internal audit harmonisation committee under the authority of the Minister for State Reform guaranteeing the consistency of the state’s internal audit policy and of the implementation thereof.

A draft decree lays down the organisation and functioning principles of the internal audit system within the state administration. It establishes the obligation of implementing a risk management system based on the internal control and internal audit within each ministry and provides for an internal audit harmonisation committee composed of heads of internal audit function from each ministry.

A draft circular complements the decree and establishes the conditions for setting up the ministerial internal audit function, the main features of which are presented below:

- an internal audit function attached to the highest level of the organisation and functionally dependent on the internal audit committee;

- an independent internal audit committee, charged with monitoring the ministry's overall audit policy;
- a ministerial internal audit function, placed under the authority of the head of the ministerial internal audit function, mainly responsible for drawing up the ministerial audit plan according to a risk-based analysis, supervising the performance of the assurance or consulting assignments included in the audit plan and ensuring the follow-up of recommendations;
- an internal audit chart defining the function's scope of competence and the activity of the internal audit function.

4.3. A proactive calendar for gradual implementation

The objective is to gradually set up an effective evaluation system of risk management systems on the basis of consistent governance at the level of all ministries and of a harmonised and shared methodological framework. The target system constitutes a medium-term objective for the administration. It shall be set up gradually, at the ministries' initiative, in several stages:

- adoption of the decree and of the circular regulating the state internal control and internal audit systems;
- establishment of the internal audit harmonisation committee and adoption of the statutory texts at ministerial level;
- setting up of the audit committees and of the ministerial internal audit functions by the ministries;
- extension of the risk management approach (mainly for financial risks) to all ministries;
- generalisation of internal control and internal audit to all 'business' areas of the ministries, as well as to the supporting functions, for the purpose of ensuring global risk management.



GERMANY

GERMANY

Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

2. Public internal control environment

2.1. Budget

The German budget, which is drawn up every year by the Federal Ministry of Finance and passed by the German Bundestag, contains all Germany's revenue, expenditure and commitment appropriations (budgetary funds) for a specific calendar year. The 2011 budget is divided into 22 sections, 178 chapters and 6 542 headings, of which 986 relate to revenue and 5 556 to expenditure. The inclusion of expenditure in an expenditure heading means that the administration is authorised to make payments to third parties during the current financial year. If the administration is already authorised in the current financial year to make commitments of payments in future financial years, commitment appropriations must also exist for each of the expenditure headings in question.

The budget does not contain any targets for the administration. No products are generated. No kind of performance budgeting whatsoever takes place.

2.2. Basic features of managing budgetary funds

Management is carried out on the basis of the headings. At the beginning of the budgetary year the Federal Ministry of Finance makes the budgetary funds for each heading available in its central IT system to the supreme federal authorities responsible for a specific section; i.e. the constitutional authorities (Federal President, Bundestag, Bundesrat, Federal Constitutional Court), the Federal Chancellery and the ministries. The authorised budget officers of the supreme federal authorities distribute the funds as far as possible and necessary to subordinate authorities and also to other bodies within the supreme federal authority. Funds can be distributed in several steps, with each heading finally having at least one heading administrator who is authorised to use the commitment appropriation assigned to him when implementing the budget or to make disbursements. There are over 8 000 heading administrators for the federal budget.

Under Section 70 of the Federal Budget Code (BHO) payments can be accepted or made only by the cash and payment offices. The heading administrator must therefore issue instructions to

⁽¹⁾ Contribution of the Federal Ministry of Finance on 17 June 2012. This contribution relates to the federation only.

a federal cash office for all receipts and payments by means of a written or (in most cases) electronic payment order. The federal cash office checks whether the payment order has been filled in correctly and signed by authorised persons whose signatures are recorded there. It books the payment in the central federal IT system.

Almost all payments are processed through federal accounts held at the German Federal Bank. The Federal Ministry of Finance and its authorised offices, such as the federal treasury offices, have sole access to the accounts, unlike an administrator (distributor of funds or heading administrator) from a federal authority with budgetary funds at his disposal.

When creating a payment order it is necessary to observe the dual principle; i.e. two people must always be involved.

The federal cash offices are monitored by the cash office supervisory authority, which is an independent body belonging organisationally to the Federal Centre for Cash and Accounts. The cash office supervisory authority checks the federal cash offices without prior warning.

3. The concept of public internal control

3.1. Managerial accountability

Top managers assume their responsibility for establishing an adequate internal control system by setting up and supporting an organisational control unit called the 'Interne Revision', hereafter internal audit.

Managerial accountability is carried out by the head of the authority.

The internal audit unit reports directly to the management, which cannot transfer its competence to other offices in the authority.

Under Section 9 of the BHO, an authorised budget officer is to be appointed for every department that manages revenue and expenditure, in so far as the manager of the department does not perform this task him/herself. The authorised officer is to report directly to the head of the department.

The authorised budget officer must draw up the financial planning documents and the documents for drafting and executing the budget. He/she is to be involved in all financially significant measures. He/she can delegate tasks involved in executing the budget and is also responsible for reporting.

The management can establish which specialist departments are to be entrusted by the authorised budget officer with managing budgetary funds. As a rule, the amount of expenditure an authority can devote to each purpose is already laid down in the budget. The management normally delegates the decision on which specialised departments can make payments, and the volume of these payments, to the authorised budget officer.

Internal audit covers all the aspects mentioned above. The management of the authority always determines the focus of the audits. It is not possible to monitor all the ongoing financial decisions in the authority. The internal audit unit always performs its monitoring on a selective and random basis only.

3.2. Internal audit

Internal audits are carried out in all departments of the federal administration. There is no legal basis, but all departments follow the 'Recommendations for internal audits in the Federal Administration', produced by the Federal Ministry of the Interior in agreement with the other ministries.

The internal audit unit does not take instructions from top management when drawing up audit reports. After completing an audit, it immediately submits the final audit report to the management of the directly superior authority.

On the basis of a threat or risk analysis relating to the authority and taking into account the cost/benefit ratio, the internal audit unit draws up a catalogue of audit topics on which it bases its audit plan. It then submits this plan to the management for approval.

The internal audit does not accept duties that are outside the scope of internal audit but fall under managerial responsibility, including the implementation of rules to solve conflicts of interest.

The internal audit unit takes suitable measures to ensure the quality of its work. These can include task-specific basic and further training, the exchange of experiences with other internal audit units and observing other internal audit units. The relevant ministries ensure the exchange of internal experiences, while the Federal Ministry of the Interior ensures the exchange of cross-ministerial experiences. There is no public certification procedure.

Audits can take the form of compliance audits, inventory audits, system-based audits, especially motivated audits or inspection audits (checking whether previous instructions and recommendations have been implemented).

Depending on their focus, the audits are carried out according to the following criteria in particular: legality, correctness, security, cost-efficiency, durability, usefulness/effectiveness and impact.

The management decides how the internal audit unit's recommendations are to be implemented. The auditee itself is responsible for implementation.

3.3. Internal audit relations with external audit

There is no relationship between the two. Internal audit is an instrument whose purpose is to support management in assuming its overall responsibility. The Federal Court of Auditors and its audit offices carry out external audits independently of the internal audit units. As a rule, the Federal Court of Auditors has no knowledge of the results of the internal audit units' work.

3.4. Audit boards or audit committees

There are no audit boards and audit committees in Germany. Clearly, bodies of this type have not been considered necessary up to now.

3.5. Coordination of public internal control

Each authority has only one internal audit unit. There are no other units acting as central coordination or harmonisation units in dealing with questions of PIC.

4. Financial inspection

There is no financial inspection department in Germany.

5. Ongoing and/or future reforms

No concrete reforms are being considered.



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GREECE

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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

Control of public expenditure is carried out by the executive (national administration), the judiciary (Court of Auditors) and the legislature (parliament — approves the state budget and ratifies the state final report and balance sheet). Control by the executive is carried out under Basic Law No 2362/1995 on 'Public accounting and control of state expenditure'. At administrative level, control of expenditure comprises internal control by the authorising officer (first stage), financial control by the financial control services of the Ministry of Finance, a body independent of the agency that carried out the expenditure (second stage), and *ex ante* control by the Court of Auditors, which approves payment of the expenditure (third stage) in the framework of administrative internal control.

The rapid developments of recent years, with the devolution of central government powers to the regions, the new organisational structure of local government and legal entities under public law and public undertakings and organisations which receive substantial resources in the form of funding or grants, the management of which has to be controlled by the finance minister, have resulted in the need to reform the public expenditure control system.

At the same time there was also a need to organise public accounting operations by putting into effect the Public Accounting Plan, which was done by Law No 2362/95, aimed at establishing the double-entry bookkeeping system, the standardisation of public accounts, the valuation of public assets and the preparation of financial statements. Following all this, on the initiative of the Ministry of Finance an ad hoc committee was set up within the State General Accounting Office to submit proposals to reform the public expenditure control system.

2. Public internal control environment

Law No 3871/2010 on 'Financial management and accountability' amended and supplemented the provisions of Law No 2362/95, setting out the new PIC environment. Specifically, with regard to state budget issues, the State General Accounting Office:

- draws up the medium-term financial framework for each financial year and any updates thereof, which is submitted by the Minister for Finance to parliament for approval and contains the medium-term financial objectives and targets regarding general results and forecasts for the year and the next three years, a summary of the main policy measures being examined for the annual budget and a statement of the principal sources of risk to the financial standing of general government;

⁽¹⁾ Contributed by the Ministry of Finance in Greece on 8 March 2011.

- establishes the draft annual state budget, which is submitted by the Minister for Finance to parliament for approval and contains specific proposals for the appropriations for the bodies of general government (central government, first-level and second-level local authorities and social security bodies) and monitors its implementation;
- draws up the state's final report and balance sheet and the other financial statements of central administration (ministries, devolved administrations and independent authorities), which are submitted by the finance minister to parliament for approval.

The state budget is normally prepared on a cash basis, i.e. it shows expenditure made and revenue received over the financial year. All public financial transactions of general government (revenue and expenditure) are structured and classified in the same category for both the budget and the accounting. These classifications, which correspond to accounts in the accounting plan, are structured in a way that ensures the comprehensive presentation of all revenue and expenditure in the annual state budget.

As regards accounting systems, the State General Accounting Office manages the general government's accounting system, known as the General Government Accounting Plan, a system which aims to account for central government's transactions in a homogeneous way, to give a true picture of its financial and asset structure, to assess its creditworthiness and to extract reliable data to simplify and facilitate all forms of control.

The General Government Accounting Plan is established by Presidential Decree No 15/2011 as double-entry bookkeeping in accordance with adjusted cash-basis accounting, the system based on the principle of accrual of revenue and expenditure. The balance sheet, the statement of financial performance, the statement of the change in the net worth of citizens and the cash flow statement are drawn up in line with the rules on double-entry bookkeeping and in accordance with the principles of adjusted cash-basis accounting.

The central accounting system of the central administration shows all the expenditure and revenue managed by the State General Accounting Office and the receipts and payments of local tax offices (DOY) relating to tax policy. In the framework of external control, all public expenditure of local authorities and other legal entities under public law and their revenue are subject to control by the Court of Auditors.

3. The concept of public internal control

Law 3492/2006 (Government Gazette Series I No 210 of 5.10.06) instituted the organisation of a control system to safeguard sound financial management of the state budget and of agencies not included in the state budget. The aforementioned law defines an internal control system as the overall system of managerial and other controls, including controls of the organisational structure, methodologies, procedures and internal audit, implemented by the administration on the operations of an agency in order to support the pursuit of its objectives in an efficient, effective and economical manner. The internal control system ensures compliance with administration policies, it safeguards the agency's assets and resources by certifying the completeness and accuracy of accounting documents and it provides timely and reliable information on healthy (sound) financial management.

3.1. Managerial accountability/responsibility

A Directorate-General of Financial Audits was established, by virtue of the aforementioned law, at the Ministry of Finance. Its mission is to safeguard sound financial management of the state budget and of agencies not included in the state budget, as determined in a joint decision issued by the Minister for Finance and the competent minister, as required. In order to realise its mission, the Directorate-General of Financial Audits:

- employs staff with increased formal and substantial qualifications;
- uses methods and models applied by international audit bodies;
- carries out audits:

- on the management of agency budgets in order to determine if the amounts granted to these agencies are used for the purposes for which they were approved, if the financial provisions in force are observed when expenditures are made, if the necessary measures for ensuring the collection of revenues are taken and if revenues are collected and appear in accordance with provisions in force;
- on management and control systems, in order to determine their adequacy;
- takes or recommends appropriate measures for improving the management and control systems of bodies in order to contribute to protecting their financial interests, to the lawful and effective management of their expenditures and to combating fraud, bribery and any other illegal activity;
- imposes the sanctions provided by law;
- cooperates with corresponding services of all other states and particularly those of the European Union in regard to issues related to its competencies;
- prepares an annual control report containing the conclusions and evaluations of its audits — this report forms the basis for the provision of adequate assurances to the Minister for Finance or for the expression of reservations in regard to part or the whole of the state financial management and control system.

The Directorate-General of Financial Audits comes under the General Secretariat of Financial Policy of the Ministry of Finance; the secretariat is headed by the Secretary-General of Financial Policy, who holds political office. The Secretary-General of Financial Policy supervises the Directorate-General of Financial Audits and has the following competencies:

- he/she is responsible for the successful carrying out of the mission of the Directorate-General of Financial Audits;
- he/she guarantees the integrity, effectiveness, objectivity and validity of the audit carried out by the Directorate-General of Financial Audits, as well as safeguarding the confidentiality of information received during the audit;
- he/she supervises and directs the personnel employed by the Directorate-General of Financial Audits;
- he/she takes or recommends appropriate measures for the protection of financial interests, for the lawful and effective management of expenditures, for combating fraud, bribery and any other illegal activity;
- he/she prepares and submits the annual control report of the Directorate-General of Financial Audits.

The Directorate-General of Financial Audits includes a Supervision Committee, which consists of the Secretary-General of Financial Policy, as chairperson, the Head of the Directorate-General of Financial Audits and the Heads of Directorates, with the following main competencies:

- approving the rules of procedure of the directorate-general;
- approving the annual audit schedule;
- monitoring the progress of audits;
- evaluating the audit work;
- approving the annual report;
- recommending the taking of additional measures in cases of non-compliance of audited parties with the recommendations of auditors;
- submitting recommendations to the Minister for Finance or any other competent minister for the improvement of management and control systems;
- monitoring and evaluating investigations to combat fraud and recommending measures to render these investigations more effective.



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The Directorate-General of Financial Audits includes three directorates established by the aforementioned law:

- Directorate for the Audit of Ministries, Public Law Bodies and First & Second Degree Local Authorities;
- Directorate for the Audit of Entities Providing Health and Social Solidarity Services, Public Corporations and Organisations, Legal Entities of Private Law and Other Entities;
- Directorate for Technical Support and Communication.

Through its directorates, the Directorate-General of Financial Audits achieves the objectives of its mission for preparing and carrying out audits, in order to achieve substantial conclusions and appropriate recommendations for taking corrective measures in order to improve management and control systems and to provide adequate assurance for part or the whole of the state's financial affairs.

The position of Head of the Directorate-General of Financial Audits is filled by an employee with a university degree and having at least three years of professional experience in the financial sector of the State General Accounting Office. The positions of the heads of the aforementioned directorates are filled by employees with a university degree and working in the financial sector, and the positions of heads of unit are filled by employees with a university degree and working in the financial, engineering, geotechnical and IT sectors of the State General Accounting Office. The personnel of these directorates include employees of the financial, engineering, geotechnical, IT and translation sectors of university or technological education.

Financial audits are conducted by order of the Head of the Directorate-General of Financial Audits and include regular audits based on an annual schedule prepared, under care of the directorates, by the directorate-general and approved by the Supervision Committee, and extraordinary audits, which are conducted following complaints or a request by the European Commission or an order by the competent public prosecutor.

The financial auditors are responsible for:

- checking the adequacy of a body's management and control systems;
- checking the legality and regularity of expenditure, the sound management of resources and the correct collection of revenue by the bodies, as well as their asset management and detection of abuse, waste or corruption;
- checking the wages of the bodies' staff;
- assessing the programming for and performance of the bodies' projects;
- verifying that the bodies have adhered to management rules;
- assessing the performance of the audited body;
- checking the handling of imprests and public administrators.

If the financial auditors, over and above the scope of their audit, become aware of any risk to the financial interests of the audited body, or detect any practices which may incur criminal liability, they must inform the Head of the Directorate-General of Financial Audits of these additional elements. If there are any indications that a tax infringement has been committed, they must inform the competent tax authorities in order for checks to be carried out. If they identify any unduly or unlawfully paid amounts on which preventive checks have been carried out by the Court of Auditors, the Head of the Directorate-General must inform the Court of Auditors thereof. This may lead to the certification of the expenditure being revoked or recovery being sought from those responsible.

After the audit has been conducted, financial auditors prepare an audit report and submit it to the competent audit directorate, which, having checked the completeness of the report, certifies it and notifies it to the audited body, as well as to individuals against whom unduly or unlawfully paid amounts are sought or who may bear disciplinary or criminal liability. The audited bodies and the aforementioned individuals have the right to submit objections against the audit report. Any objections submitted are examined by the Objection Committee, which consists of the

Head of the Directorate-General of Financial Audits, as chairperson, the two heads of the other directorates, with the exclusion of the directorate whose report has been contested, and two experts from the public or private sector. The Objection Committee decides whether to accept or reject the said objections; if the objections are rejected and financial corrections must be imposed, a recovery order to that effect is issued and signed by the Head of the Directorate-General of Financial Audits. If no objections are submitted and the audit report imposes financial corrections, a recovery order to that effect is issued per level of hierarchy (auditor/department head/directorate head/head of directorate-general), depending on the amount imposed. If the body competent for issuing the recovery order disagrees with the conclusions of the audit report, this dispute is resolved by the Objection Committee and a corresponding act is signed by the Head of the Directorate-General of Financial Audits. Recovery orders are notified to interested parties in accordance with the Code of Administrative Court Procedure.

The competent directorate of audits notifies the audit report, any objections, the decision by the Objection Committee and the recovery orders to the Directorate of Support and Communication, so that the latter may monitor the compliance of bodies and the implementation of measures taken. The directorate in question evaluates the implementation measures taken by the bodies in compliance with the findings of the auditors and notifies the Supervision Committee on taking additional measures in cases of non-compliance. The above are included in the annual control report prepared by the Directorate of Support and Communication and approved by the Supervision Committee.

3.2. Internal audit

Law 3492/2006 defines internal audit as the independent auditing-consulting activity providing assurance on the adequacy of a body's management and control systems, aiming at improving its operation and achieving its objectives, using systemic and structured methodologies that mainly aim at improving the effectiveness of the processes that govern its operation, risk management processes and control processes.

The aforementioned law instituted the establishment of internal audit units at all ministries and regions of the country, as well as the bodies supervised by ministries and regions with a budget exceeding EUR 3 million, following a presidential decree by the Minister for the Interior, Public Administration & Decentralisation, the Minister for Finance and the competent minister. This presidential decree sets out the competencies of internal audit units within the framework of protecting their financial interests. To date, the relevant presidential decrees setting out the competencies of internal audit units in regard to the functional independence of internal auditors vis-à-vis top administration levels have not been issued.

With regard to the work of the internal audit units, the aforementioned law provides for:

- the imposition of financial corrections by the internal audit unit of each body in cases where individual or systemic irregularities are identified in the services of the body or the services supervised by that body, provided these bodies do not have an internal audit unit;
- the basic relationships (process flowchart) between the Directorate-General of Financial Audits and the internal audit units of ministries and regions.

Specifically, the Directorate-General of Financial Audits:

- prepares the specifications concerning the organisation, internal operation and competencies of internal audit units, following relevant approval by the Minister for Finance and the competent minister (these specifications must be fully implemented by internal audit units);
- receives information from internal audit units with regard to audit findings;
- provides directions to internal audit units with regard to the imposition of financial corrections and monitors the execution of such corrections;
- provides instructions to internal audit units with regard to the evaluation of corrective measures taken by the audited bodies and monitors their accurate implementation;
- evaluates audits and findings by internal audit units and includes them in its annual control report.



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Additional competencies are:

- regular audit of imprests;
- financial & management audit of public administrators and public management;
- carrying out of sworn administrative investigations regarding the loss of supporting documents for the payment of public expenditures;
- investigation into the failure to present an advance payment order.

These competencies are exercised by the Financial Inspectorate of the Ministry of Finance and transferred to the Directorate-General of Financial Audits before being finally transferred to internal audit units after the latter begins operating.

Other internal audit services

► **A. Inspector-Auditors' Body for Public Administration (SEEDD)**

SEEDD was established by virtue of Law 2477/1997 and was upgraded by Law 3074/2002. SEEDD's mission is to safeguard the proper and effective operation of public administration by identifying phenomena of maladministration, non-transparent processes, ineffectiveness and poor quality services. The main competencies of SEEDD include:

- carrying out inspections, audits and investigations;
- carrying out disciplinary prosecutions and referring the individuals responsible to the competent public prosecutor's office so that accountability is attributed;
- carrying out audits on the assets of the employees of audited bodies;
- carrying out preliminary examinations or investigations at the request of the public prosecutor;
- collecting evidence for criminal or disciplinary prosecution.

The scope of SEEDD audits covers public services, legal entities of public law, first and second degree local authorities, state legal entities of private law and public enterprises. SEEDD is headed by the Special Secretary of the Inspectors' Body of Public Administration, who holds political office. SEEDD is staffed by 80 inspector-auditors and employees of the Secretariat Directorate and carries out audits and investigations following orders independently issued by the Special Secretary or following orders by a minister, secretary-general of a region, the General Inspector of Public Administration, the Greek Ombudsman or the head of an independent administrative authority.

► **B. The General Inspector of Public Administration**

The authority of the General Inspector of Public Administration was established by virtue of Law 3074/2002. Its mission is to safeguard the proper and effective operation of public administration, to monitor and evaluate the work of the Inspector-Auditors' Body for Public Administration and all particular bodies and services for the inspection and control of public administration and to identify cases of corruption and maladministration. The General Inspector of Public Administration:

- on his own initiative orders SEEDD and particular inspection and audit bodies to carry out inspections, audits & investigations on public services, legal entities of public law, first and second degree local authorities, state legal entities of private law and public enterprises;
- monitors the action and progress of audits carried out by SEEDD and particular inspection and control bodies and evaluates their work;
- carries out audits, repeat audits and investigations into public services, legal entities of public law, first and second degree local authorities, state legal entities of private law and public enterprises;
- carries out audits on the annual financial statements of all inspection and control bodies;

- investigates complaints concerning instances of maladministration;
- presides over the Coordinating Body for Inspection and Audit.

The post of General Inspector of Public Administration is assigned to a distinguished individual of broad public acceptance, who is assisted by four Assistant General Inspectors of Public Administration and supported by eight special inspectors and the secretariat directorate.

3.3. Coordination of public internal control

The Directorate-General of Financial Audits of the State General Accounting Office, which falls under the General Secretariat of Financial Policy of the Ministry of Finance, is mainly responsible for coordinating PIC. Its directorates will be responsible for carrying out its audit work, including internal audit procedures of the audited bodies and an evaluative assessment thereof. The conclusions of its checks, the evaluation of its findings and the assessment of the work of the internal control teams (together with the relevant recommendations) are contained in the directorate-general's annual report. This report forms the basis for the provision of adequate assurances to the Minister for Finance or for the expression of reservations in regard to part or the whole of the state financial management and control system. The annual audit report for a given year accompanies the general state budget for the second following year.



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4. Financial inspection

I. Through the aforementioned law, the Directorate of Inspection of Public Management, Legal Entities and Public Enterprises and Organisations of the Directorate-General of Financial Inspection of the Ministry of Finance is renamed the Directorate of Inspection of Management of National Endowments, with the main competency of carrying out controls on national endowments. The other competencies of the former Directorate of Inspection of Public Management, Legal Entities and Public Enterprises and Organisations concerning the carrying out of inspections on public enterprises, legal entities of public and private law, as well as public enterprises and organisations are transferred to the Directorate-General of Financial Audits.

A Directorate for the Supervision of Internal Audits was established within the Directorate-General of Financial Inspection of the Ministry of Finance in 2008 and has been operating since that year. Its mission is to monitor, evaluate and redefine, if necessary, the internal audit and administrative hierarchical audit systems of the services of the Ministry of Finance. This directorate carries out controls on all services of the Ministry of Finance; as these controls are carried out through its internal auditors, who have no hierarchical or other dependence on the services and individuals being controlled, the independence of the controls of the Financial Inspectorate is guaranteed.

II. The Financial and Economic Crime Unit is a special audit service of the Ministry of Finance that was established in 1995 through Law 2343/95. Its main mission is to combat tax evasion, smuggling, financial and economic crimes, fraud, violations and unlawful acts under the competency of the Ministry of Finance that are carried out against the economic interests of the Greek state. By virtue of Presidential Decree 157/1997, this unit's activity was expanded to cover economic and financial crimes carried out against the economic interests of the European Union; at the same time, its mandate included other crimes, such as counterfeiting, public procurements, unlawful stock exchange activities, etc. By virtue of Law 3296/2004, SDOE was renamed the 'Special Audit Service' and provisions for this organisation were instituted by Presidential Decree 85/2005. Law 3824/2010 changed the name of the Special Audit Service back to the 'Financial and Economic Crime Unit' (SDOE), keeping its current competencies and providing for specific interventions to combat tax evasion and to recover assets gained from criminal activities.

Currently, the mission of SDOE includes:

- investigating, identifying and suppressing financial and economic interventions;
- carrying out preventive controls on the application of taxation provisions;
- investigating, exposing and combating unlawful transactions carried out with the use of electronic means;

- preventing, pursuing and combating other provisions (narcotics, weapons, hazardous substances, antiquities);
- monitoring the country's marine space in order to combat tax evasion and smuggling;
- protecting the coastline and public property from unauthorised encroachment.

SDOE is headed by a Special Secretary, who holds political office, and staffed by 1 200 employees, who are distributed among the three directorates of the Central Service, the directorates for special cases in Athens and Thessaloniki and 13 regional directorates throughout the country. SDOE activities include carrying out daily audits, investigating complaints lodged by citizens, providing aid during audits at the request of other ministries, carrying out audits at the request of public prosecutor investigations and executing operational plans on the basis of the correlations of the General Secretariat for Information Systems, as well as targeted interventions.

5. Ongoing and future reforms

As part of the management of public expenditure, the General Government Accounting Plan is being implemented for the first time this year. The balance sheet, the statement of financial performance, the statement of the change in the net worth of citizens and the cash-flow statement are drawn up in line with the rules on double-entry bookkeeping and in accordance with the principles of adjusted cash-basis accounting. This is being implemented for the first time for the 2011 financial year.

As regards the General Government Accounting Plan, the double-entry bookkeeping system will continue to be used to prepare the balance sheet, the final report and the financial statements, in accordance with the relevant presidential decree in each area, until such time as the presidential decree specified in Law 3871/10 (which is to define the basic principles and content of the abovementioned accounting plan) is issued.

The PIC processes, as described in detail in Section 3, are at their early stages of operation. The competencies of the three directorates of the Directorate-General of Financial Audits have been set out in Presidential Decree 24/2008 and the staffing of these directorates has begun. At the same time, the processing of the remaining legislative framework governing the directorate-general operation and the methodological tools for audit processes are nearing completion, so that the audit schedule for the current year may be drawn up.

With regard to the internal control system at the country's ministries and regions, its implementation process has not begun, since the relevant presidential decrees setting out the competencies of the internal audit units have not been issued to date.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The roots of the Hungarian regulation of the public control system go back to 1989. This was the date of the establishment of the State Audit Office (SAO) — the Hungarian supreme audit institution (SAI). The next milestone was in 1992, when the parliament accepted Act No XXXVIII of 1992 on public finances (PFA). The PFA describes the framework of the budgetary system, the main procedures of planning and implementation of the budget and the rules of establishing, supervising and functioning of the public budgetary organisations (PBOs). In the first years there was no change concerning the cash management of the PBOs, and the functioning of the decentralised system continued. In 1995, in order to decrease the needs of external financing, and to ensure the transparency of public finances, the parliament created the Hungarian state treasury (hereinafter the ‘treasury’). The treasury’s main role was to ensure the centralised management of the public finances.

As a result of the accession negotiations, and as part of the legislative and amendment process, the PFA was amended with provisions concerning budget auditing (only in three articles), and its implementation was regulated by Government Decree 15/1999 (II. 5.). The scope of the regulation included government inspections and supervisory audits, and the internal audit system of public budgetary organisations. The internal audit system of public budgetary organisations had three components: managerial control, ongoing controls and the independent internal audit. At this stage the regulation did not meet completely the requirements of the European Commission. The financial audit department within the Ministry of Finance (MoF) was established in 2000 and it was the precursor of the later central harmonisation unit (CHU).

The establishment of the new PIFC system in compliance with the new terminology was a result of the recommendation of the European Commission (Accession Negotiations Chapter 28 — Financial Control), and of the proposal of the national audit bodies. The Hungarian PIFC Development Strategy (hereinafter the ‘policy paper’) considered the following important financial audit-related documents as crucial starting points: EU Common Position (CONF-H 30/00, 07.06.2000), Accession Partnership of 2002 and the annual reports 2001 and 2002. The government accepted the policy paper in 2003. After the acceptance of the policy paper the CHU responsible for the development of the PIC system was strengthened by appointing a ministerial commissioner as head of the unit, increasing the staff numbers and involving external human resources. In the elaboration of the PIFC methodology the MoF used external help (within the framework of the twinning programme). As a result, the legislative basis for a harmonised PIFC (with the components 1. financial management and control (FM/C); 2. internal audit; 3. central harmonisation unit) had been set up. Also in 2003, the MoF adopted the IIA standards for use

⁽¹⁾ Contributed by the Ministry of the National Economy of Hungary on 31 March 2011.

by the public sector. A full law harmonisation has been realised in the area of PIFC; most of the methodologies and guidelines were drawn up and published in 2004 on the MoF website and in the Official Journal of the MoF. Finally, PIFC for local governments was included in municipal law in 2005.

In 2008, in line with national and international professional developments, the PIFC system was reviewed and new legislation entered into force on 1 January 2009. The new PIC system is based on the COSO model. The internal control system of the PBOs — in accordance with the COSO model — contains five well-known components. With the implementation of the COSO model and its components, the internal control system is covering all operational functions of the public budgetary organisations, the relevant regulations and internal instructions (control environment), the identification of possible factors which can hinder the legal and effective implementation of the functions (risk management), the establishment of legal functioning assurance provisions (control activities), the related continuous communication tasks and the continuous monitoring and internal auditing of the public budgetary organisations (monitoring). The regulation on the internal control system described in the PFA reflects not only international best practice in using the INTOSAI and COSO recommendations, but also the principles of corporate governance.

Since 1 January 2011, as a continuous system development, the public control system is built up from external audit by the SAO, the government control activities (as financial investigation) and the PBO-level internal control systems (which contain the internal audit activities also).

2. Public internal control environment

The elements of the PIC system have been described in the PFA, and extend to all subsystems of the public budget (central and local governments). The implementing regulations of the PIC system are described in special government regulations and guidelines, and there are also methodologies and manuals which support the practical implementation. The Minister for National Economy (MNE) (former Minister for Finance) is responsible for the harmonisation and development of the PIC system.

The external audit of the public finance system is performed by the Hungarian supreme audit institution, the State Audit Office. The tasks, authority and organisational structure of the SAO are determined in a separate act. The SAO is the financial-economic audit body subordinated to the parliament and acts. The SAO audits the final account of the implementation of the central budget and management of public finances. Within this framework it also audits the substance of the budget proposal, fulfilment of income appropriations, management of local and minority governments and operation of the chapters which come under the framework of the central budget. Finally it audits the use of separate state funds, national health service funds, regularity and expediency of the application of investment appropriations which link with government commitments and application and repayment of budget borrowing. The SAO audits the management of the assets which form part of the public finance subsystems. The SAO's audit reports are public.

The governmental control function is performed by the Government Control Office (GCO). The tasks of the GCO are laid down in a government decree. The scope of its activities cover the monitoring of the implementation of government decisions, and *ex post* controls of the state budget, extra-budgetary state funds, social security funds, the central-level PBOs, state-owned enterprises, (public) foundations, micro, regional, county, territorial and regional development councils, as well as social organisations that receive subsidies from the budget.

Budgetary planning is performed by the line ministries led by the MNE. The draft of the Budget Act is submitted by the government to the parliament which accepts it until the end of the current year. The ministries (and the chapters) report on the implementation of the year's budget within the framework of a final account.

The treasury is a key element of the PIC environment. The treasury performs first-level control activities concerning the financial implementation of the budget and *ex post* controls in case of certain subsidies. The treasury management system was established in 1995 in order to achieve the objectives of the public finance reform. The main objective of the treasury is ensuring sound

financial management. In order to meet this requirement the treasury has tasks concerning the financial implementation of the budget and also performs control activities.

The control function of the treasury includes several activities. The most important activity is the control function during the financial implementation of the budget. This control covers the classic treasury, cash management and control functions as well as certain *ex post* control functions concerning the implementation of national and EU subsidies. Fulfilment of public debt monitoring activities and commitment registration activities is also a control function. The treasury monitoring system with disclosure and registration of the supporting basic data applies to avoid accumulation of subsidies/double financing. Another important control activity covers the authority controls performed by the regional directorates in respect of the local governments and recipients of several forms of social assistance.

The budgetary superintendent activity should be considered as the new element of the PIC system, which is delegated to the treasury. The government is allowed to delegate a budgetary superintendent to the PBOs; the MNE is responsible for appointment of budgetary superintendents and provides professional management. The budgetary superintendents give an a priori opinion on the financial arrangements and planned commitments and can thus be vetoed. The budgetary superintendent shall also give an opinion on internal regulations. The fight against fraud, corruption and other irregularities is an obligation of every PBO.



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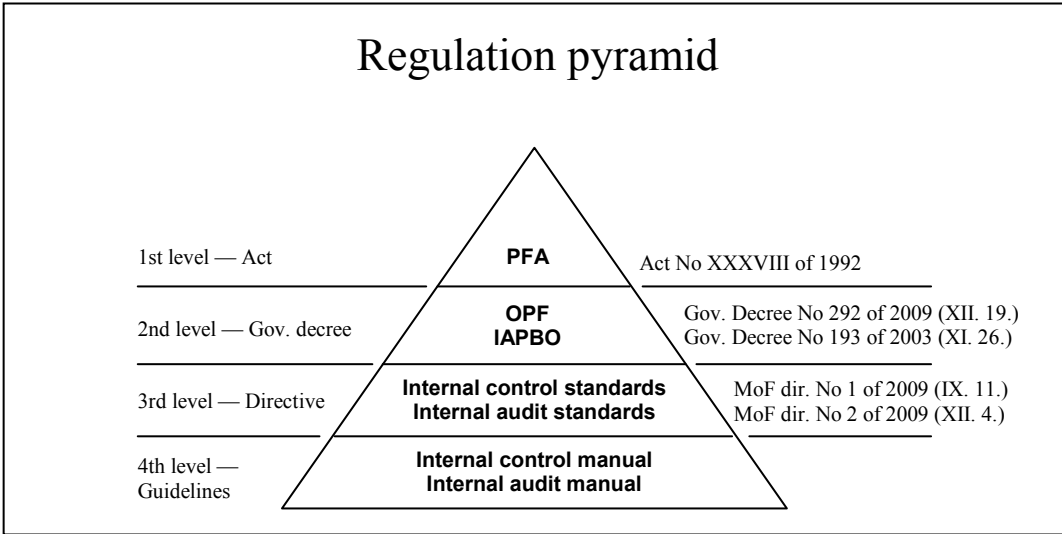
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3. The concept of public internal control

To understand the Hungarian PIC system, we present the regulation of internal control systems in a four-level structure. This is a regulation pyramid which from top to bottom starts with the first level, represented by Act No XXXVIII of 1992 on Public Finances (PFA). It then goes down to government decree level (second level), directive level (third level) and finally the guideline level (fourth level).

The internal control system is an integral process that is designed to obtain reasonable assurance and to ensure assessment of risks. The aim of the internal control system is to ensure that the PBOs achieve the following objectives:

- legality of the transactions, and the requirements of economy, efficiency and effectiveness;
- accountability;
- protection of the resources from losses and inappropriate use.



First level — law

According to the responsibilities described in the PFA, the head of a public budgetary organisation (HPBO) is responsible for the establishment of the PBO's internal control system and liable for developing, operating and also following up and analysing the proper working of a suitable control environment, risk management policies, control activities, information, communication and monitoring.

Second level — government decree

The detailed instructions concerning the internal control system are laid down in Government Decree No 292 of 2009 (XII. 19.) on the rules of operation of public finances (ROPF). The ROPF regulations are connected to the PFA's regulations and clearly determine the scope of duties about establishing and operating the internal control system. The HPBO is responsible for establishing, operating and developing the organisation's internal control system, including internal audit. While establishing internal controls the HPBO should follow the guidelines on internal control standards and contents as published in the directive of the MoF. The internal control system includes all principles, processes and internal regulations that ensure the management of the PBO in accordance with the principle of sound financial management. Recommendations and suggestions from the public external audit and internal audit organisations have to be taken into account while developing the internal control system.

Exposition of the five elements which have been mentioned on the first level.

► *Control environment*

The HPBO shall establish the control environment which stands for:

- a clear structure of the organisation;
- clear relations and tasks about accountability and jurisdiction;
- ethical rules for all levels of the organisation; and
- transparent HR management.

The HPBO shall establish and regularly update the PBO's audit trail which is a holistic description of the operational and financial processes of the PBO that in particular includes the accountability and information levels and relations, management and control processes either in text form and/or tabulated and/or illustrated with flowcharts, allowing monitoring and *ex post* audit activity on these processes. Furthermore the HPBO is liable for regulating the procedures about treatment of irregularities, which — with the exception of ministries, the prime minister's office and government offices — is part of the PBO's organisational and operational rules.

► *Risk management*

The HPBO is responsible for risk management policies and for the operation of a risk management system. During risk assessment the risks of the organisation's activity and management shall be estimated and determined. Within risk management procedures the organisation shall develop methods against risks and determine how to apply these methods. The MNE has published a guideline on risk management to support the PBOs.

► *Control activities*

The head of the PBO shall establish control activities dealing with the acknowledged risks and contribute to the achievement of the organisation's objectives. The internal procedural rules shall regulate at least the following:

- procedures of authorisation and approval;
- access to information;
- physical controls (access to equipment);
- procedures of reporting.

► **Information and communication**

The HPBO shall establish and operate systems assuring a correct and timely information flow to the right organisation/unit/person. The reporting system has to be effective, reliable and precise, and the levels, deadlines and methods of reporting are precisely determined.

► **Monitoring**

The HPBO shall operate a monitoring system, which helps to monitor the activities of the organisation and the achievement of its objectives. Within the operational functions, ongoing and ad hoc monitoring and non-operative functions, the functionally independent internal audit creates the PBO's monitoring system. One of the main tasks of the internal audit activity is to facilitate the improvement of the quality of the internal control system of the PBOs. The internal audit activity of the PBOs has been regulated by a government decree.



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Third level — directives

Hungarian standards of PIC are based on the recommendations of internationally recognised institutions like COSO and INTOSAI. These standards contain the main principles; the practical implementation shall vary amongst organisations.

The HPBO has the right and duty to determine the quantity, quality and rigidity of the controls within the system. Laws and decrees determine only some of them, directives (third level) and guidelines (fourth level) provide for suggestions for further refinement. Control activities shall be applied as *ex ante*, process-built and *ex post* controls. It is important to note that the development of various regulations — referred by standards — does not always mean that the PBO has to establish new ones, because in many cases they are already part of other documents (such as: memoranda and articles of association; organisational and operational rules) or exist otherwise. It is the HPBO's responsibility to determine the additional elements of the internal control system where necessary.

The standards related to the five elements which have been mentioned on the first level and detailed on the second, here we mention briefly (only headings) as follows:

► **Control environment**

- Objectives and structure of the PBO.
- Internal regulations.
- Scope of duties and responsibilities.
- Definition and documentation of processes.
- Human resources management.
- Ethical values and integrity.

► **Risk management**

- The determination and assessment of risks.
- Risk analysis.
- Risk management.
- Regular review of the whole process of risk management.
- Fraud, corruption risks.

► **Control activities**

- Control strategies and methods.
- Separation of duties.
- Continuity of tasks.

► **Information and communication**

- Regulation of information and communication.
- System of file registration.
- Report of incompleteness, irregularities and corruption.

► **Monitoring**

- Monitoring of the realisation of organisational goals.
- Evaluation of internal controls.

The full description of internal audit standards can be found in the internal audit section of this contribution.

Fourth level — guidelines

The essence of the internal control system as an integrated approach to corporate governance is that it covers regulations, procedures, functional methods and organisational structures aiming to achieve the objectives of management. Internal control shall prevent, detect and/or correct events which endanger such objectives. The HPBO will decide on the methods and forms of implementation, i.e. review the current internal regulations or create new ones.

The internal control manual (the 'IC manual') — issued by the MNE — is a document that elaborates the internal control standards in detail. It supports a proper and equivalent interpretation of laws and other government decrees, a flexible adaptation and a high standard of work. Its contents are basically recommendations, practical guides which support the HPBO in establishing and operating a lawful internal control system. Besides the detailed standards there are control issues that can assist the self-assessment of the compliance of the internal control system. The IC manual supports the HPBOs to raise confidence about their internal control system legitimacy at organisational and department levels. Irregularities concerning public finances represent a high level of risk. Aggravated cases: intentional irregularities like fraud and/or corruption have to be treated with high priority because of their damaging nature. The IC manual deals with procedures on treating irregularities within the legal framework. Regarding the guidelines on internal audit more information can be found in the internal audit section of this contribution.

3.1. Managerial accountability/responsibility

Managerial accountability/responsibility in the public sector is a high priority issue. This is why the regulation of managerial accountability/responsibility appears also in other legislation that was not previously involved.

The PFA stipulates that the head of the PBO is responsible for the fulfilment of activities prescribed in the deed of foundation and in line with the requirements determined in legal regulation of the managing organisation.

The PFA stipulates that the head of the PBO is also responsible for ensuring effective and sound financial management concerning all activities of the PBO — like the use of public assets. The head of the PBO is also responsible for the establishment and operation of the internal control system. The head of the PBO may delegate his tasks and duties — in the organisational and operational rules of the PBO and in the job description — to lower-level hierarchy. The managers take the responsibility for the work of employees at the subordinated organisational unit(s). The managers have the right to report and to request a report. The detailed rules of the responsibilities are set out in separate laws.

The head of the subordinated PBOs must report on the functioning of the internal control system of the PBO to the head of the budgetary chapter (i.e. line ministry), who reports directly to the MNE about the internal control systems (including internal audit) of the ministry and the subordinated PBOs. The abovementioned report on the internal control system (so called declaration of assurance) is attached to the financial statement and the final accounts of the head of the budgetary chapter and the subordinated PBOs, in which the head of the PBO evaluates the operation of the internal controls. According to the content of the declaration, the head of the

PBO, who is aware of the legal responsibilities, declares that the internal control system ensures economical, efficient and effective functioning.

Furthermore he/she ensures that:

- any public assets are used in the PBO in accordance with legislation;
- the available appropriations are properly used;
- the functioning of PBOs follows the requirements of economy, efficiency and effectiveness;
- planning, reporting, information providing responsibilities and their verifications are well performed;
- the commitments are in line with the budget;
- an institutional accounting system exists.

In the report he/she declares that:

- the submitted reports give — in compliance with legal requirements — a clear and precise picture of the current annual budgetary revenues and expenditures;
- a system has been introduced that provides appropriate legal and regular assurance of the procedures and ensures that the accountability is in compliance with national and EU laws;
- the responsibilities — within the PBO — are clearly defined, that all managers are aware of the objectives and that they have tools at their disposal to complete the given tasks and evaluate the result. The procedure is continuously evaluated through the managerial report system.

The head of the PBO briefly summarises how the internal control provisions have been completed in compliance with the five components. In the report he/she outlines the need for improving the internal controls of the PBO, and also certifies that the CFO (chief financial officer) of the PBO has fulfilled the biannual internal control training obligations.

Since 2010 ⁽²⁾ the operational head of the ministry (as a PBO) is the Administrative State Secretary. The minister is the political manager. In the case of ministries, the Administrative State Secretary is responsible for the establishment of the internal control system of the ministry and for the accountability of the organisational unit managers.

The crucial part of the accountability is publicity and transparency. The publicity rules are based on Act No LXIII of 1992 on the protection of personal data and the publicity of public data. The main purpose of this act is to ensure that all persons have access to data of public interest. Data of public interest shall mean any information or knowledge, not falling under the definition of personal data, processed by an agency or person performing a state or local government function or other public function determined by a rule of law. Act No XC of 2005 on the freedom of electronic information was established to reinforce the provisions laid out in Article 19 of Act LXIII of 1992. The purpose of this regulation is to ensure that the range of data of public interest specified herein is available electronically to anyone, on a permanent basis, and free of charge, without any personal identification and a procedure of requesting data, in order to ensure that the public is accurately and quickly informed.

3.2. Internal audit

According to the PFA and in accordance with international standards, internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's activities. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control and governance processes.

⁽²⁾ Article 61 of Act No XLIII of 2010 on the central administrative bodies and the legal status of the members of the government and of the secretaries of state.



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The concept of internal audit is embedded in the regulations of the PFA and in a government decree supplemented by standards and guidelines. The MoF's Directive No 2 of 2009 (XII. 4.) on the public internal audit standards contains the following national standards.

- 1000 Tasks of internal audit.
- 2000 Chief audit executive's tasks.
- 3000 Independence.
- 4000 Expertise and due professional care.
- 5000 Planning.
- 6000 Implementation.
- 7000 Audit report.
- 8000 Quality assurance.
- 9000 Follow-up.

Many guidelines were published in connection with internal audit activities of the PBOs. The most important of these are:

- model of the internal audit manual;
- methodology for performance audits;
- methodology for system-based audits;
- guidelines for the annual audit plan and summary annual audit plan, annual audit report and summary annual audit report;
- guidelines for tasks to be completed by internal audit units of PBOs;
- guidelines for ensuring internal audit activity by involving an external service provider.

According to the rules and regulations the head of the PBO shall guarantee functional (operational) independence of the internal auditors, especially in relation to the:

- drawing up of the annual audit plan;
- selection of audit methods;
- preparation and implementation of the audit programme;
- preparing audit report;
- drawing up of conclusions and audit recommendations.

Aside from the objective assurance and consulting activity, the internal auditors shall not be involved in any other management function.

The PBO's internal auditor has to be authorised by the MNE, which means that the auditor has to be registered. PFA and MoF Decree No 18 of 2009 (X. 6.) on the registration and continuous professional training of internal auditors contains the rules for vocational training for public sector internal auditors. Internal auditors are obliged to attend vocational training every two years. This training is organised by the Public Internal Financial Control Methodology and Training Centre (hereinafter 'MTC').

The MNE is responsible for the establishment, operation and professional management of the MTC. Currently the MTC works within the organisation of the National Tax and Customs Administration's Health and Cultural Institute. Internal auditors must take an exam in the subject of 'Public Internal Financial Control I' (with three obligatory modules) after they have been registered for one year and then they must perform one freely selected module from the modules of 'PIFC II' once every two years. If he/she fails to complete these obligations, the internal auditor will be removed from the registry.

PIFC I is structured as follows:

Introduction general module

1. Public finances
2. European Union and Hungary
3. Control system of the public administration

General internal audit module

1. Legal basis of PBOs' internal audit
2. Guidelines relating to internal audit of Ministry of Finance
3. Internal audit's standards and practice directions
4. New methodologies in the area of internal audit

Public internal control (PIC) system module

1. Corporate governance
2. The COSO model
3. PIC in Hungary
4. Managerial accountability



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Civil servants who work as internal auditors shall take an administrative vocational exam three years after their appointment. Also, in accordance with the regulations of the PFA, the PBO's financial manager (since January 2010) and the head of the PBO (since January 2011) shall attend professional PIFC-related training every two years.

Internal audit presents draft audit findings and recommendations to the head of the PBO in compliance with laws and internal regulations, economy, efficiency and effectiveness. The internal auditor or the internal audit unit perform their duties directly subordinated to the head of PBO and report directly to him/her. The audit team leader is responsible for drafting the audit report and drawing conclusions. Internal auditors are responsible for the trustworthiness of the audit results. In case of objective assurance activity, internal auditors shall perform a legality/regularity audit, a financial audit, a systems-based audit, a performance audit and an information technology system audit.

The internal auditors shall send the draft audit report to the auditee for the contradictory procedure. The audit is closed when the final audit report has been sent to the auditee. If during the course of the audit the suspicion of an act, negligence or deficiency arises that may result in a criminal, infringement, liability or disciplinary procedure, it is the task of the head of the PBO to take the necessary measures, however this does not influence the closure of the audit.

Audited organisations or organisational units, assigned by the PBO's manager, are liable for keeping records about the use and implementation of findings and recommendations mentioned in external or internal audit reports. This task is not transferable to internal auditors. Records contain a short description of implemented measures and reasons for non-implemented measures. The reporting system has three levels in this area, as mentioned above. Within the framework of the annual audit report the head of the PBO reports to the head of the chapter manager organisation (CMO), and the head of the CMO provides a summary of controlled PBO activity and the work of his/her own organisation in an annual audit report to the Minister for Public Finances. Additionally, the chief audit executive (CAE) shall follow up the use of action plans. For this, the CAE must keep records that contain actions undertaken on the basis of the audit report's findings and recommendations.

The annual audit report and annual summary audit report shall contain the following.

Report on the internal audit activity in the respective year:

- the scope of activities mentioned in the audit plan, the reasons for deviating from the plan, and the justification of any ad hoc audits;
- the quality, staff and material conditions of the audits as well as the factors promoting or hindering the audit activity (based on self-assessment);
- the main findings, conclusions and recommendations of audit reports;
- the number and a short summary of cases reported on fraud and/or serious irregularities;
- the main recommendations for the improvement of the internal control system's regularity, economy, efficiency and effectiveness.

Implementing audit findings and recommendations:

- report of realised action plans based on internal audit's records, considering the report sent by the head of the audited organisation or unit;
- proposals on the development of the internal audit activity.

3.2.1. Internal audit relations with external audit

The SAO and internal audit cooperate and complement each other's work. The SAO often uses internal audit reports by external auditing of a PBO. Internal audit usually assists (mainly acting as a contact point) in the external audits of the SAO in a PBO. The SAO has the right to participate on an advisory basis in the meetings of the PIFC Interministerial Committee. Audited organisations shall report on the follow-up of the SAO's recommendations until 31 January of the year following audit activity.

3.2.2. Audit boards and audit committees

The Public Internal Finance Control Interministerial Committee (hereinafter 'PIFCIC') has been established to provide guidance to the improvement of the PIC system, the cooperation, coordination, harmonisation and preparation of further needed developments. Under its terms of reference, the PIFCIC shall assume the following tasks (through its subcommittees).

- Support the MNE management in the area of:
 - overview of PIC operations, along with regulation, coordination and harmonisation of the system;
 - giving an opinion on the annual plans, strategies and reports as required by EU legislation.
- Elaboration of recommendations on the improvement and operation of the PIC system, including:
 - opinion on draft legislative provisions, practice manuals, nationally and internationally accepted standards relating to internal audit;
 - monitoring of the application and implementation of draft legislative provisions, practice manuals, nationally and internationally accepted standards relating to internal audit;
 - monitoring of the application and implementation of draft legislative provisions, practice manuals and PIFC standards relating to the internal control system;
 - coordination's support and continuous monitoring of audit activity relating to use of EU funds (ESF, ERDF, CF), other EU and international assistance;
 - evaluation and support of functional independence of internal auditors.
- Coordination of planning and implementation of government audits.
- Finding solutions to specific questions asked by the MNE or PBO's representatives.
- Discussion of the MNE's annual report on PIC.

3.3. Coordination of public internal control systems

The MNE is responsible for development, preparation of regulation, coordination and harmonisation of the internal control systems relating to the subsystems of the public finances. The minister coordinates and harmonises the control systems for national and international funds and makes recommendations for drafting and adopting relevant legislation; elaborates, issues and regularly reviews directives and methodological guidelines to be used for the internal control system; and is responsible for the establishment and operation of the PIFCIC, for developing its rules and procedures and for organising the internal control system-related training. The tasks of the central harmonisation unit are performed by the Department of Public Internal Control (within the Ministry for National Economy). The main responsibilities of the department are:

- the coordination and harmonisation of the internal control systems relating to the subsystems of the public finances;
- the evaluation and development of the procedures and methodologies of the system of the budgetary superintendent;
- the elaboration of the proposals and concepts related to control planning, control implementation and reports;
- the coordination of the annual control planning procedure — processing and analysing the control plans forwarded to the minister from the chapter manager organisations;
- preparing the annual report for the minister to be used concerning the situation and the function of the PIC report, and as a part of this, preparing proposals related to the internal control system — including rule modifications — for the government, based on the annual audit reports forwarded to the minister;
- providing professional supervision for the internal audit support IT system;
- inspecting and monitoring the compliance of the PIC system's quality within the framework of quality assurance, and assessing the implementation of the international audit and control standards related to acts, directives and methodological guidelines;
- coordinating the managerial accountability system — processing and analysing the managerial assurance declarations forwarded to the minister by the chapter manager organisations;
- the establishment, operation and professional supervision of the PIFC Methodology and Training Centre;
- operating the Hungarian Internal Auditors Forum;
- liaising with the national professional organisations;
- arranging professional conferences;
- the development of the internal control system of the EU funds (including the FM/C), establishing and developing the relevant regulations and methodological guidelines;
- professional supervision of the audit authority (the Directorate-General for Auditing European Funds);
- drawing up professional opinions and guidelines related to the internal control system of the EU funds;
- adapting the EU recommendations related to the internal control system of the EU funds;
- participating in the coordination and harmonisation of the EU and international funds in relation to the internal controls;
- monitoring and inspecting the application and the implementation of the laws, methodological guidelines and international audit standards to be used concerning the participating countries in the implementation of the EU support transactions.



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4. Financial inspection

The task of government control shall be performed by the Government Control Office (the GCO). The GCO is subordinated to the Minister for Administration and Justice of Hungary. The duties of the GCO are:

- monitoring of the implementation of government decisions;
- *ex post* control of the state budget, non-budgetary state funds, national health service funds and the central-level PBOs (except organisations that are outside the supervision of the government or the minister);
- *ex post* control of economic enterprises, public foundations, foundations, microregional, county, territorial and regional development councils as well as social organisations — with the exception of political parties — who obtained support from the state government and funds or aid and support from international contracts;
- monitoring of the state-owned economic entities excluding the Hungarian National Bank;
- *ex post* control of foundations, public foundations established and/or sponsored by the government, members of the government;
- *ex post* control of the legitimacy of the undertaking and the redemption of state guarantees within this framework, along with the state budget — it may examine both the original obliged party and the entitled party with regard to whether the conditions of the guarantee contract have been observed;
- *ex post* control of private pension funds, and financial mechanisms of the transfer of private pension funds to the state pension fund;
- *ex post* control of transactions and subcontractors in connection with the subsections above, performance of these contracts, and in connection with this, control of the parties who are responsible for the performance of or who participate in the contracts;
- other *ex post* control tasks determined in separate laws.

According to the PFA the GCO carries out regularity and expediency *ex post* controls concerning the execution of the budget, transaction of national and international assistance, utilisation of government-owned properties, operation of government-owned economic entities, transaction of public procurements and execution of governmental decisions. Currently, GCO activities are performed according to the regulations of the internal audit of budgetary bodies, but the special regulation on the rules of procedure of governmental control activity will be adopted in April 2011. The activity of the Government Control Office is based on annual work plans, but, mandated by the prime minister or the Minister for Administration and Justice, the chairman of the GCO can initiate an ad hoc control task which is not in the annual work plan. Anybody can initiate monitoring in accordance with the relevant regulations (citizen notification) but there are no obligatory monitoring consequences of these notifications.

The GCO carries out mainly *ex post* controls, but *ex ante* controls as well. GCO's reports shall be received by the government or the person/body which is assigned by the act.

The GCO and the internal audit units of the ministries coordinate their activity and share their observations through the Government Control Sub-Committee of the PIFCIC mentioned above.

5. Ongoing and/or future developments

The Department for the Public Internal Control System of the Ministry of the National Economy seeks to introduce the following improvements to the PIC systems:

- the further development of the internal control system, with a focus on managerial accountability and this inside the framework of the Public Finance Reform;
- reduction of the administrative burdens concerning control and audit activities;

- modification of the government decree on the internal audit in accordance with internal audit, widening the scope of public internal audit to cover government-owned economic entities;
- reinforcement of the control activities of the Hungarian state treasury and other PBOs;
- enhancing the central harmonisation of the internal control and internal audit at the level of local governments with development of manuals and targeted guides together with new subcommittees;
- review of the data and information content of the MNE Report on the PIC system, in order to make the information readily available and usable to the government;
- continuous development of methodology for internal control and internal audit systems (e.g. review internal audit manual and internal control manual, issue guidelines for monitoring);
- development of a new quality assessment methodology;
- development of proposals for improving the training system, participating in the accreditation methods (where needed);
- promoting recognition of internal audit as a profession at higher education levels;
- enhancing cooperation between the audit organisations (State Audit Office, Government Control Office, DGAEF) and professional organisations, and re-establish professional relationships.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The historical background to some of the features of existing Irish public financial procedures derives from Ireland's relationship with Britain and the resulting inheritance at independence. From 1690 government policy was controlled by specific appropriations. A period of reform in the 19th century and the consequent expansion of state activity provided the impetus for the Northcote-Trevelyan Report of 1845 which ultimately succeeded in replacing an administrative system bedevilled by political patronage with a permanent civil service distinct from, but accountable to, a political master — a structure still discernible in both the UK and Ireland. Financial administration was further enhanced at the time by the passing of the Exchequer and Audit Departments Act 1866, which still provides some of the statutory basis of public financial procedures in Ireland today.

Upon independence in 1922, the Free State government did not see the need to radically overhaul this system of impartial public administration which it had inherited. The control of the Irish civil service, which had previously been exercised by the UK treasury, was maintained, with unbroken continuity, by the Minister for Finance. The 1937 Constitution of Ireland offered few innovations in the state's financial framework, but nevertheless provides the basis for the following features of the system.

Financial transactions of the state are to be conducted through one account — later named the Central Fund, and often referred to as the Exchequer Account.

The government is required to present annual estimates of receipts and expenditure to the Dáil Eireann, the Irish parliament. The Comptroller and Auditor General (C & AG) is a constitutionally independent officer, responsible for ensuring that expenditure is incurred/revenue received only as the Dáil has authorised. The right of initiative in financial matters more generally is reserved to the government.

Administrative reform would appear to be always on a government agenda. Recent attempts at reform in Ireland include: the Devlin Report — 1969, Serving the Country Better — 1985, the Strategic Management Initiative (SMI) — 1994, Delivering Better Government (DBG), the Public Service Management Act 1997 and Programme for Government — 2011 to 2016.

The Report of the Working Group on the Accountability of Secretaries-General and Accounting Officers examines the authority, responsibility and accountability of secretaries-general and other accounting officers in relation to management of public money. As a result of the recommendations within that report, accounting officers now submit with the Appropriation Accounts

⁽¹⁾ Contributed by the Ministry of Finance of Ireland on 16 June 2011.

a descriptive statement of internal financial control. This signed statement by the accounting officer to his/her minister about the department's system of internal financial control confirms that:

- the responsibility for the system of internal financial control has been accepted;
- a sound financial control environment is in place;
- a framework of administrative controls and management reporting exists;
- the department has an internal audit function with appropriately trained personnel; and that
- this statement is reviewed by the Comptroller and Auditor General for consistency with information that he becomes aware of during the audit.

2. Public internal control environment

2.1. The accountability framework

The central government area is made up of 41 departments and offices who receive voted money in order to carry out their functions. For 2010 that amounted to EUR 46.3 billion or, to put it in context, about one third of GNP for that year.

When the Dáil passes the estimates it is indicating its approval of how public money is to be spent. There is then a clear need for the Dáil to check whether the money has been spent as authorised. There are two types of financial check: firstly on the issue of the money to see that departments receive only the funds to which they are entitled, and secondly on the final appropriation of funds by means of audited accounts.

The process of public accountability is not complete until the Dáil has an opportunity to review the results of these checks. In Ireland this is achieved by the Public Accounts Committee of the lower house (PAC), examining how the money is spent and reporting its findings to the Dáil.

2.2. Public sector accountability

In the central government area generation of profit is not a business objective. Traditionally the emphasis has been on access to services, equity of treatment, process propriety and compliance with regulations. Recent shifts in that emphasis to outputs and outcomes means that in the giving of account, matters such as economy, efficiency and effectiveness have been gaining a greater traction.

The Annual Appropriation Account is still very much a set of accounts in the traditional sense, however, presenting actual results beside the estimate for the year. This format facilitates the evaluation of whether the budget has been exceeded or not. It is left to documents such as the Annual Output Statement to complete the picture with regard to targets set and targets achieved.

There is a project currently underway on a pilot basis with a number of government departments where the structure of the estimate is being reformed to align it more closely with other reporting documents and integrate performance and output information. This will transform the annual account into a key all-inclusive document on accountability, though still on a cash basis.

The public sector framework of accountability consists of accounting guidelines, audit guidelines and law as in the private sector. Legislative provisions also extend to the prescription of the personal responsibilities of accounting officers, who are the department and office heads, with regard to the safeguarding of public money and the giving account on its use. In addition there is the constitutional element where Article 28 of the Constitution requires the government to account to the Dáil on an annual basis for the money it has spent.

2.3. Authority to spend

The collection and spending of public money is a closely monitored activity. Expenditure is either voted or non-voted. Voted expenditure which is ratified each year by legislation in the annual Appropriation Act has its basis in Article 17 of the Constitution. This article provides that the Dáil may not vote money unless requested to do so by the government. The government

makes such a request at the end of the estimate process. All voted money has to be accounted for to the Dáil. Voted money is reflected as an outflow of Exchequer funds in the Finance Accounts and its disbursement is accounted for in the Annual Appropriation Accounts of government departments and offices. Allocations to local government come from funds voted to the Department of Environment, Heritage and Local Government.

In addition to voted money the Finance Accounts also include outflows of non-voted money with regard to spending authorised funds under legislation. Such outflows can occur frequently, as in judicial salaries and the salary and expenses of the President. Non-voted payments can also be more ad hoc but still arise under legislation, as in the payment of election costs or interest payments made in the service of the national debt.



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2.4. Obligation to account

The annual account which is prepared by the 41 government departments and offices, and showing how the money granted to them by the Dáil has been spent, is called the Appropriation Account. The Appropriation Account is prepared under provisions contained in the Exchequer and Audit Departments Act 1866. The Act, which arose out of the need to control and reduce spending at the time, accomplished great reform in providing not only that all accounts of government should be audited but also that this audit should be carried out by an officer of the parliament reporting directly to it. The Act itself remained in law until 1983 in the UK and was substantially repealed in Ireland in 1993 though a few sections still remain on the statute books.

Section S22 of this Act specifically requires that each department or office in receipt of funds from the Exchequer will prepare an account of the use of those funds and pass that account to the Comptroller and Auditor General to examine. The Comptroller and Auditor General examines all 41 accounts and prepares his report on matters that have arisen. Section S21 of the Act provides for the preparation of the accounts of the Exchequer known in Ireland as the Finance Accounts. Section S19 is still in use as the authority by which accounts at commercial banks are sanctioned for the receipt and management of public funds.

3. The concept of public internal control

3.1. Managerial accountability and responsibility

A principle of accountability is that the participants in the process are known and their roles and interrelationships are clearly defined and understood. The participants in the accountability regime are as follows.

- The Constitution: arrangements for control and accountability are rooted in the Irish Constitution, governs the financial relationships between the parliament and departments and offices, provides for the independent external audit function (C & AG).
- The PAC: a committee of the Dáil (lower house) established to 'examine and report to the Dáil on the accounts of sums appropriated by the Dáil', meets in public to examine accounting officers on their Appropriation Accounts. PAC reports are published.
- Accounting officers: usually the head of a civil service department or office, responsible for the safeguarding and the regularity and propriety of public funds, prepares the Appropriation Account for the C & AG, answerable to the PAC.
- The Department of Finance: responsible for the administration and business generally of the public finances, presents estimates to government and monitors expenditure by departments, provides a framework for civil service control and accountability through issue of instructions/circulars and publication of public financial procedures.

Origins of the role of accounting officer: duty of preparing Appropriation Accounts

The role of the accounting officer has its origins in the Exchequer and Audit Departments Act, 1866 (the 1866 Act). Section 22 of that Act provides for the preparation of Appropriation

Accounts by departments. The term ‘department’, when used in connection with the duty on departments of preparing the Appropriation Accounts, was to be ‘construed as including any public officer or officers to whom that duty shall be assigned by the [UK] treasury.’ The term ‘accounting officer’ does not appear in the 1866 legislation: the UK treasury first proposed the term to the Westminster PAC in 1872. The first statement of the duties of accounting officers was in a UK treasury minute of 1872, which stressed the responsibility of an accounting officer for the safeguarding of public funds and for the regularity and propriety of expenditure of these funds.

The 1993 Act: ‘accounting officer’ defined, and the duties stated

The Comptroller and Auditor General (Amendment) Act 1993 defined the term ‘accounting officer’ in Irish law for the first time. The accounting officer is defined in the Act as the ‘Officer referred to in Section 22 of the Exchequer and Audit Departments Act, 1866 to whom the duty of preparing the Appropriation Accounts of a department is assigned...’

The statutory duties of accounting officers in giving evidence to the PAC are set out in Section 19 of the 1993 Act (see Section 2.7 below). The Act broadened the duties from their earlier focus on regularity and propriety to include economy and efficiency in the use of resources and the systems, practices and procedures used to evaluate effectiveness. Even before the Act, the C & AG had drawn attention to economy and efficiency as part of the financial audit and would ‘look behind’ certain transactions, and accounting officers had had to deal with these matters in giving evidence to the PAC. Since the introduction of the Act, the Office of the C & AG has been carrying out value-for-money (VFM) examinations which result in stand-alone reports dealing with economy and efficiency as well as with the systems, procedures and practices employed to evaluate the effectiveness of the department’s or office’s operations.

Principles and conventions governing the role of accounting officer

Apart from the statutory provisions, accounting officers operate within established principles and conventions that are derived mainly from the Constitution and from the institutional and financial relationships that have been developed between the Dáil and the Executive over the years. The reports and recommendations of the PAC are one of the main sources of these principles. The principles and conventions are set out in the Public Financial Procedures Guide.

Responsibilities of accounting officers as set out in public financial procedures

In addition to the preparation of the Appropriation Accounts, the main responsibilities of accounting officers are as follows:

- the safeguarding of public funds and property under his or her control;
- the regularity and propriety of all the transactions in each Appropriation Account bearing his or her signature;
- ensuring that all relevant financial considerations are taken into account and, where necessary, brought to the attention of the minister where they concern the preparation and implementation of policy proposals relating to expenditure or income for which he or she is the accounting officer;
- economy and efficiency in the administration of the department — this includes ensuring that there are adequate financial management systems in place to support the proper administration of the department in an economical and efficient way;
- the adequacy of arrangements within the department/office to ensure the correctness of all payments under his/her control and the prompt and efficient recovery and bringing to account of all receipts connected with the vote or with any fund for which the department is responsible;
- ensuring that the Department of Public Expenditure and Reform’s sanction for expenditure has been obtained and for the maintenance of a central record of both delegated and specific sanctions;

- responsibilities for internal audit, including regularly reviewing the internal audit function to ensure there is the desired quality of assurance on the adequacy, reliability and efficiency of the department's internal control system;
- responsibilities in respect of grants-in-aid to outside agencies, particularly in regard to the conditions of the grant, the submission of accounts and being satisfied that the accounting systems and organisational arrangements of the grantee are adequate to ensure the proper administration of the money; and
- ensuring that there is a clear framework for control (including financial reporting) and accountability for public funds in bodies operating under the aegis of the department.

Accounting officers are required to include with the Appropriation Account for their department/office a statement on their organisation's systems of internal financial control.



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Accounting officers and the PAC

The 1993 Act: duties of accounting officers before the PAC.

Under section 19 of the 1993 Act, accounting officers must, when required to do so, give evidence to the PAC about:

- the regularity and propriety of the transactions recorded in any account subject to C & AG audit which the accounting officer or the department or office concerned is required by or under statute to prepare;
- the economy and efficiency of the department or office in the use of its resources;
- the systems, procedures and practices employed by the department or office to evaluate the effectiveness of its operations; and
- any matter affecting the department or office referred to in a special report of the C & AG under Section 11(2) of the Act (essentially, a special report in relation to any C & AG inspection, examination or audit) or in any other report of the C & AG.

The terms 'regularity' and 'propriety'

'Regularity' and 'propriety' are standards against which expenditure and receipts are judged in order to establish whether they accord with the intentions of the Oireachtas. The concept of regularity reflects the concern that public money should be used only for those purposes approved by the Dáil. The checks for regularity are set out in Section 3 of the 1993 Act: the C & AG must satisfy himself/herself as to whether the amounts spent have been applied by the department or office for the purposes for which the appropriation made by the Oireachtas was intended and as to whether the transactions recorded in the account conform with the authority under which they purport to have been carried out.

As to propriety, an Auditing Practices Board Practice Note on the Audit of Central Government Financial Statements, prepared with the support of the Office of the C & AG, defines propriety as 'concerned with the way in which public business is conducted, including any conventions agreed with Dáil (and in particular the PAC), and any guidance issued on governance and ethics. Whereas regularity is concerned with compliance with appropriate authorities, propriety goes wider than this and is concerned more with standards of conduct, behaviour and corporate governance. It is concerned with fairness and integrity and would include such matters as the avoidance of personal profit from public business, even-handedness in the appointment of staff, open competition in the award of contracts and the avoidance of waste and extravagance.'

'Value for money'

In addition to regularity and propriety, the accounting officer must answer to the PAC for value for money in the terms specified in the 1993 Act. Value for money (VFM) encompasses economy — that is, providing suitable resources for a task at the lowest cost having regard to quality and efficiency — which relates the cost of resources to the outputs achieved. VFM also encompasses the systems, procedures and practices used by departments and offices for the purpose of evaluating

the effectiveness of their operations. VFM issues can be raised by the committee when considering the C & AG's report on the Appropriation Accounts or they can arise from consideration by the committee of a VFM report by the C & AG about the department or office concerned.

The public scrutiny process

The Dáil votes annually on the estimates (budget) of the government departments and offices. It does this after the estimates have been examined by a group of 'sector based' joint committees (of the Dáil). These committees examine on behalf of the government the estimate for the relevant departments and ministerial attendance is required.

The C & AG audits the Annual Appropriation Account with the current estimate and the prior year outturn as comparisons.

The Public Accounts Committee or PAC is the nominated review arm of the Dáil in the scrutiny process. The current public sector accountability framework focuses on the oversight by the PAC of the accounting officer's use of voted monies supported by the C & AG's annual report on each departmental vote.

Following the presentation of the C & AG's report, the PAC, together with the relevant accounting officers, reviews the Appropriation Account. Transcripts of the examination sessions available from the PAC website illustrate the depth of review that takes place and the committees' pursuit of clarity with regard to efficiency, effectiveness and economy. Media accessibility to and coverage of the PAC review sessions has greatly increased the profile of the scrutiny role they play in the accountability process.

Cycle of accountability

Taken all together, these are the participants in the accountability process. The 'cycle of accountability' that falls out of that process covers the Appropriation Account, the Comptroller and Auditor General Reports, the PAC Review and the Minute of the Minister for Finance. The cycle of accountability begins with the preparation of the Appropriation Account which under law is required to be given to the C & AG by 31 March. The C & AG audits and reports on the account and again under law submits its report to the Dáil by 30 September. The PAC conducts its examination of each account by reference to the audited accounts and the report of the C & AG. The committee's report on its review is generally available in quarter one or two of the following year. The report when received by the Dáil is sent to the Department of Finance for formal response by the Minister for Finance.

3.2. Internal audit

3.2.1. Scope of internal audit

The internal audit function is a very important support to accounting officers and internal audit activity covers the whole network of the systems of a government department or office. Its primary objectives are to review and appraise:

- the systems and procedures (financial and managerial) that are intended to control the department's operations;
- the adequacy, reliability and integrity of the information being provided for decision-making and accountability;
- the degree of compliance with legislation, with requirements laid down centrally (e.g. by the Department of Finance) and with management plans, procedures and policies;
- the procedures for the acquisition and disposal of assets and the safeguarding of assets and interests from losses, including those arising from fraud, malpractice and irregularity; and
- the arrangements for economical and efficient use of resources.

The internal audit function may also be required from time to time to carry out special investigations and provide a consultative role to management.

Finally, in some cases — for example in the Department of Finance and the Department of Agriculture and Food — internal audit also has specific EU funds responsibilities.

3.2.2. Internal audit as an aid to accountability

Sound control of public money depends on a robust system of internal control. By providing independent opinion on systems, procedures and controls, internal audit is an important element in providing assurance to the accounting officer on the system of internal control. This in turn assists accounting officers in discharging their responsibilities for the integrity of the accounts that they must furnish to the C & AG to be audited and reported on to the Dáil, and also in discharging their responsibilities to the PAC.

In recognition of its importance, accounting officers have specific responsibilities for the internal audit function. They are expected, in accordance with the *Public Financial Procedures Manual* (the *Public Financial Procedures Manual* is a practical guide which assists all officials to gain a better understanding of the public service financial management framework) and the *Internal Audit Standards* (issued by the Department of Finance), to:

- approve the written charter or mission statement of the internal audit;
- ensure the independence of the unit by, inter alia, ensuring that the head of the internal audit unit works under the general direction of the accounting officer, to whom he or she has direct access; and
- agree with the audit committee, where one exists, the planned work schedule for the unit.

Planning should be documented and should include:

- agreement with the accounting officer of audit scope and objectives;
- setting priorities as regards areas to be audited;
- determining the requirements in terms of people, time and other resources;
- reviewing the internal audit function to ensure that they are getting the desired quality of assurance;
- ensuring appropriate follow-up action is taken on internal audit reports;
- ensuring that a programme of staff training and development is in place for staff involved in internal audit; and
- establishing appropriately resourced audit committees.

Traditional role of internal audit

Traditionally the focus of internal audit has been to provide a service to the accounting officer and to management generally in relation to the reliability and integrity of the systems underlying financial transactions and financial statements of the organisation. Internal audit units adopt a systems-based approach to their work but transaction testing may also be employed.

VFM role of internal audit since the 1993 Act

As stated already, under the expanded remit introduced in the 1993 Act, the accounting officer has a statutory responsibility to give evidence to the PAC on economy and efficiency in the use of resources and on the systems, procedures and practices employed to evaluate effectiveness. Internal audit has a role in providing the accounting officer with assurance that the systems and procedures are in place to discharge his or her VFM responsibilities. It is important that this added function be emphasised, so that accounting officers can come to defensible conclusions as to the efficiency and effectiveness of their department's operations — though it is not, of course, the task of the internal audit unit to carry out programme evaluations or other reviews proper to line management.

Internal audit and risk management

Internal audit has an important role in providing assurance or otherwise on systems of internal control in the wider sense as it is now understood. In that context it is well positioned to independently assess the adequacy or otherwise of the systems in place to assess and manage risk. While internal audit can contribute to assessing whether systems and procedures are in place



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and are adequate for the task in hand, risk assessment and management are of course the responsibility of management. Risk management itself is dealt with later — see below.

Internal audit and computer systems

With the growing complexity of the technology used to deliver government services, it is important that departments and offices have an internal audit capacity to undertake critical examination of the computer systems used to deliver government services.

An internal audit report (called hereafter the Mullarkey Report) recommends that departments/offices have either:

- a fully functioning, adequately resourced internal audit unit (capable of undertaking broad audit coverage of the organisation) whose staff are appropriately trained, preferably to an appropriate professional standard; or
- where the size or the risk to the department/office does not warrant a separate unit, that they have access to such a unit through a joint venture or client arrangement with another department, or some other appropriate arrangement.

In addition, the report recommends that accounting officers should ensure that the internal audit unit, including the head of internal audit (who should not have other responsibilities), has sufficient status and access within the organisation to promote the unit's independence and to ensure follow-up on its recommendations.

Audit committees

Audit committees are also an important support to accounting officers in the performance of their duties. Audit committees can, as the Mullarkey Report points out, perform the following useful functions:

- they can act as another source of independent advice to accounting officers;
- they can review the plans and reports of the internal audit unit and can assure the quality of service provided by the unit;
- they can assess whether appropriate action is taken to deal with key issues identified by the internal audit unit and by external audit;
- they can examine and monitor the implementation of the department's risk management strategy; and
- provided they have representatives external to the department, they can facilitate improvements in internal audit and internal control through the exchange of information between (i) departments/offices and (ii) the private and public sectors.

The Mullarkey Report recommends that each department and office has, by the end of 2003, a formally constituted audit committee (or in the case of small offices that cannot justify having a separate committee, they should have access to one, e.g. a committee that covers a number of smaller offices).

Each audit committee should:

- operate under a written charter;
- have significant external representation (at least two members), including, in the normal course, representatives from the private sector with appropriate expertise. The chairperson of the committee should come from outside the department or office;
- prepare an annual report to the accounting officer reviewing its operations;
- invite the Comptroller and Auditor General, or his nominee, to meet the committee at least once a year.

Risk management

As the Mullarkey Report points out, systematic risk assessment and management is becoming an increasingly important part of internal control, as identification and management of risk is seen as necessary to maximise the likelihood of achieving desired outcomes. As part of this process, formalised risk management is becoming an increasingly important element of the internal control framework in central government internationally. The risks to be addressed as part of a risk assessment and management programme are wide-ranging and include strategic, operational, financial and reputational risk. A risk strategy does not mean that sensible risks should not be taken, but that they should be properly assessed and managed.

Importance of risk management

Clearly risk assessment and management are key elements in a robust system of internal control. Because of the relevance of a sound system of internal control to all the activities of the department, measures taken to assess and manage risks should work to support the accounting officer in carrying out his or her responsibilities.

Risk assessment and management, in the wider sense referred to above, is also carried out informally in departments but formal risk management strategies are not, in general, in place. The Mullarkey Report made recommendations and considered that formal strategies should be integrated formally into the management processes of departments and offices. It recommended that the following approach be adopted in introducing a formalised risk management system.

- Central guidance on the development of a risk strategy, appropriate to government departments, should be prepared by the Department of Finance. This should address the principal elements of the risk identification and management process.
- Within departments the risk management system should concentrate on the principal risks to the organisation as well as the principal risks arising from its relationship with other organisations. The risk assessment and management process should be integrated into existing management systems and should be kept as simple and straightforward as possible.
- In introducing a risk management programme, full use should be made of existing systems, processes and procedures. For example, audit committees could advise on departmental risk management strategies. Risk assessment should also be formalised into the processes for the preparation of the strategy statement, business plans, PMDS and annual reports.
- Risk management should feature on the agenda of divisional meetings and of meetings of the Management Advisory Committee.

The Mullarkey Report recommends that departments and offices should introduce formal risk strategies into their management process by the end of 2004.

The whole system of controls, financial and otherwise, is established by management in order to carry on the business of the enterprise in an orderly and efficient manner, ensure adherence to management policies, safeguard the assets and secure, as far as possible, the completeness and accuracy of the records. It is the responsibility of management to decide the extent of the internal control system which is appropriate to the enterprise' (2).

Internal financial control

The requirements of parliamentary accountability have meant that there has traditionally been an emphasis on internal control in Ireland, particularly internal financial control, in government departments and offices. Internal financial control includes:

- a system of delegation and accountability;
- proper authority for the making of payments (e.g. Department of Finance sanction);
- segregation of duties, particularly where the processing of transactions is involved;



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(2) The Auditing Practices Committee quoted in 'Internal audit in local authorities,' Department of the Environment and Local Government, p. 5.

- careful selection of officers with responsibility for money, including ensuring that they have the skills commensurate with their responsibilities and that they are appropriately monitored;
- documentary and physical controls to safeguard assets;
- information and reporting arrangements to management;
- documented financial policies and procedures, including ensuring that they are available throughout the department;
- systems to ensure budgetary control; and
- systems to review and evaluate controls (e.g. internal audit).

3.4. Internal control and the external audit

The C & AG, in carrying out his audit of the accounts of government departments, has particular regard to the system of internal control in place in the organisation, and highlights in his reports instances of the financial consequences of weaknesses in the system of internal control. Accounting officers should therefore satisfy themselves that adequate systems of financial control are in place in their departments and offices.

3.5. Coordination of public internal control

Policy matters with regard to internal audit in the central government sector are the responsibility of the government accounting section within the Department of Finance. The practice of internal audit in the central government sector is guided by the Department of Finance publication *Internal audit standards*. A cross departmental group of the heads of internal audit meets periodically to discuss matters of relevance to the practice of internal audit in the central government area.

4. Financial inspection

There is no such financial inspection body.

5. Ongoing and/or future reforms

The programme for government published following the election of the Fine Gael Labour Coalition reflects a significant thread of reform. Under the heading 'More effective financial scrutiny':

- public sector bodies will be required to publish balance sheets and to move to accrual accounting;
- performance indicators will be identified to monitor progress on high level priorities; and
- annual reports of departments will include output statements and audited financial accounts prepared on generally accepted accounting principle .

These changes signify a move towards reporting the true cost of service delivery. This will be a significant change in terms of the story that the annual accounts will be telling. The implementation of these changes also creates a significant challenge for the relevant public sector organisations.

The accounts for the 41 departments and offices of central government report on cash spend versus estimate granted. The cash basis is modified to reflect payroll on a gross. Mid 1990 format changes saw the introduction of summary accruals information as part of the notes to the Appropriation Account. A 2010 enhancement saw the addition of prior year outturn for comparison purposes. Despite these enhancements, the accounts effectively reflect the information requirements of the 1866 Exchequer and Audit Department Act and that is what is required to be audited by the C & AG and examined by the PAC. Indeed while the C & AG examines and reviews the Appropriation Account and all accompanying notes his statutory responsibility extends to the outturn statement only.



ITALY

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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

PIC in the Italian public administration started in the first years of life of the new Italian state, with Law 5026 of 1869 on public accounts. Over the following decades a legal framework was gradually developed that was set out in Royal Decree 2440 of 1923, which tasked the treasury with controlling not only legitimacy and accounts but also the soundness of expenditure; this type of control looks at the merits and utility of expenditure. The focus thus shifts from merely formal assessments to assessments that also examine the proper management of resources. According to many scholars, however, this provision remained a dead letter until the 1990s; the internal control of public expenditure confined itself in practice to checking the formal legitimacy of the measures.

After an interlude of almost a century, internal control was again addressed in some important reforms of the 1970s. Presidential Decree 748/1972 bestowed independent negotiating powers on senior managers in the public administration and as a counterweight gave managers specific responsibility for the results achieved and the organisation of their departments. This was perhaps the first real effort to involve top administrators directly in the management of public policies. However, the most striking innovation of this period was Law 468/1978, which reformed the national budget. This law made important overall changes to the budget process, such as multiannual budgeting and the finance law. The multiannual budget running alongside the annual budget was designed to be a useful support for various attempts at national economic planning, something that had never been implemented before. The finance law was intended to provide a tool for periodically adapting financial legislation to the needs of the budget policy.

Lastly, in the 1990s, a series of laws introduced a number of important changes.

- Law 241/1990, known as the ‘Law on transparency’, obliged administrative bodies to identify the internal organisational units and persons responsible for the results to be achieved.
- Law 142/1990 introduced, for the first time, the fundamental principle of the separation of powers and responsibilities (political and administrative policy and the results of administrative management). This is a fundamental pillar of the reform of the Italian public administration.
- Legislative Decree 29/1993 obliges public administrations to set up internal control offices to assess, steer and correct the work of the offices according to the objectives and responsibilities assigned to them.

⁽¹⁾ Contributed by the Ministry of Economy and Finance on 23 March 2011.

- Law 20/1994, known as the State Audit Court Reform Law, has strengthened internal and external monitoring of the results of administrative action, of the consistency of the action with political programmes, of the cost and performance of the services and of user satisfaction.
- Legislative Decree 286/1999 ‘sums up’ this first reform phase, revising and clarifying the entire system of internal controls by identifying the different types of control and those responsible for them. This decree in particular examines four different types of internal control:
 1. monitoring administrative and accounting regularity, which has to guarantee the legitimacy, regularity and correctness of the administrative action and is conducted by the accounting departments and by the inspection services;
 2. management control, which has to check the effectiveness, efficiency and good value of the administrative action in order to optimise the cost–benefit ratio and is conducted by departments that collaborate directly with the head of the department;
 3. management evaluation, which has to evaluate the work of managers in order to renew managerial appointments;
 4. strategic control, which has to evaluate the choices made when implementing the plans, programmes and other tools for determining the political direction in terms of consistency between results achieved and set objectives and is conducted by structures that answer directly to political and administrative steering bodies.

The State General Accounting Department and the accounting system

The State General Accounting Department (*Dipartimento della Ragioneria Generale dello Stato*) is one of the four departments of the Italian Ministry of the Economy and Finance. It is a central body that supports and verifies policies, processes and budget implementation for the parliament and government and its main institutional objective is to ensure the correct programming and strict management of public resources.

One of the main duties of the State General Accounting Department is the supervision and control of public financial management. The control and supervision functions are conducted through an integrated system of public finance controls that operates over the entire country. This system comprises: the accounting checks conducted by the Central Accounts Offices (*Uffici Centrali del Bilancio*) and by the Territorial Accounts Units (*Ragionerie territoriali dello Stato* (RTS)); the inspections conducted by the Public Finance Inspection Services (S.I.Fi.P); the supervision and control of non-territorial public bodies by representatives of the treasury appointed in the audit boards of public entities.

The ‘accounting system’ of the State General Accounting Department thus consists of the Central Accounts Offices and of the Territorial Accounts Units. The Central Accounts Offices are located in the ministries and are the essential link between the State General Accounting Department and the central administrations. They provide support and supervision in order to ensure correct financial management and application of the budget lines. The main functions are keeping bookkeeping records of the management of the administrations, checking the regularity of the individual expenditure documents issued by the administrations, evaluation of the charges for institutional functions and services and programmes and projects, in order to draw up the budget.

In particular, the Central Accounts Offices receive from the administrations all the information relating to the income statement drawn up for cost centres, evaluate the related charges and supervise compliance with the rules governing the protection of state assets, ascertaining exactly income and the correct management of budget funds.

The Territorial Accounts Units are located in each of the 103 administrative capitals of the Italian provinces and are the network that liaises with the territorial administrations. The Territorial Accounts Units mainly monitor the financial data and the administrative processes of local state administrations, providing support to these bodies for the correct and proper application of laws and regulations.

To sum up, the main tasks of the Territorial Accounts Units consist of:

- checking the administrative documents issued by the various administrations in Italy;
- accounting and bookkeeping, recording expenditure commitments and collecting data for the income statement;
- estimating costs of services and functions;
- controlling and monitoring public finance;
- monitoring the activity of the boards of statutory auditors of educational institutions;
- monitoring and analysing the data on personnel.



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2. Public internal control environment

The draft annual provisional budget of the Italian state is the subject of a single bill and consists of the revenue forecast, the expenditure forecast for the ministries with the attached budgets of the autonomous agencies and administrations and the general summary framework. The Italian provisional budget is drawn up according to both accrual and cash-based accounting. The budget therefore indicates:

- the income and expenditure forecast for the period under consideration, regardless of whether the right to collect or use funds arose in the period under consideration or in the previous period (cash-based accounting); and
- in a column alongside, the income and expenditure that are respectively authorised to be collected and committed for expenditure in the period considered, regardless of whether the said income and expenditure are collected or paid over the period in question (accrual-based accounting).

2.1. The reform process for the state budget and current legislation

Law 196 of 31 December 2009, ‘Law governing public accounts and finances’, which replaces the previous law on public accounts (Law 468 of 1978), overhauls all the rules and laws governing the tools for managing public accounts and the Italian budget.

Law 196 confirms and consolidates the structuring of the budget into ‘missions’ and ‘programmes’ already being applied since 2008. This budget approach shifts the focus from reporting accounting data in terms of responsibility (administrative responsibility centres) to that of the aims of the underlying policies. The classification meets the need to highlight the functional aspects of the expenditure in order to better inform the government, parliament and citizens of the total resources available for the specific institutional aims. ‘Missions’ refer to the main functions and strategic objectives of the expenditure; ‘programmes’ constitute aggregates aimed at achieving the objectives set by the missions and are the new parliamentary voting units.

The budget bill is submitted to the parliament by 15 October each year. In the economic-financial programming cycle, the budget bill is the tool used to allocate resources. The bill in fact enables proposals to be made for amending expenditure envisaged by existing laws (legislative factors) and the funding of the operations of public bodies can be quantified. The reform implemented by Law 196/2009 assigns a medium-term programming function to the budget, on the basis of which the budget is effectively a three-year budget. The administrations must in fact provide proposals for each of the three years considered in the budget and provide not only accrual-based but also cash-based forecasts.

2.2. The main innovations of Law 196/2009

Law 196/2009 to reform public accounts and finances arose from the need to bring the laws and rules governing public finances and budget management in line with the requirements arising from Italy’s membership of the monetary union, the evolution of the economic system and the new institutional relationship between the state and decentralised bodies. The new law is aimed at the public administrations.

2.3. The unitary government of public finances

One of the main new features is the mandate to harmonise the draft balance sheets and accounting systems of public administrations and set up a single database to collect their accounting and management data to ensure that easily comparable information is available promptly and to facilitate the monitoring and control of public accounts. The new programming cycle and the procedures for formulating the relevant instruments provide for a greater involvement of all levels of government in defining budget policies and more coordination between these policies and Union objectives. Financial and budget programming has a medium-term focus, with policies, objectives and resources being programmed over three years.

2.4. Control of public finances and the quality of expenditure

In order to make the tools for controlling public finances more effective, the practice used hitherto of covering each new legislative initiative with three balances (net balance to be funded from the budget, debt and deficit of the public administrations) has been put on an institutional footing; it makes implementation of the cover required by the constitution consistent with the criteria and parameters adopted by the European Union. The new law helps to reinforce the mechanisms and tools for quantitative and qualitative control of expenditure. Greater focus on measuring and evaluating results is achieved by providing, for the central state administrations, a programme of analysis and evaluation of expenses that is also to be conducted by setting up analysis and evaluation units for that purpose.

2.5. Transparency

The information content of the public financial programming documents has been improved by revenue and expenditure forecasts that are divided into subheadings, the drafting of explanatory notes on the methods used to forecast trends, the drafting of annexes on the efficacy of the public finance measures and on annual monitoring of income, expenditure and the public sector borrowing requirement.

2.6. Notes to the Accounts

The Notes to the Accounts are documents that are attached to the national budget that complete and supplement the accounts themselves. They are the tool by which each minister illustrates, in relation to the expenditure programmes, the criteria for drawing up the forecasts, the objectives to be reached and the indicators to measure them. They are an integral part of the wider programming process that starts with the general definition of the government objectives, details them in the context of the single administrations, checks that initial budget forecasts are compatible with the constraints and public finance objectives and concludes, after approval by the parliament and by the budget law, with the annual directives issued by the ministers. The Notes to the Accounts basically define and describe the objectives of the expenditure programmes and provide concise indicators to make it easier to ascertain whether the objectives have been attained.

2.7. The mandates: completion of the review of the structure of the national budget and the changeover to cash-based reporting

The organisation and structure of the Italian budget will change through the implementation of two mandates: the first mandate relates to the completion of the reform of the structure of the budget; the second relates to the changeover from commitments and cash-based reporting to only cash-based reporting.

The mandate to complete the reform of the national budget, which has to take place within two years of the law coming into effect, relates in particular to the review of the number and structure of the missions and programmes, so as to ensure a better correlation between the vote units and the functions performed by the administrations.

The objective is to ensure a clear link between the programme and the relevant ministry and entrust each programme to a single centre of administrative responsibility. The programmes

must be identified in such a way as to ensure their homogeneity with reference to the results to be achieved in terms of products and final services.

Review of the elementary income and expenditure units: with reference to income, the review must ensure that the name enables the source of revenue to be identified correctly and more clearly. 'Actions' will be introduced for expenditure as elementary units for managing and reporting instead of the current chapters and the actions will be accompanied by an integrated plan of accounts.

The Ministry of the Economy and Finance and the other ministries have to agree on the three-year schedule of resources and objectives (with the definition of simple and measurable indicators), the definition of criteria and methods for fixing expenditure ceilings and the adoption of three-year agreements as well as the resources, objectives and deadlines for achieving them.

As part of the fight against fraud, the General Accounting Office manages EU funding. The General Inspectorate for Financial Dealings with the European Union (*Ispettorato generale per i rapporti finanziari con l'Unione Europea*), one of the 10 general departments of the General Accounting Office, helps to draw up, implement and certify the budget of the European Union and conducts overall monitoring of the corresponding financial flows and controls delegated by the European Union.



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3. The concept of public internal control

3.1. Managerial accountability

Managerial responsibility is governed in Italy by Legislative Decree 165 of 2001, although the origins of the current arrangements can be found in Legislative Decree 29 of 1993. One of the principles behind the 1993 reform is the clear separation between politics and administration (today set out in Article 4 of Legislative Decree 165/2001).

According to this principle, government organs provide political and administrative guidelines to define the objectives and the programmes to be implemented and check the compliance of the results of the administrative activity and management with the guidelines given. This principle assigns managers the task of adopting the administrative actions and measures (including those that involve the administration in external commitments) and of implementing the financial, technical and administrative management. For this purpose, managers are given independent powers of expenditure, organisation of human, instrumental and control resources: definitively, they are exclusively responsible for administration, management and the corresponding results.

In other words, whilst the political management organs have the task of defining the objectives to be pursued, the basic organisation of the offices and overall staffing levels, the managers have the concrete task of managing the offices.

This framework was further defined by subsequent legislative measures (firstly Law 145 of 2002) that gave public managers dual responsibility: disciplinary and managerial responsibility.

The disciplinary responsibility is that common to all public-sector employees and stems from infringement of the general duties provided for in Article 54 of the Italian constitution and set out in detail in the Code of Conduct for Employees of Public Administrations. The code of conduct, which was drawn up by the Public Function Department, sets out a series of principles of ethical conduct for public-sector employees (diligence, fairness, impartiality, etc.), infringement of which may involve civil, administrative, criminal or accounting responsibility.

Managerial responsibility, on the other hand, relates specifically to public managers and substantially relates to the results achieved by the managers in their administrative activity and in management. In particular, there are two possibilities: failure to reach objectives (i.e. a management failure by the senior administrator) and failure to comply with the directives issued by bodies responsible for policy (this non-compliance must be due to the behaviour of the manager).

An annual appraisal is conducted, as prescribed by Article 5 of Legislative Decree 286 of 1999, which is based on the elements supplied by the evaluation organ and on a strategic control and is conducted on a hierarchical basis: the individual manager of the single office is evaluated by the

head of the general managerial office concerned; the general manager is evaluated by the head of department; the head of department is evaluated by the minister.

If the appraisal is unfavourable, the managerial appointment is not renewed or it is terminated early. In the most serious cases, the manager may also be dismissed under the terms of the national employment contract.

3.2. Internal audit

The Italian public administration has not developed a legal basis for an internal audit in the strict sense of the term. Nevertheless, many of the tasks that are part of an internal audit, above all financial and accounting activities, are performed by the offices of the Ministry of the Economy and Finance (Central Accounts Offices and Territorial Accounts Units), with the aim of increasing the efficiency and efficacy of public expenditure. No laws or regulations refer to internal audits and no apparently equivalent terms indicate the function of internal audit in the strict sense of the term. This applies particularly to the central administrations of the state (ministries, the Prime Minister's Office, etc.).

Nevertheless, forms of internal audit are found in various bodies owing to the organisational independence that they are given by the regulatory set-up, which has enabled them to be given their own responsibilities and activities under their articles of association or through their standing rules governing the organisation of offices, responsibilities and activities pertaining to their functions. These forms of internal audit have been developed in public bodies, both in the first tier of government (for example, the Inland Revenue, State Property, Land Registry and Customs Agencies, which have taken over ministerial responsibilities) and in instrumental public bodies and regional and local administrations ('*comuni*' and provinces).

Nevertheless, Legislative Decree 286/1999 (framework law governing internal controls) does not provide a legal basis for the function of internal auditing. Although no kind of internal audit has yet been introduced into the public administration, the reform introduced by Legislative Decree 150/2009 should be remembered as relating to measures for increasing the productivity and efficiency of public administrations. In particular, an appraisal system has been introduced for both managerial and non-managerial public-sector employees, which is based on performance evaluation and has in turn been made possible by the adoption of the so-called three-year performance plans. The system aims to award the productivity of public-sector employees.

This function is performed in each body or administration by an independent evaluation body (individual or collective person) that is coordinated by a central committee known as the Independent Commission for the Evaluation, Integrity and Transparency of Public Administrations. Although the function of evaluation of public employees does not coincide with that of internal audit, there are some points in common: first of all, the independent nature of the body responsible, the scheduling of the activity that is the object of the control and the planning of the control.

In view of this similarity, in order to put internal audits on a more solid footing in the public administration, the Independent Commission for the Evaluation, Integrity and Transparency of Public Administrations — the organism at the central level — has been entrusted with issuing directives in order to provide a minimum legal basis. Without such a basis, owing to the wide powers of discretion in drawing up articles of association and standing rules, any provision for forms of internal audit would not only be random but differ according to the bodies, their size, their activities, etc. For example, the function is sometimes made to coincide only with internal inspections whereas in other instances it is fully developed in structures that ensure ordinary activity.

It is thus clear that the degree of independence of the internal auditor, where this function exists, varies according to the body, how it is set up and its size. In general, this function is assigned to a manager, who is assigned a department or structure that does not have any distinguishing features as regards its position or dealings with the directorate or administrative board of the body, compared with all the other departments or structures. If, on the other hand, the function of the internal audit were developed as part of an independent evaluation set-up, greater independence from the body would obviously be assured.

The foregoing remarks reflect the objective difficulty of describing in general terms the internal audit's freedom to report and make recommendations and the relationship between the internal audit and management.

As far as professional training is concerned, the certification issued by the Internal Audit Association is not generally required for appointment to managerial positions. Appointments to managerial positions are normally made on the basis of competitive examinations in general administration subjects that are not usually closely connected to the functions that will have to be performed. It is, however, possible to make fixed-term managerial appointments that are proportional to the total number of managers, and are based on the experience and professional qualifications of the appointee: if fixed-term managerial appointments are made, professional qualifications of this type, including relevant certificates obtained, will probably be taken into consideration.

Different types of audit: in general, checks of accounting regularity can also be used as financial audits. Compliancy audits are nevertheless more frequent. Financial inspection, on the other hand, corresponds to administrative accounting checks, except that the inspection is obviously non-routine and makes greater use of sampling. Compared with the internal audit function, it checks thoroughly compliance with the law and regulations and ascertains the administrative and accounting responsibilities of administrators and management.

3.2.1. Internal audit relations with external audit

As there is currently no legal basis for conducting the internal audit in the strict sense of the term, the relationship between internal audits and external audits is not institutionalised in the Italian system. At present, it is possible to report allegations to, or at least alert, the bodies that perform the function of external audit. They can also acquire any documentation relating to the body or administration that is the subject of the report.

3.2.2. Audit boards or audit committees

Legislative Decree 150/2009, which implemented Law 15 of 4 March 2009 on improving the productivity of the public sector and the efficiency and transparency of public administrations, set up a new framework to measure and evaluate the organisational and individual performances of public administrations: a central body known as CIVIT (Independent Commission for the Evaluation, Integrity and Transparency of Public Administrations) and, for each individual administration, the OIVs (independent performance evaluation bodies).

The law tasks CIVIT, which is called upon to show independence of judgement and evaluation and work in complete autonomy, with directing, coordinating and supervising the evaluation functions to ensure the transparency of the systems adopted and the visibility of the indicators of the management performance of the public administrations. This task — which essentially aims to improve the efficiency of the public sector and the quality of services to citizens, whilst recognising and rewarding the merits of individuals and of groups that operate inside the administrations — accompanies that of ensuring the total transparency of administrations, i.e. the accessibility of data relating to their operation also by the online provision of a careful selection of the data that is truly useful to enable the institutions and citizens to take an active part in controlling the way in which the 'public domain' is managed. Also, this function is particularly relevant because the legislator intends the transparency of data to be the tool for ensuring the integrity of public administrations and thus preventing the serious phenomenon of corruption. The components of the CIVIT are appointed by the cabinet.

Each administration also has an independent performance evaluation body (OIV) that performs a multitude of tasks, such as:

- monitoring the overall operation of the system of evaluation, transparency and integrity of the internal controls and drawing up an annual report on its state;
- promptly reporting any problems to the relevant internal government and administration organs;
- ensuring that the measuring and evaluation processes are correct in order to uphold the principle of rewarding merit and professionalism;



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- applying correctly the guidelines, the methods and the instruments provided by CIVIT;
- promoting and certifying transparency and integrity;
- checking the results and good practice of the promotion of equal opportunities.

In the Italian system there are also management control units, provided for by Legislative Decree 286/1999. Each administration, as indicated in Article 4 of this legislative decree, sets up at individual department level units that are responsible for designing and implementing management control. These units map the processes, products and aims of the administrative action of the department to which they belong, measuring the results of the administrative action in terms of efficiency, efficacy and cost and conducting periodic monitoring of the time, resources, costs and quality of the activities of the department. The main objective is indicated in Article 1 of Legislative Decree 286/1999: checking the effectiveness, efficiency and cost of the administrative action in order to optimise, also by prompt interventions, the cost–benefit ratio.

Within the general framework of the system, as outlined by Legislative Decree 150/2009, the performance plan and the performance report, which are both specified by Article 10 of the decree, take on particular importance.

In order to ensure the quality, understanding and reliability of the performance documents, public administrations must each year (by 31 January) draw up a three-year programme report called the 'Performance Plan'. This must be consistent with the contents, financial programming and budget cycle and must define the guidelines and the strategic and operational objectives, defining, with reference to the final and intermediate objectives and the resources, the indicators for measuring and evaluating the performance of the administration, the objectives assigned to managers and the relative indicators. By 30 June, a report, called the 'Performance Report', must be adopted, which shows with reference to the previous year the organisational and individual results obtained compared with the individual programmed objectives and resources and points out any deviations.

The plan and the report are sent to CIVIT and to the Ministry of the Economy and Finance.

3.3. Coordination of public internal control

The Italian system has four types of control that are described in Section 1 above. Different organisms are responsible for coordinating these types of control.

The Ministry of the Economy and Finance coordinates and harmonises the control of administrative and accounting regularity, which has to guarantee the legitimacy, validity and propriety of the administrative action. This task is performed in particular by the State General Accounting Department and the branches of this department: the Central Accounting Offices (located in each central administration), the Territorial Accounts Units (located throughout the country in each of the provincial capitals) and the Central Inspectorate of Public Finances (a specialised body of inspectors).

The offices for departmental control have the task of checking the efficacy, efficiency and good value of the administrative action to optimise the cost–benefit ratio. These offices are set up in each department of the individual ministries. The offices for departmental control collaborate directly with the head of the department and they are coordinated by the independent organisms for performance evaluation (see Section 3.2.2 on audit boards or audit committees).

As already illustrated in Section 3.1 above on managerial accountability, there already exists a hierarchical evaluation system for evaluating managers: the individual manager of a single office is evaluated by the head of department; the head of department is evaluated by the minister.

Finally, the strategic control, which has to evaluate the appropriateness of choices in terms of the consistency between the choices made and the set objectives (see Section 1 above), is conducted by the aforementioned OIV (independent organisms for performance evaluation). These are structures that are directly answerable to the organisms providing political and administrative guidelines and they are coordinated by the CIVIT (Independent Commission for the Evaluation, Integrity and Transparency of Public Administrations). See also Section 3.2 on audit boards or audit committees.

4. Financial inspection

Financial inspections are extra-hierarchical and conducted by the Ministry of the Economy and Finance where public finance is involved.

The absence of a hierarchical relationship between the administration conducting the inspections and the offices or inspected administrations means that this type of inspection is legitimised by law. In particular, in the framework measure governing public-sector employees, the Ministry of the Economy and Finance has the authority to monitor expenditure on staff and is obliged to report irregularities to the State Audit Court. When exercising this power, the Public Finance Inspection Services of the Ministry of the Economy and Finance use their prerogatives under the previous standard that gave them a particular role in inspecting the administrative and accounting regularity of the administration. This means that the inspections may relate to all the aspects of the inspected administrations and not only to the regularity of expenditure on staff.

In addition to the duty to report to the State Audit Court any irregularities detected, the inspection also involves questioning the managers of the inspected offices or administrations. This inspection tends to exceed the formulated investigations or to ensure that suitable remedial measures are taken.

The inspection initiatives are generally programmed on the basis of directives signed by the ministry, but this does not exclude the possibility of individually reporting or drawing attention to presumed irregularities. The ministry directive is implemented by scheduling the inspections if the main and most frequent financial irregularities in the system have been detected and the inspections are also conducted to reduce waste and inefficiencies in public expenditure as also defined in general programming documents (see the financial economic programming document, now called the Public Finance Decision).

In general, the inspections relate to past administration, in particular to the administration of the previous five years, a term beyond which compensation for tax loss can no longer be filed in accordance with the measures governing exactly this type of responsibility.

Relations between inspection and control functions: it should be remembered that the inspection has primarily an auxiliary, collaborative function and serves to spread good administrative practice even though it has the role of repressing irregular or unlawful conduct.

5. Ongoing and/or future reforms

The reform of controls under way is also based on the new law governing public accounts and finances (Law 196/2009). This law charges the government to issue a series of implementing measures that are still being drawn up. The legal principles governing the controls can nevertheless be summarised as follows: monitoring public finances; comparing the results of different administrations; achieving public finance objectives defined in terms of financial balances that comply with EMU limits, a different basis for the public administration subject to the controls, no longer formally but substantively defined, following the adoption of Eurostat criteria.

More generally, Law 196/2009 introduces new instruments for achieving the objectives of transparency and coordination and reinforces the role of Notes to the Accounts. These are documents attached to the national budget by means of which the individual administrations illustrate, in relation to the expenditure programmes, the criteria for formulating forecasts, the objectives to be achieved and the indicators for measuring them. The most important innovations are the three-year time scale and a greater focus on measuring the effects that the public policies aim to produce (greater focus on output and outcome indicators).

Legislative Decree 150/2009, on the other hand, aims to optimise the productivity of public work and the efficiency and transparency of the public administrations, providing that they should adopt a system for measuring and evaluating performance with reference to the administration as a whole, to the organisational units and to the single employees.

Measuring and evaluating organisational and individual performance (provided for in Legislative Decree 150/2009) is designed to improve the quality of the services offered by the public administrations whilst measurement of the result of objectives within the expenditure programmes



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of the national budget (specified by Law 196/2009) will make the allocation of public resources better and more transparent.

Both laws establish a link between the two systems for measuring performance. Currently, we are studying how to integrate the various systems provided for in the reform (organisational performance, individual performance and performance of the budget programmes). This integration will determine the minimum requirements for developing the measuring systems and a common glossary valid for the entire Italian public administration at all levels of government will be compiled.

Another important reform arises from the approval of Law 42 of 2009, entitled 'Mandate to the government on fiscal federalism', implementing Article 119 of the constitution.

In 2001, the Italian parliament passed a constitutional law (Law 3 of 2001) that deeply changed the part of the Italian constitution relating to the system of local autonomy and dealings with the state. The objective was to create the bases and the essential conditions for a future transformation of Italy into a federal republic, overturning the order of priorities in law-making. Whereas before the matters were listed on which the regions could pass laws (on a joint basis) and the state was left responsible for all the rest, in Constitutional Law 3 of 2001, on the other hand, the matters for which the state is solely responsible are listed together with matters for which the state and regions are jointly responsible. The regions are left with the general or 'residual' responsibility (so-called legislative federalism).

This reform has different effects. The main effects include:

- polycentric (and no longer 'hierarchical') organisation of the Italian Republic, which now consists of municipalities (*comuni*), the provinces, the major cities, the regions and the state;
- the possibility of giving regions that have standard status particular forms and conditions of autonomy (so-called differentiated federalism) if they request it (and subject to the agreement of the state);
- giving the *comuni* priority in administrative action (inclusion in the constitution of the principle of administrative federalism);
- the introduction of the principles of vertical subsidiarity between the various government levels of the republic and of horizontal subsidiarity between public bodies and citizens;
- the inclusion of the principles of fiscal federalism and the setting up of a compensatory fund for disadvantaged areas of the country;
- the abolition of prior state control of regional legislation.

Law 42 of 2009 is a decree that implements the new Article 119 of the constitution that arose from the changes introduced by the reform of 2001. The new Article 119 in fact confers tax-raising and expenditure autonomy on *comuni*, provinces, major cities and regions (obviously in accordance with the principles of solidarity and social cohesion).

The main objective is to replace at all levels of government the criterion of historical expenditure with that of standard expenditure. Standard costs and needs shall be the indicators (or parameters) to which public actions shall be compared. In this way, the maximum degree of responsibility, effectiveness and control transparency will be ensured.

Law 42/2009 also contains provisions for establishing the main principles of the coordination of public finances and of the tax system and for organising the setting up of a compensatory fund for the territories and the national areas that have lower *pro capita* tax income.

Tax federalism will be implemented as far as is compatible with Italy's commitments at the European level to the Stability and Growth Pact and, in order to avoid duplicated functions, with the transfer of central administration functions to local administration, which will of course also be accompanied by a transfer of staff.



LATVIA

LATVIA

Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The development of the internal control system in Latvia is closely related to the integration of Latvia into the European Union. During the pre-accession talks, Latvia assumed an obligation of establishing an internal audit system comprising all ministries and subordinated bodies and specifying the responsibilities of heads of the bodies for establishing the internal control system. The regular EC Report of November 1998 on the progress of EU integration achieved by Latvia stressed a necessity to strengthen the internal audit and control systems.

On 5 October 1999, the cabinet of ministers approved Regulation No 342, Internal audit regulations, containing a definition of the internal control: an internal control system is an activity plan, as well as all methods and procedures adopted by the administration of the body to ensure efficient management of the body; however, the main requirements for the internal control system had not been legally regulated by legislation until the cabinet of ministers adopted regulations on the basic requirements regarding establishing an internal control system on 23 August 2003. The regulations set out basic requirements regarding the internal control system and the main principles of establishing and organising the internal control.

The regulations were based on the COSO (Committee of the Sponsoring Organisations of the Treadway Commission) model of the internal control system. The regulations contained five main elements of the internal control system: control environment, assessment of completed work and risks, information and communication, control activities and monitoring. The Ministry of Finance was the authority responsible for preparing and introducing regulations for the internal control system.

However, the existing legal regulation had to be improved over the course of time. Basic requirements regarding establishing the internal control system set out in Cabinet Regulations No 466 of 19 August 2003, Regulations on basic requirements regarding establishing the internal control system, proved general and did not ensure a universal understanding of the internal control system in public administration. The above regulations were repealed on 1 October 2010. Currently, new cabinet regulations on basic requirements regarding the internal control system are being prepared. The state chancellery is the authority responsible for preparing the regulations in Latvia (the cooperation authorities are the Ministry of Finance and the Corruption Prevention and Combating Bureau).

⁽¹⁾ Contributed by the Ministry of Finance on 11 March 2011.

2. Public internal control environment

The national budget in Latvia is planned for a one-year period. The budget is distributed pursuant to the Budget Law prepared by the Ministry of Finance and approved by the Saeima (the parliament). Specific plans for programmes and bodies are prepared in accordance with the Budget Law. For payments from the national budget funds, bodies prepare payment orders and send them electronically for the state treasury to transfer the funds. For communication with the state treasury, a special electronic tool *e-Kase* is used. Payments in *e-Kase* are subject to an automatic control whereby payments are compared against the budget assigned and the financing plan. Latvia has adopted cash-basis accounting for the national budget funds. A plan is currently being prepared for a transition to accruals-based accounting.

The accounting system is decentralised; however, it is currently being centralised at the departmental level. The procedures for preparing, approving and implementing the national and local budgets and budget-related responsibilities are regulated by the Law on the Budget and Financial Management (hereinafter referred to as the LBFV), pursuant to which financial management refers to the national and local budget funds, as well as to financial operations of enterprises and organisations in cases where these are assigned national or local budget funds, their capital shares contain national or local budget investments, or if law or cabinet regulations so specify.

The following significant measures have been taken to strengthen control over the national budget funds.

- Revenue and expenditure calculations are compiled to enable the planning of funds within the approved budget, analysing revenue and expenditure across financial indicators under programmes and sub-programmes and tracing their compliance with approved financing plans (Cabinet Instructions No 2 of 20 January, Procedure for preparing and approving current year calculations under national budget programmes, subprogrammes and measures in national budget bodies).
- The preparing and approval of financing plans (revenue and expenditure plans of bodies executing the budget, prepared in accordance with the annual National Budget Law and drafted across months) used to control the execution of the budget in accordance with funds allocated from the national budget revenue (Cabinet Regulations No 1220 of 28 December 2010, Procedure for awarding and executing budget assignments).
- Opening accounts with the state treasury for receiving national budget funds and making payments. National budget bodies open main national budget accounts and special purpose national budget accounts with the state treasury only. In order to receive national budget funds and make payments from these funds, bodies financed from the national budget, except for national budget bodies and local authorities, open operating accounts with the state treasury only. In order to receive national budget funds and make payments under investment projects and single measures financed from these funds, local authorities and bodies subordinated to them open operating accounts with the state treasury. Bodies that are not financed from the national budget open accounts with the state treasury only (Section 27(1) of the LBFV).
- Accounting under the national budget is kept by the state treasury (Section 29(1) of the LBFV), while ministries and central public bodies are responsible for submitting to the state treasury financial statements and financial information regarding enterprises subordinated to these bodies, as specified by the cabinet of ministers. The financial statements mentioned in this section must also be submitted to the State Audit Office (Section 30(4) of the LBFV), whereas the state treasury is responsible for financial management in accordance with provisions of this law (Section 46(3) of the LBFV).
- The LBFV specifies the responsibility of the Minister for Finance for preparing the draft annual national budget law (a set of draft laws), commentaries and a midterm macroeconomic development and fiscal policy framework enclosed with the law (Section 16), as well as the organisation and management of execution of the budget and monitoring the operation of the state treasury in accordance with the LBFV (Section 46(2)). Section 46(1) of this law sets out the responsibility of heads of bodies financed from the national budget, bodies that are not financed from the national budget, local authorities and capital societies (with public

or local authority investments in their capital shares) to observe, comply with and control procedures and requirements of the LBFV, as well as effective and economical use of budget funds for intended purposes.

- Additionally, a system for midterm planning of the budget was introduced in Latvia in 2008; this system is implemented pursuant to the concept of introducing strategic planning and midterm budget planning in public administration approved by Cabinet Resolution No 703 of 14 September 2006. According to the midterm budget planning system, the national budget law is prepared for one year and the maximum permissible expenditure in the subsequent two years is determined. On 3 October 2009, the cabinet of ministers adopted Cabinet Regulations No 1127, Regulations regarding basic principles of preparing and submitting budget requests setting out basic principles for preparing midterm budget requests in ministries and other central public bodies in accordance with the maximum permissible national budget expenditure specified in the midterm macroeconomic development and fiscal policy framework and submitting these requests to the Ministry of Finance.



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External audit

Financial statements of all departments, as well as financial statements from general public administrations (prepared by the state treasury) are audited on an annual basis by the State Audit Office, which also gives an opinion, in accordance with international standards on auditing.

The State Audit Office is the highest independent collegial audit body, the operation of which is governed only by the law. The Law on the State Audit sets out the following responsibilities of the State Audit Office:

- submitting to the Saeima an annual opinion regarding the Minister for Finance report on the execution of the national budget and financial condition of local budgets in the economic year;
- giving annual opinions regarding the correctness of annual statements of ministries and other central public bodies;
- carrying out audits of legitimacy and performance in accordance with an audit plan approved by the State Audit Office Council.

Information regarding results of audits carried out by the State Audit Office is provided to the Saeima and the cabinet of ministers; violations of law revealed during audits are reported to law enforcement bodies. Pursuant to Sections 2(1)(1) and 2(1)(2) of the Law on the State Audit, in the course of financial, legitimacy and performance audits, the State Audit Office controls revenue and expenditure of budget funds in public and local authorities and other derived public bodies, and the use of funds of the European Union and other international organisations and bodies included in the national budget or local authority budgets. The aim of the State Audit Office is to make sure that the use of funds specified in the first paragraph of this section is legitimate, correct, economical and efficient and to provide recommendations for correcting revealed irregularities.

The State Audit Office and the Ministry of Finance continuously maintain contact in order to ensure the exchange of information. The State Audit Office provides to the Ministry of Finance copies of all reports, as well as special information reports regarding its operations, whereas the Ministry of Finance provides to the State Audit Office information regarding internal audit activities and internal control evaluation; additionally, the Ministry of Finance participates in meetings of Saeima commissions during which the State Audit Office gives presentations regarding its reports.

The State Audit Office carries out annual audits in the Ministry of Finance and the State Revenue Service based on the Minister of Finance annual report on the execution of the national budget and revenue of local budgets. The aim of this audit is to provide assurance that the existing system of administrating revenue enables adequate presentation in the annual report of taxes collected. The audit comprises checks on the main processes of tax administration affecting records and control of payments and tax payers, as well as collection of national taxes, duties and other mandatory payments in Latvia.

Initiation of controls: the State Audit Office is an independent body and it takes independent decisions regarding its plans and unscheduled audits. The analysis of risks and of the planning of operations in the State Audit Office are based on all information available to it, including publicly available information, application forms submitted by individuals, etc.

The State Audit Office carries out *ex post* controls only: pursuant to Section 25(1) of the LBFV, the State Audit Office, in cooperation with the State Revenue Service, makes sure that all revenue due to be received in the national budget is received in a timely and correct fashion and ensures that national budget expenditure complies with the existing law. The State Audit Office holds annual meetings with internal auditors to share information regarding audit findings and plans and to discuss current issues. When initiating an audit in a body, the State Audit Office holds a meeting with the internal audit unit and uses internal auditors' reports and other information in its work.

The State Audit Office sends information reports on its audits also to the Minister for Finance to ensure exchange of information between the State Audit Office as the controlling authority and the Ministry of Finance.

The fight against fraud and/or irregularities

Latvia has established a number of bodies responsible for combating and investigating fraud, such as the Corruption Prevention and Combating Bureau, the Financial Police, the Economic Police and the State Revenue Service Customs Criminal Police. Irregularities discovered in European Union funds are coordinated by the Anti-Fraud Coordination Service (AFCOS) Council operating on the basis of regular meetings. The Head of the AFCOS Council is the State Secretary of the Ministry of Finance, and among the members of the council there are head officers of authorities managing European Union funds and of the abovementioned investigating authorities, as well as of the Ministry of Justice. The AFCOS Council maintains contact and exchanges information with OLAF departments.

The Ministry of Finance as the managing authority under European Union Structural Funds and the Ministry of Agriculture as the managing authority under the Agriculture and Fisheries Fund are responsible for daily operations in connection with administering irregularities and preparing reports.

3. The concept of public internal control

3.1. Managerial accountability/responsibility

Pursuant to Latvian law, heads of bodies are responsible for organising the execution of the functions of the bodies and for managing administrative activities so as to ensure continuity, performance and legitimacy. The head of the institution is responsible for establishing, monitoring and improving the internal control system. Heads of bodies also have the following responsibilities:

- management of financial, human and other resources of the body;
- specifying responsibilities of administration officers and employees of the body;
- appointment and dismissal of officers and employees;
- ensuring that the annual operational plan and the budget request of the body are prepared;
- specifying procedures for pre and post control of administrative resolutions.

The head of a body is an officer who is a civil servant or an employee of the body and who is appointed or employed on the basis of professional criteria.

3.2. Internal audit

The legal basis of internal audit is the Law on Internal Audit setting out the establishment, operation and coordination of the internal audit system, the responsibilities of officers responsible for establishing internal audit units, the tasks of internal audit units, the principles of independence of internal audit units and the responsibilities of the internal auditor, including the principles

of ethics. Internal audit in Latvia is an independent and objective activity of an internal auditor resulting in the auditor's statement or consultation aimed at improving the operation of the internal control system in a ministry or an authority.

The internal audit unit is independent from other units of the body in planning its operations, carrying out internal audit and reporting results of its operation. The internal auditor is not engaged in direct functions of the ministry or body, in implementation of programmes and projects wholly or partially financed by the European Union or implementation of foreign financial aid, in preparation of specific projects and programmes, or in the establishment of the internal control system. The internal auditor may be engaged in performing these functions in the capacity of a consultant.

Regulations of the internal audit unit are approved by the head of the body. Regulations of the internal audit unit specify the status, aims, functions, tasks, essence of consultations, scope of work, structure and rights and responsibilities of the internal audit unit. The internal audit unit submits reports on internal audits to the head of the body. Additionally, the head of the body specifies officers to whom the contents of internal audit reports are to be made known. The head of the internal audit unit must ensure that the contents of internal audit reports are made known to the responsible officers.

The head of the internal audit unit is responsible for preparing a review of operation of the internal audit unit over the previous calendar year and submitting this review to the head of the body. The review must contain the following parts: plans of the internal audit unit, systems audited in the reporting year, opinion regarding the internal control system, employees of the internal audit unit and other significant information. The review of the internal audit unit of a ministry or body must contain also information regarding execution and quality indicators of operations of the internal audit unit.

On the basis of information provided by internal audit units by 1 June of the current year, the Ministry of Finance prepares a review of operation of the internal audit system in ministries and bodies, and submits this review and the opinion of the Internal Audit Council to the cabinet of ministers and the State Audit Office, in accordance with the established procedure. Internal audit units carry out internal system audits based on risk assessment, as well as internal audits of the quality management system. Depending on the aim of the audit, internal audit units carry out compliance audits, financial audits, performance audits, IT audits and functional audits.

The procedure for the monitoring of internal audit recommendations is specified in internal regulations of the internal audit within each body. The head of the internal audit unit is responsible for informing the head of the body about the progress in implementing recommendations. If a recommendation is not implemented in due course, the head of the body takes a decision regarding further activities.

3.2.1. Internal audit relations with external audit

The internal audit unit is responsible for monitoring implementation of recommendations given by the State Audit Office and external auditors in the body. The internal audit unit provides to the State Audit Office the strategic and annual plans and the annual report of the internal audit unit. Internal auditors carry out system audits on the basis of results of audits carried out by the State Audit Office.

3.2.2. Audit boards or audit committees

The Internal Audit Board has been established in Latvia; the board is a consultative body whose aim is to promote the improvement of internal audit, as well as implement and develop internal audit policy and methodology in state administration. The responsibilities of the Internal Audit Board are as follows:

- evaluation of annual reports of internal audit units and other information regarding operation of internal audit units, as well as providing opinions;
- providing an opinion regarding the Ministry of Finance annual draft report regarding internal audit in public administration;



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- evaluation of proposals regarding amendments and improvements in internal audit prepared by ministries and bodies and submitting recommendations to the Minister for Finance;
- evaluation of internal audit unit information regarding instances where the independence or objectivity of internal audit are affected;
- the board may participate in peer reviews of internal audit units carried out by the Ministry of Finance.

Audit committees in public administration bodies in Latvia are established on a voluntary basis, and these have been established in specific bodies. Audit committees usually consist of senior administration officers of bodies (ministers, state secretaries, deputy state secretaries). No mandatory requirements for establishing audit committees are considered necessary, since the structure of public administration bodies does not ensure complete independence of audit committees of administrative and political management, whereas maintaining special organisations for this purpose outside the structure of bodies is not reasonable.

3.2.3. Coordination of public internal control

No formal units or authorities responsible for coordinating PIC have been established in Latvia. Evaluation of the internal control system is a responsibility of internal audit units. In the annual report on the operation of the internal audit unit, internal audit units give their opinion regarding the operation of the internal audit system. The Ministry of Finance prepares a summary of the information provided and includes it in the annual report on internal audit in public administration. The report is submitted to the cabinet of ministers.

4. Financial inspection

Pursuant to Section 2 of the Law on the Corruption Prevention and Combating Bureau, KNAB is a public administration body subordinated to the cabinet of ministers; the functions of KNAB in preventing and combating corruption and in the control of compliance with regulations regarding financing of political organisations (parties) and their unions are set out in the above law. The bureau is an entity carrying out operational activities.

5. Ongoing and/or future reforms

On 24 February 2010, the cabinet of ministers adopted the plan of measures for improving the internal audit system. This plan sets out measures for improving the internal control environment and raising the internal audit competence of head officials, as well as for optimising the internal control system and improving service quality. Measures for improving the internal control environment include preparing draft cabinet regulations regarding procedures for establishing and monitoring internal control systems in bodies, specifying competences for head officials in bodies and organising information and education measures for head officials, as well as measures for exchanging experience gained in implementing the internal control system.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The beginning of the Lithuanian PIFC reform is the year 2000, in parallel with other ongoing public administration and public expenditure management reforms supporting the PIFC system, when the following main legal instruments for internal audit and financial control were adopted in the Republic of Lithuania:

- Law on the Budget Structure — on 11 July 2000;
- Law on Local Self-Government — on 7 July 1994 (amended on 12 October 2000);
- Law on Public Administration — on 17 June 1999;
- Government Resolution No 127 on Internal Audit of State Enterprises and Establishments of 7 February 2000 (amended by Resolution No 1098 of 13 September 2001);
- Government Resolution No 273 on the Composition of the Standing Interdepartmental Commission for Coordinating the Development of the Internal Audit System in the Public Sector and on the Commission's Regulations of 9 March 2001;
- Government Resolution No 1116 on Internal Audit Standards of 19 September 2001;
- Government Resolution No 379 on the Approval of the Procedure for Control and Assessment of Programme Implementation by Appropriation Managers of the State Budget of 5 April 2001;
- Minister for Finance Order No 26 on the Internal Audit Manual for Public Enterprises and Institutions of 31 January 2001 (amended by Order No 22 of 23 January 2002).

The coordination of PIFC was especially enhanced when the Standing Interdepartmental Commission for Coordinating the Development of the Internal Audit System in the Public Sector was established under Government Resolution No 273 of 9 March 2001. The Ministry of Finance is in charge of the overall methodological guidance on internal audit and financial control issues and on 1 October 2001, the Financial Control Methodology Department was established as a central harmonising unit (the CHU). Thus, the Ministry of Finance, following the appropriate obligations delegated by the government and the Seimas (parliament) of the Republic of Lithuania, became the main driver of the reform in the field of internal audit and financial control. The CHU responsible for implementing the requirements for the accession negotiations of Chapter 28: Financial Control prepared the 'policy paper' document, which triggered the further establishment and full development of a comprehensive and effective PIFC system in the Lithuanian public administration area.

⁽¹⁾ Contributed by the Ministry of Finance of Lithuania on 16 March 2011.

Taking into consideration the recommendations and practical support from the European Commission, twinning partners and the recommendations provided under SIGMA Peer Review of 2002, as well as further ongoing monitoring activities by SIGMA, also following the internationally accepted principles (COSO, IIA), the existing internal audit legislation was consolidated into a single primary document — the Republic of Lithuania Law on Internal Control and Internal Audit (hereinafter referred to as the PIFC Law) at the end of 2002. Progress was made and the accession negotiation Chapter 28 was closed in December 2002. Then secondary and tertiary legislation in the field of PIFC (internal audit charters, internal audit and financial control manuals, code of professional conduct, guidelines, etc.) followed.

Internal audit units (hereinafter referred to as IAUs) were established in all the branch ministries and county governors' administrations, and other public institutions, a few years later on — also in municipalities. The majority of internal audit posts and positions were occupied in the public sector. Internal auditors were regularly trained under a newly prepared four-module continuous training programme for internal auditors in the training centre of the Ministry of Finance. In addition, a number of twinning projects (Phare, SPP II, etc.) comprised training components on internal audit and financial control not only for internal auditors and accountants, but also for the heads of the public institutions. These contributions considerably enhanced the administrative capacities of IAUs in the public sector.

The year 2001 was especially important in the external audit area. The National Audit Office of Lithuania prepared the Strategic Development Plan for 2001–06. According to the appropriate regulations and in line with international standards, the National Audit Office was reorganised into a supreme government audit institution.

2. Public internal control environment

This section presents an analysis of the top-level state institutions, such as the Seimas (parliament), government and ministries of the Republic of Lithuania. The key principles and the rules of internal control are also applied to the lower-level institutions and those in local self-government (municipalities); still, due to different government and activity structures as well as organs regulated by individual legal acts, these can only be analysed with the knowledge of the legal acts regulating their activities.

Lithuania has developed a PIC system embedded in the Law on Internal Control and Internal Audit, which defines the basic objectives, principles, responsibilities and accountability of the functioning of internal control (including financial control and internal audit). At state level the state assets are audited by the supreme audit institution (National Audit Office of Lithuania), which is accountable to the Seimas. The National Audit Office performs financial and performance audits.

Internal audits of a public legal entity (that are in compliance with the criteria established in appropriate legal acts) are performed by internal audit units (IAUs), which are subordinate and accountable to the head of a public legal entity. Other legal entities are audited by a centralised internal audit unit of a superior institution. IAUs of public legal entities report on their activities directly to the Ministry of Finance on an annual basis. Public legal entities submit a report on the functioning of the financial control system to the public legal entity they are subordinated to or within whose sphere of regulation they are, and the top-level state institutions submit this report to the Ministry of Finance.

The programme budget, prepared in accordance with the strategic planning principles, is drafted in Lithuania, and is approved by the Seimas. Public sector accounting reform is under implementation, and it switched from cash-basis to accrual-basis accounting. The introduction of new accounting principles should create more favourable conditions for better information flows improving internal controls.

National Anti-Corruption Programmes (2002–07 and 2009–10) were developed; their implementation is arranged and controlled by the government with involvement of the Special Investigation Service. The prevention of corruption is carried out by the government, the Chief Official Ethics Commission, the Special Investigation Service and other state and municipal as well as non-state institutions. The Special Investigation Service, in accordance with the Law on

Operational Activities, carries out operational activities and discloses and clears up criminal acts of corruption (bribery, corruption, abuse of office, etc.).

In the event of the detection of irregularities during the internal audit to be investigated by law enforcement institutions, the head of the internal audit unit should transfer all internal audit documents to the competent law enforcement institutions. When the statutory audit detects irregularities to be investigated by appropriate public administration entities or law enforcement institutions, the statutory audit documents should be transferred by an appropriate decision of the Head of the NAO and his deputies.

3. The concept of public internal control

The PIC system was built and developed in accordance with INTOSAI principles. The following provisions are consolidated in the Law on Internal Control and Internal Audit.

- Internal control is the entire set of controls established by the management of a public legal entity in order to provide reasonable assurance that the operations of the public legal entity are legal, economical, efficient, effective and transparent, that the strategic and other plans are implemented, that assets are safeguarded, that financial information and reporting are reliable and exhaustive, that contractual liabilities to third persons are satisfied and that all identified risks are managed.
- Financial control is a constituent part of the internal control system of a public legal entity, which is used to ensure the legality of the economic activities of a public legal entity and compliance with the principles of sound financial management: economy, effectiveness, efficiency and transparency.

In Lithuania the responsibility for the creation and functioning of effective internal control in the public legal entities is assigned to the heads of these legal entities. In development and implementation of monitoring of financial control, the heads must approve their rules for financial control. The rules for financial control are based on the minimum requirements for financial control approved by the Minister for Finance. The rules for financial control (including references to other internal documents) should contain the control procedures implemented from adoption of the decision to its implementation, and inclusion of economic operations into accounting registers. Correct and timely drawing up and submission of accounting reports is another essential objective of financial control. The rules for financial control specify financial control procedures that are established in view of the nature of activities and peculiarities, performance risks, organisational structure, accounting and information systems and the state of protection of assets in a public legal entity.

The head of a public legal entity regularly supervises the functioning of the financial control and analyses its efficiency in the public legal entity. Internal audit units provide significant assistance in this area by providing recommendations on the development of the internal control system and the monitoring of implementation of the recommendations provided.

The National Audit Office as the supreme audit institution also provides significant recommendations on improvement of internal control.

3.1. Managerial accountability/responsibility

The Law on Internal Control and Internal Audit establishes the responsibility of the heads of legal entities in the public sector for the creation of an efficient internal control system, its functioning and improvement and appointment of the staff responsible for financial controls. In accordance with this law, internal control covers all five COSO interrelated components. In creating its internal control system, the head of a public legal entity ensures that its activities comply with legal texts, work regulations (the rules on internal work procedure), procedures, strategic plans and contracts of the public legal entity and ensures the reliability of performance and financial information, the effectiveness of performance and the protection of assets and liabilities. In accordance with the law the top administrative manager of the public legal entity, called the Chancellor, is responsible for the functioning of internal control and its monitoring. He or she is a career civil servant, not the civil servant of political (personal) confidence, i.e. not a politically



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appointed manager. He or she appoints the staff to be responsible for implementing the financial control procedures in the public legal entity.

Although the assignment of control functions falls within the competence of the Chancellor, the delegation of decision-making powers falls under the competence of top managers (e.g. ministers) of the public legal entity. Ministers, as members of the government, are responsible for the implementation of the government programme, for its priorities as well as for the planned results in the area assigned to them. The Chancellor is responsible for drawing up and implementing the strategic plans of the ministry and for the coordination and control of the activities of administrative units of the ministry. He or she ensures that in implementing strategic activity plans of the ministry, financial, material, intellectual and information resources are used to the optimum extent. On the minister's order the Chancellor coordinates and controls the activities of bodies subordinated to the ministry.

Before the head of a public legal entity takes decisions, *ex ante* control takes place through either acceptance or rejection of decisions related to the use of state and municipal assets and liabilities to third persons. The *ex ante* control function is separated from decision initiation and implementation. The *ex ante* financial control is performed by the chief accountant (the head of an accounting structural unit). The chief accountant, in performing *ex ante* financial control, signs or refuses to sign appropriate documents allowing an economic operation to be carried out. The chief accountant, by signing the documents of an economic operation, certifies that the economic operation is legal, the documents relating to the performance of such operation are prepared adequately and that the appropriation resources approved are sufficient for carrying out the economic operation.

The chief accountant, in performing *ex ante* financial control, has the right, without a separate instruction to be given by the top manager (head) of the public legal entity, to receive from heads (senior officials) of structural units and civil servants of public legal entities the written and oral clarifications on the preparation of documents necessary for the performance of the economic operation and copies of documents related to the performance of the economic operation. In accordance with the current legal acts, the chief accountant is directly subordinate to the top administrative manager of the public legal entity.

The Seimas (parliament) approves the state budget of the Republic of Lithuania. Public legal entities approve their estimates by programme and their measures for implementation in accordance with the approved budget. Top managers of a public legal entity, in delegating powers of implementation, may not delegate their responsibility for the implementation of these functions and expenditure related to the implementation thereof.

Internal control ensures that the activities of a public legal entity are carried out in accordance with the procedure prescribed by laws and other legal acts in accordance with strategic or other activity plans and with programmes and procedures aimed at protection of the state and municipal assets, as well as liabilities to third persons against fraud, misappropriation, embezzlement, illegal management or other illegal acts, and that the public legal entity follows the principles of sound financial management in its activities. During the period of economic crisis and in order to save funds, greater attention was given to the legality of economic operations performed and the integrity and economy of accounting records.

The Law on Public Procurement sets strict requirements for the arrangement and carrying out of public procurement, and establishes the responsibility of top managers of a contracting authority as well as detailed public procurement procedures. Part of the procurement procedures is carried out by the Central Purchasing Body — by centralised purchasing procedure at the state level. The arrangement of public procurement procedures is supervised by the Public Procurement Office under the Ministry of Economy of the Republic of Lithuania.

Each year the top manager (the head) of the public legal entity presents a report on the state of financial control (an annual statement) in the public legal entity, including the public legal entities subordinated to it or assigned to its management area. The principle for submission of the report is based on the principle of accounting to the superior public entity — inferior entities summarise the data on public legal entities and report on the activities they have performed. The report comprises essential aspects of financial control. This ensures the accountability of the public sector. The top manager of the public legal entity signs the report. The Ministry of Finance

analyses the financial control reports by top level public legal entities and prepares an analysis of these reports. According to the data received, the requirement for the improvement of the existing legal acts and other documents is examined.

3.2. Internal audit

The legal basis.

- The Law on Internal Control and Internal Audit (the PIFC Law) approved in 2002. The document defines the basic legal framework, goals and procedures for the functioning of internal control, including financial control and internal audit in a public legal entity, as well as responsibilities of its heads (according to internationally accepted principles: COSO, IIA, etc.).
- The Standard Charter of the Internal Audit Unit approved by the government resolution in 2003. The activities of the internal audit unit shall be governed by the Internal Audit Charter approved by the head of the public legal entity, which is developed following the template text for the Internal Audit Charter, approved by the government.
- The Rules of the Professional Ethics for Internal Auditors (the Code of Ethics) approved by Minister for Finance of the Republic of Lithuania Order in 2003. The document defines the principles and norms of professional conduct of internal auditors of a public legal entity, which they shall follow when exercising their rights, carrying out responsibilities and functions.
- The Standard Internal Audit Methodology approved by Minister for Finance of the Republic of Lithuania Order in 2003. The document aims at assisting the internal audit unit in drafting the internal audit methodology, having regard to the characteristics of activities performed by the public legal entity.
- The Internal Audit Guidelines approved by the Standing Interdepartmental Commission for Coordinating the Development of the Internal Audit System in the Public Sector in 2003. The guidelines serve as an additional and comprehensive reference tool to provide the internal auditors of the public legal entities with principles, concepts and recommendations, which are to support them in conducting their activities and in preparing the specific manuals on internal audit.

The nature of functional independence of the internal auditor vis-à-vis the top manager to which the internal auditor is attached can be clarified as follows.

3.2.1. Freedom of audit reporting and recommending to top management or lower levels

The basic aspects and status of the functional independence of the internal audit in Lithuania are embodied in the existing PIFC Law and secondary and tertiary legislation. Functional independence of the internal auditor refers to being free from interference in determining the scope of internal audit, the performance of audit work and communicating results. Also, the IAU may not be involved in the performance of any managerial function of the public legal entity. The IAU reports directly to the head of a public legal entity, which means that the IAU is organisationally free from undue influence and control of senior management.

Furthermore, in cases of disagreements and conflicts, the head of the IAU has the right to discuss the situation with the Ministry of Finance (the CHU). The CHU assesses how the aforementioned aspects are implemented and function during quality assessment reviews of the internal audit units, consultations and other sources of information. Also, the CHU monitors the appointment and dismissal of the head of the IAU: the representative of the CHU participates as a member of the commission for selection of candidates to the position of the head of the IAU. The head of a public legal entity, dismissing the head of the IAU, shall inform the Ministry of Finance about the dismissal, indicating the reasons in all cases, except when the head of the IAU retired on his/her own initiative or request (the PIFC Law).

The IAU also provides the manager of the legal entity and the Ministry of Finance with the annual report on its activities during the year, which shall cover various performance aspects,



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including the details of any major audit findings where action is urgently required but has not been taken, including those identified in previous years' reports.

3.2.2. The use of audit charters to be agreed upon between management and the internal audit function

The PIFC Law states that the activities of the IAU are governed by the Internal Audit Charter approved by the head of a public legal entity, which is developed following the Standard Internal Audit Charter approved by the government. The goals, tasks, functions, rights and other organisational aspects of the IAU are defined in the aforementioned document. Also, the internal auditor shall sign his/her job description (that usually makes reference to the Internal Audit Unit Charter) after he/she is employed as a civil servant. The internal auditor may not be involved in the performance of any managerial function in the organisation (the PIFC Law). The independence of the head of the IAU is a key issue in providing an effective service to the management. Sometimes it happens that the internal auditors are involved in the day-to-day operations of the organisation, e.g. internal auditor participating in the activities of various commissions as a member (not in observer's capacity), developing an audit trail within the organisation, creating anti-corruption programmes, etc. The CHU follows such situations and communicates them to the heads of the public institutions (in writing or during quality assessment reviews of the IAUs) in order to preserve the functional independence of the internal auditor. The head of the IAU can also inform the CHU about such cases and/or present them in the annual report on the activities of the IAU.

The internal auditor is bound by the Rules of Professional Ethics and must refuse to carry out the internal audit by notifying the head of the IAU and the head of the public legal entity about such cases where performance of the internal audit in the public legal entity may give rise to a conflict of public and private interests (the PIFC Law).

3.2.3. Training

Until 2009 the Training Centre of the Ministry of Finance continued organising training for internal auditors and other PIFC actors. The major part of the training programmes was created in 2000–01. However, the outdated training system had to be reformed; the training programmes had to be revised and updated in accordance with the most modern EU standards. The Ministry of Finance (the CHU) as coordinator of internal auditor training has implemented, in cooperation with the Training Centre, the project 'Strengthening the Administrative Capacities of Civil Servants in the Area of Financial Control and Internal Audit' (under the EU Transition Facility Programme). Since 2010 a new programme for certification procedures has been introduced to public internal auditors. The training programme consists of six level training modules, each of which takes 40–60 academic hours. The training package and training arrangements are professionally organised, concentrating on an understanding of the concepts and regulations governing internal audit; internal audit of public institutions; internal audit by sector; and an internal audit focus on administrative capacities, strategic planning, EU assistance audits and psychological aspects. The modules are given by university professors and professional internal/external auditors. Each module ends with an appropriate module examination. After the successful completion of the required training programme, the internal auditors from the public sector are awarded with a certificate. The PIFC Law encourages internal auditors to continuously upgrade their knowledge, skills and other professional qualities and capacities. At present, the certification for public sector internal auditors is voluntary. The certificate demonstrates the quality of the internal auditor. There are also other types of public sector training frequently provided by the local and foreign experts and the Ministry of Finance, in a particular field of internal audit (e.g. public procurement audits, information systems audits, etc.) in one- or two-day seminars.

Heads of IAUs are organisationally free from undue influence and control of the senior management by virtue of reporting directly to the head of the public legal entity (the PIFC Law).

According to the existing legal framework, every public institution assumes the responsibility for the implementation of particular budgetary programmes, compilation and execution, within the limits of approved appropriations, expenditure estimates and the effective use of appropriations approved. The main function of the internal audit is to provide recommendations

to the head of a public legal entity with the goal of improving the activities, management and internal control of the public legal entity. In implementing this function, the internal auditor shall assess strategic and other action plans, the implementation of the programmes of a public legal entity and the economical, efficient and effective use of state and municipal assets. The internal auditor, following the objective of the internal audit, may perform financial, operational, performance and compliance audits as well as information systems audits and potential combinations of these audits.

The consultancy assignment is defined in the PIFC Law: the internal audit provides an independent, objective assessment (examination, evaluation and consulting) designed to improve the performance of a public legal entity. Consulting activities are basically oriented towards the internal audit work already performed by the internal auditor and are based on the findings and recommendations provided.

The PIFC Law states that the head of a public legal entity shall ensure that the head of the audited entity makes a decision on the implementation of the internal audit recommendations provided in the audit report. In case of disagreements with the provided recommendations, the head of the audited institution/division shall give the heads of the public legal entity and the IAU a written explanation of the reasons for their disagreement. The head of the public legal entity shall take the final decision on the implementation of the recommendations. Also, the head of the public legal entity ensures that the recommendations presented by the internal audit unit are implemented within a certain timeframe.

The standard audit methodology (approved by the Minister for Finance) stipulates that in cases where a level of risk (assumed by the head of the audited entity) regarding the errors and deficiencies detected during the internal audit may have an adverse impact on the activities of the auditee, the IAU shall notify the head of the public legal entity, especially so if the head of the auditee does not take into consideration the recommendations given by the internal auditor and does not eliminate the deficiencies. The head of the IAU has also the right to approach the CHU regarding concerns which he/she believes are not being adequately addressed. If indications of fraud and/or irregularities are identified during the course of the internal audit, the head of the IAU shall submit without delay all such cases to law enforcement institutions following the procedure established by laws and other regulatory enactments.

3.2.4. Internal audit relations with external audit

The cooperation between the National Audit Office (the NAO) and internal auditors is based on the existing legislation:

- internal auditors shall submit the annual internal audit plans and annual reports of the IAU activities to the NAO (the PIFC Law);
- in order to avoid duplication of appropriate functions or works, the activities of the IAU shall be coordinated and information exchanged with other auditors performing audit activities in a public legal entity (the PIFC Law);
- the NAO collaborates with other audit institutions, enterprises and internal audit units (the Law on National Audit Office);
- an external auditor can use the results of internal auditor's work in reducing the extent of its audit procedures (the Requirements on National Audit).

Given their common interest in a properly functioning PIFC and improvement of public sector management, the NAO and internal auditors support each other in the following ways:

- sharing professional audit experiences;
- increasing scope for use by both internal and external auditors of each other's work;
- improving audit methodologies;
- developing audit quality assurance.

Close cooperation between the NAO and the CHU takes place in terms of developing the internal audit training format. As the CHU coordinates the training process for internal auditors and



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other PIFC actors, the representatives of the NAO are often invited to give lectures and share their practical experience with specific training issues (i.e. information systems audits, public procurement audits, etc.).

The representatives of the NAO, the CHU and public sector internal audit are sometimes invited to participate in joint meetings organised by the Audit Committee of the Seimas in order to raise urgent questions and give their opinions from the perspective of internal and external auditors.

3.2.5. Audit boards or audit committees

In 2001, at the beginning of the internal audit development process in Lithuania, the Standing Interdepartmental Commission for Coordinating the Development of the Internal Audit System in the Public Sector (SIC) was established under a government resolution. The main task of the SIC was to monitor and coordinate the development of the internal audit system in the public sector. It also performed other functions such as assessing, commenting, issuing opinions and recommendations to state institutions on the establishment of internal audit units, on methodologies and internal audit procedures, on individual internal audit reports and recommendations and the annual reports of the Ministry of Finance on the state of internal audit units in the public institutions. The SIC functioned for eight years and in 2009, following the changes of the government law, finished its proceedings. Alternatives, when needed, will be considered in the future.

The Parliamentary Audit Committee deals broadly with the issues related to the National Audit Office. However, it also considers the annual report on the functioning of the internal audit system in the public sector prepared by the CHU. This audit committee debates draft laws, prepares conclusions thereon and examines issues of accounting, financial statements and external and internal audits.

3.3. Coordination of public internal control

To support the harmonised PIFC system in the Republic of Lithuania, the functions of the CHU were assigned to the Financial Control Methodology Department (now called the Internal Audit and Financial Control Methodology Department) of the Ministry of Finance, which was established on 1 October 2001. The department is accountable to the Chancellor and appropriate Vice-Minister for the Ministry for Finance and has the following structure:

- Internal Audit and Financial Control Methodology and Monitoring Division (combining as of 2009 two separate divisions — the Financial Control Management Methodology Division and the Internal Audit Methodology and Monitoring Division), hereinafter the 'division';
- Internal Audit Analysis Division.

It performs the following main functions:

- development of legislation and methodological guidance on financial control and internal audit;
- quality assurance reviews of internal audit units' activities (on-the-spot checks);
- analysis of functioning internal audit and financial control systems, analysis of annual reports;
- reporting annually to the government and parliament on the functioning of the internal audit system in the public sector;
- coordination of the training in the field of internal audit and financial control;
- special tasks regarding audit coordination for EU funds (programming period 2004–06).

The division performs the quality assurance reviews and on-the-spot checks of internal audit units' activities according to the established requirements, as it is stipulated in the PIFC Law and other legal acts regulating internal audit, and analyses the internal audit units' functions in the public sector. The quality assurance reviews are performed in accordance with annual IAU review schedules drawn up by the head of the division, or as the need arises. The division

examines the activities of the IAU under the quality assurance reviews as well as the organisation of the IAU activities, the development and implementation of the IAU plans, the procedures and documentation of the internal audit, its follow-up activities, human resources management and other issues related to the functioning and quality of the IAU. After completing the review of the IAU performance a review report is issued. The review report is addressed to the head of the public legal entity, which may comment on the findings and recommendations and/or take appropriate decisions concerning the further development of the IAU. The review report is also made available to the head of the reviewed IAU, who is responsible for the implementation of the recommendations provided.

Each year by 1 July, the CHU in the Ministry of Finance prepares and sends to the government and the Parliamentary Audit Committee the annual report on the functioning of the internal audit system in the public sector (the PIFC Law). This annual report is prepared on the basis of information collected from the internal audit units (each year by 1 March, the head of the IAU shall prepare and submit the annual report on the activities of the unit, including information on the functioning of the internal control system in the public legal entity, to the Ministry of Finance). The annual report on the functioning of the internal audit system also covers the main issues related to the activities of the CHU and information collected during the quality assurance reviews of IAUs. The annual report informs line ministries and other authorities about the CHU's plans and recommendations for any new actions towards further improvements. Later on, the annual report on the functioning of the internal audit system is analysed by the government and the Parliamentary Audit Committee, where appropriate decisions on the further development of the internal audit system within the public sector may be taken.

Also, the head of a public legal entity annually reports to the Ministry of Finance on the status of financial control in the public legal entity, including the institutions subordinated to and regulated by them. The Ministry of Finance issued a template/standard form for the information collected. The annual reports are concise and focus on system weaknesses, so that the heads of the public legal entities could themselves assess the status of the main control components and use them to their benefit. The annual reports are used for benchmarking progress over the years as well.

4. Financial inspection

There is no financial inspection service, but the Financial Crime Investigation Service (FCIS) is a law enforcement institution accountable to the Ministry of the Interior. Its purpose is to detect and investigate crimes, other legal violations against the financial system and related crimes.

In pursuing its tasks in accordance with the relevant laws, the FCIS discloses and investigates the activities relating to deceptive and negligent management of accounting by taxpayers, submission of knowingly false data about taxes, state levies and other payments to the responsible institutions and agencies, the evasion of taxes, state levies, state social insurance and other payments, and also discloses and investigates activities relating to the legitimisation of money or property derived from criminal activity and other violations of law related to the financial system. The FCIS carries out operational activities, inquiries and preliminary investigations into economic and financial activities and also controls and cooperates with law enforcement and other institutions and agencies of the Republic of Lithuania, other countries and the international organisations on issues within its competence and performs other functions laid down by law.

The FCIS is the main institution responsible for the coordination of anti-money-laundering activities and has the status of the Financial Intelligence Unit of Lithuania. It also acts as a partner to the European Anti-Fraud Office (OLAF) and performs the role of an Anti-Fraud Coordination Service (AFCOS) in Lithuania.

5. Ongoing and/or future reforms

Reforms are ongoing or planned in respect of the following issues.

- Amending and developing the existing legal acts for the elaboration of issues like internal control assessment, quality of the internal audit and internal audit function in the municipalities.



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- Continuing of training and certification process for the internal auditors of the public sector. The certification process for the internal auditors will be further elaborated. The established groups for supervision, examination and experts (and other working groups) will expand their activities.
- Quality assurance reviews of the internal audit units in the public sector. With reference to the developed methodology and annual plans, the number of on-the-spot checks will be increased to enhance the quality of the IAU's performance.
- A new Cooperation Agreement between the National Audit Office, the Ministry of Finance, the Association of Municipality Controllers, the Association of Internal Auditors and the Lithuanian Chamber of Auditors was signed on 30 December 2010. Pursuant to its provisions the committee and newly established working groups will focus on the amendment and/or development of existing or new methodologies, audit quality assurance matters, sharing audit experiences, etc.



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Public internal control (1)

1. Brief history of the public internal control (PIC) system

The first Chamber of Auditors of the Grand Duchy of Luxembourg was established by the Royal Grand Ducal Decree of 4 January 1840. The Chamber had jurisdiction to control the revenue and expenditure not only of the state, but also of communes, as well as of foundations and establishments placed under state control. The Chamber could submit proposals to reduce spending to the government. Moreover, it had administrative and judicial jurisdiction as regards accounts and accountants and had the power to exercise disciplinary control over accountants.

The Chamber's jurisdiction to control the accounts of communes and public establishments was not maintained for long. Pursuant to the Law of 23 September 1847 regulating the accounts of communes and public establishments, the control thereof has been assigned to the Minister for Home Affairs.

Subsequently, the organisation and attributions of the Chamber of Auditors were further modified, especially by the Law of 19 February 1931 concerning the organisation of the Chamber of Auditors and of the general revenues and by the Law of 27 July 1936 concerning the accounts of the state. Henceforth, the Chamber conducted the control of all state financial operations and to this purpose held the power to deny budgetary discharge. The Chamber also performed the *ex ante* control of state expenditure, verifying, based on documentary evidence, the legality and regularity of expenditure after commitment but before payment.

By means of the modified Law of 7 March 1969, the General Inspectorate of Finance (Inspection Générale des Finances) was established.

In 1999, the reform of the entire public finance control and management system led to the Law of 8 June 1999 establishing the Court of Auditors and to the Law of 8 June 1999 on the state budget, accounts and treasury, as well as to the revision of Article 105 of the Constitution.

The objectives of the Law establishing the Court of Auditors, the successor to the Chamber of Auditors, were the following:

- to invest the Court with the full missions and means necessary for conducting an independent, neutral and efficient control of public finance;
- to operate a clear separation between, on the one hand, internal financial control, to be organised and ensured by the government, and, on the other hand, external financial control, to be carried out by the Court of Auditors;

(1) Contributed by the Ministry of Finance, General Inspection of Finance on 30 June 2011.

- to entrust the Court of Auditors with the *ex post* verification of the legality and regularity of revenue and expenditure, as well as with the assessment of the sound financial management of public funds;
- to expand the activity scope of the Court of Auditors beyond the control of the financial management of state bodies, services and administrations to those legal entities of public and private law that are beneficiaries of public funds;
- to reinforce the advisory and assistance function of the Court of Auditors to the parliament on issues related to its control of state financial operations;
- to guarantee the independence of the Court of Auditors, as the control body, from the executive body, as the controlled body.

The reform was accompanied by the establishment of a Directorate for Financial Control (Direction du Contrôle Financier) responsible for financial control within ministerial departments. The treasury service set up in 1936 was reformed and replaced by the current State Treasury (Trésorerie de l'Etat). The General Bank of the State, whose services had been ensured by the State Savings Bank (Banque et Caisse d'Epargne de l'Etat), became integrated into the State Treasury.

2. Public internal control environment

2.1. Financial control by the Chamber of Deputies

In financial matters, the control of the government by the Chamber of Deputies consists of the annual vote on the budget and taxes, the right to close each year the accounts of the state and the supervision, to a certain extent, of the administration of public patrimony.

In fact, the Constitution confers upon the legislative body the right to grant or deny to the government the authorisation to collect revenues and make expenditures. This authorisation is normally expressed in the annual vote on the budget. The budget is established in the form of a law, according to the rules on governmental initiative set out by the legislative procedure.

The Chamber's right to close the accounts of the state is the corollary of its right to vote on the budget. Each year, the government submits to the Chamber the general account of the state, presenting the revenues collected and expenditures made during the last completed budgetary year. The general account is accompanied by a general report of the Court of Auditors. Like the budget, it is passed by the Chamber of Deputies in the form of a law.

Besides the annual control of the current state financial management, the Constitution reserves to the legislative body a series of decisions surpassing the scope of the regular administration of public patrimony. No tax may be imposed except pursuant to a law. The budget law contains the authorisation to collect ordinary taxes. Extraordinary taxes require authorisation by a special law. The government may not contract loans, make any important state financial commitment, alienate any state real estate, acquire any important real estate property for the benefit of the state or conduct for the benefit of the state a large infrastructure or building project without having been authorised by a special law. However, a general law determines the threshold below which the Chamber's special authorisation is not required. No commitment may burden the state budget further than one fiscal year, except by means of a special law.

The Court of Auditors exercises a consultative function at the request of the Chamber of Deputies. At the latter's request it issues an opinion on the provisions of the budget law and on proposals or bills of law regarding the accounts of the state and of legal entities of public law. It can be consulted by the Chamber on proposals or bills of law with a significant financial impact on the public treasury. Finally, the Chamber may at any moment commission the Court to draw up special reports on specific fields of financial management based on its controls for several budgetary years.

2.2. Budgetary accounting

Expenditure operations are complex processes from the fundamental point of view of the diverging objectives pursued by the different participants. Thus it is necessary, on the one hand, to

strictly observe the rules of public accounting and the limitations defined by the budget law and, on the other hand, to spend as efficiently as possible.

All expenditure operations aim or should aim at reconciling the two objectives.

In order to achieve this aim, expenditure operations were broken down into four distinct phases: commitment, liquidation or confirmation of service performed, payment authorisation and payment.

The commitment is the act by which a public body ascertains or creates a financial obligation that will result in a liability.

Since all expenditure is initiated by commitment (from that moment on), it is important, for the correct application of financial legislation, to define and implement a system for the registration, monitoring and *ex ante* control of all commitment operations.

It should also be noted that budgetary accounting, which is concerned with registering revenue collection and expenditure payment operations, is held according to the principle of annuality, under the accrual method.

Under the principle of annuality, the revenue and expenditure during one year is recorded according to when the acquired entitlements and the debts resulting from commitments were earned or incurred during that year, irrespective of their subsequent date of recovery or effective payment.

Finally, it is worth noting that the commitment of capital expenditure is subject to multiannual indicative planning. Multiannual planning only serves for orientation purposes, as it does not establish a multiannual ceiling for capital expenditure, and especially for investment expenditure, but simply provides at any moment comprehensive and detailed information on the progress of projects whose implementation covers several years.

3. The concept of public internal control

3.1. Managerial responsibility and accountability

Ministerial responsibility

Ministerial responsibility is inseparable from the absence of responsibility of the Grand Duke. For an act of the Grand Duke to take effect, it must be countersigned by a member of the government who assumes full responsibility for it.

The Constitution provides, in a general manner, for the responsibility of ministers. This responsibility is general with regard to acts having a direct or indirect relationship to ministerial functions. It can be legal, i.e. criminal or civil, as well as political.

Ministers are responsible for acts of which they themselves are the authors, either individually or collectively. Responsibility for any measure taken in the Council of State is incumbent upon all the members of government involved in adopting the respective measure. However, a minister who has a dissenting vote recorded in the minutes of the Council session is released from responsibility.

The government as a whole and each individual minister are politically responsible for their acts before the Chamber of Deputies. When the Chamber disapproves of the actions of one or several ministers or of the entire government, it expresses its disagreement either by casting a negative vote on an item proposed on the agenda by the government or by rejecting a bill of law submitted by the ministers. By refusing to vote on the annual budget, the Chamber can make it practically impossible for the government to administrate public affairs.

The political responsibility of ministers may be subject to sanction consisting of the obligation to cease their functions when the Chamber no longer has confidence in them (motion of censure). It is customary for ministers to resign when they receive the first hostile vote from the Chamber.

On no account can a verbal or written order of the Grand Duke release a minister from responsibility. Indeed, ministerial responsibility would become illusory and deprived of all sanction if the Grand Duke could cover it by asserting his own inviolability.



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In accordance with the Constitution, only the Chamber is entitled to indict ministers. This constitutional provision forms an exception to the right of pursuit against public officials. Indictments against ministers are reserved to the Chamber in order to prevent any distortion in the development of public affairs by means of misplaced or vexing legal actions pursued by the citizens. Indictments admitted against ministers for acts committed in the exercise of their functions are brought before the Supreme Court of Justice sitting in plenary session. To avoid the criminal responsibility of ministers becoming purely theoretical, the Constitution establishes an exception to the Grand Duke's right of pardon, stipulating that a convicted minister may only be pardoned upon a request from the Chamber.

Appointment of public officials to management positions

The stability of employment constitutes a fundamental principle of public positions and contributes to ensuring the continuity, independence and neutrality of public service. It provides an essential guarantee against arbitrary dismissals of a political or other nature. The statute consecrates this stability by stipulating that public officials within state administrations and services are appointed to positions held on a definitive and permanent basis. Consequently, a public official cannot be removed from office except in extraordinary situations such as following disciplinary sanction or in the case of an ailment that no longer allows him/her to exercise his/her functions.

In its declaration of 12 August 1999, the government solemnly reiterated the traditional principle of appointing public officials for life. An exception was made for officials occupying management positions within the administration. In this respect, the governmental declaration sets out that: 'Managerial staff within the administration shall be rendered more responsible when the hierarchical authority has the possibility to prematurely cease their functions and reintegrate them into previous or equivalent positions, in accordance with the provisions of the statute.' Notwithstanding the principle of appointment for life of all public officials as enshrined in the statute, the government considered it useful and necessary in this particular case to establish a mechanism that helps to give a further sense of responsibility to the managerial staff within the administration by limiting their appointment to a renewable period of seven years.

Public administration

The government exercises its administrative functions through ministerial departments and their related public services. Among others, it supervises, to a certain degree, the administration of communes. This role is specifically entrusted to the Ministry of Home Affairs.

The organisation, functioning and control of public administration are ensured by the bodies of the executive body, i.e. the Grand Duke and the members of the government. Nevertheless, the legislative body has the exclusive competence to establish the administrations, with the exception of the formation and establishment of the government, which are reserved to the Grand Duke. The government exercises its supervisory and administrative role by means of general and special provisions.

Each government member is in charge of one or several ministerial departments, which do not constitute legal entities distinct from the state. The distribution of ministerial departments among ministers is carried out by the Grand Duke when the government is formed. The members of the government exercise, each with regard to the department(s) under their responsibility, the attributions assigned to the government by the Constitution, laws and regulations.

The actual management of a department pertains to the relevant member of government. He or she is assisted, according to service exigencies, by one or several counsellors to whom the signing of documents regarding decisions relating to details can be delegated. The drafting of documents of a certain importance, especially the preparation of pilot studies on legislative acts and the drafting of legal opinions or reports on issues of general policy, is assigned to governmental counsellors and to the agents of central administration assistance services.

The written reports of the ministries regarding their activity during the last completed budgetary year are made available to the Chamber of Deputies at the latest by 1 March.

Some public services are detached from ministerial departments and form special administrations headed by chief administrative officers endowed with certain decision-making powers. Examples of such services are the Direct Tax Administration, Domain Registration and Administration, Customs and Excise Duty Administration, Bridges and Roads Administration, Work and Mining Inspectorate and Employment Administration.

These administrations are set up for technical and practical reasons. They remain directly dependent upon, and closely monitored by, the relevant minister. They are not decentralised services like the public establishments. In fact, whereas decentralised services enjoy some autonomy and constitute legal entities distinct from the state, the administrations come exclusively under the legal entity of the state and represent a case of deconcentration rather than decentralisation.

The same applies for the military and for police corps. By their very nature, public enforcement organisations come under the control of the executive body. However, the Constitution explicitly reserves to the legislative body the right to regulate the organisation and attributions thereof.



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Internal budgetary control within governmental administration

The Minister for the Budget has the right of inspection with regard to the financial management of other ministerial departments in order to ensure that their financial commitments are established with due care.

The General Inspectorate of Finance is present at all the essential stages of the state's financial life: it plays an active role in the elaboration and clarification of the draft budget; it participates in financial, economic and social programming activities; and it issues an opinion on the proposals and bills of law likely to have an impact on state finance. It carries out, on behalf of the Minister for the Budget, the *ex ante* control of the economy of budgetary execution measures, verifying their conformity with the general policy of the government. As such, it intervenes before the commitment of expenditure. As a control body, it monitors both the execution of the proposals and bills of law approved by it and of multiannual programmes decided by the government, and it also controls the execution of the state budget by following revenue movements and expenditure operations.

The State Treasury, which is considered to be 'the budget banker', comprises the Payment and Recovery, Financial Administration and Accounting divisions. The latter conducts the budgetary accounting and the general accounting. Commitments made by authorising officers are registered and entered in the budgetary accounting in order for the state to have available during the budgetary year complete and updated information regarding each stage of budgetary execution.

The Financial Control Directorate, which comes under the Ministry of Finance, is independent from the General Inspectorate of Finance. The Directorate is responsible for the coordination and supervision of financial control officers, who, in their turn, are responsible for controlling the commitment and the payment authorisation of all expenditure, as well as the liquidation and recovery of all relevant non-fiscal revenue of the departments placed under their control. By verifying the regularity and legality of the acts of the authorising officers under their control, controllers carry out an *ex ante* control with regard to budgetary authorisations without having the right to assess the appropriateness or the economic efficiency of financial decisions.

External control by the Court of Auditors

In defining budgetary and fiscal matters as matters to be decided by law, the Constitution implies that the ultimate power of decision belongs to the Chamber of Deputies. The Chamber is also ascribed the power to control the general account of the state. In order for the Chamber to be able to effectively exercise this control, it has a right of information regarding all the financial operations of the state. To this end, the Constitution establishes the Court of Auditors as a permanent control instrument, which enables the Chamber to monitor and control the financial management of the executive body.

The 'Eye of the Chamber', the Court of Auditors is independent from the executive body but is responsible to the Chamber of Deputies as regards the appointment of its members and the exercise of its functions. The Grand Duke appoints the president, the vice-president and the three chancellors of the Court of Auditors from a list of three qualified candidates submitted by the

Chamber of Deputies for each vacant position. The members of the Court of Auditors may not exercise any other elective or non-elective public function, nor can they participate directly or indirectly in any type of enterprise, supply or affair that places them in a conflict of interests with the state. They may not intervene in any affair they had previously become acquainted with in the context of functions exercised prior to their activity within the Court. Among others, they may not be present at deliberations concerning them and their relatives by blood or marriage up to the third degree inclusive.

The Court of Auditors can be consulted by the Chamber with regard to proposals and bills of laws with a significant financial impact on the public treasury. At the request of the Chamber of Deputies, it can also issue an opinion on the provisions of the budget law and on proposals and bills of law regarding the accounts of the state and of legal entities of public law.

In particular, the Court examines the legality and regularity of revenue and expenditure, as well as the sound financial management of public funds. Its control covers the accounts, that is, it is subsequent to the liquidation of expenditure and to payment. Court control is immediate and permanent in the sense that the Court refers any irregularity to the Chamber without having to wait for account submission.

The controls conducted by the Court of Auditors are not limited to state bodies, administrations and services; they may also cover legal entities of public law, i.e. communes and public establishments, as well as entities of private law that are beneficiaries of public funds.

The general account of the state

The general account of the state comprises the entire budgetary revenue and expenditure operated during the last completed budgetary year. It is drawn up by the State Treasury and submitted for approval to the Minister for the Budget. In this case, too, the Chamber's right to information is ensured by the comments issued by the Court of Auditors. Indeed, each year, at the latest by 31 May, the bill of law approving the general account of the state for the last completed budgetary year is submitted to the Chamber of Deputies and referred to the Chamber of Auditors. The latter presents its comments at the latest by 30 December to enable the discussion of the general account in the Chamber before the end of the budgetary year immediately following the year concerned by the account.

3.2. Internal audit

3.2.1. General Inspectorate of Finance (Inspection générale des Finances, IGF)

The organic law concerning the General Inspectorate of Finance does not specifically set out an internal audit function, but provides for it indirectly. Thus, when an *ex post* control is necessary, the government, as a rule, mandates the IGF.

In this respect, it is worth noting that when the IGF was established in 1969, the concept of internal audit was not common practice, not even in the private sector. Nevertheless, since the lawmaker stipulated that the IGF 'monitors state expenditure' and that it 'may carry out any mission deemed appropriate by the government', it is perfectly possible to infer that the internal audit function is set out indirectly within the framework law concerning the IGF.

Currently, audits are performed at the explicit request of the government, usually following information on potential issues within a state administration or service. This type of operation is better designated as an inspection than an audit.

In the field of European Union structural funds, the General Inspectorate of Finance carries out audit missions on a regular basis.

In fact, compared to the traditional controls performed by the General Inspectorate of Finance which concern isolated cases, such missions develop according to an annual programme and observe EU requirements, in accordance with international audit rules. To this end, the European Commission provides audit guidelines and orientation to the Member States.

The main tasks within the responsibility of the General Inspectorate of Finance as the audit authority for structural funds are set out below.

- Drafting a report and a preliminary opinion on the conformity of fund administration and control systems, based on an analysis of the description thereof. This mission must be carried out before any expenditure can be declared for EU co-financing.
- Drawing up a detailed audit strategy and audit plan covering the entire period 2007–13.
- Performing audits regarding the actual functioning of fund management systems at the beginning of the period.
- Performing controls of co-financed projects: at least 10% of the projects submitting expenditure statements.
- Following up in detail the findings of previous audits and controls.
- Drafting an annual control report and issuing an annual opinion on the functioning of the systems.

Besides its responsibilities with regard to structural funds, the General Inspectorate of Finance has served since 2008 as the audit authority for the general EU programme ‘Solidarity and management of migration flows’ for the period 2007–13.

In the framework of EAGF and EAFRD, the IGF is the national competent authority, whose mission is to ensure the verification and constant monitoring of the eligibility criteria of the Grand Ducal payment agency.

The IGF is also responsible for appointing the certifying body (an external auditor) and monitoring its audit activities (financial and conformity audits). Since all these activities cannot possibly be performed by IGF agents, on-the-spot control activities (system audits and audits of operations) are assigned on principle to external audit enterprises, which are fully accountable for their performed activities.

3.2.2. Directorate for Financial Control (Direction du Contrôle Financier, DCF)

The mission of financial control is defined in Article 24 of the Law of 8 June 1999 on the state budget, accounts and treasury (‘the Law’) and mainly consists of verifying the conformity of expenditure with the applicable laws, regulations, conventions and governmental and ministerial decisions. The State Treasury is normally responsible for the payment of all state expenditure. The *ex ante* control that blocks commitments and payment authorisations established by the law helps to shorten payment delays in the case of invoices issued to the state. Upon the financial controller’s second refusal to approve a commitment or a payment authorisation, the authorising minister may issue an overriding decision to unblock the situation, provided that the necessary credit is available. Such a decision is referred for information purposes to the Court of Auditors and the Chamber of Deputies.

DCF comprises 33 controllers divided into six groups led by coordinators. The placement of controllers within the different ministerial departments aims at facilitating the dialogue between controllers and authorising officers. Controllers are called to change department every three to four years in order to, on the one hand, help enlarge their field of competence and, on the other hand, avoid too great a routine between the two parties. According to Article 87 of the Law, the financial controller is independent as he or she ‘shall not receive any instruction regarding a given payment authorisation or commitment’.

Self-administered state services (schools, cultural institutes, etc.) are subject to biannual *ex post* controls on a random and case-by-case basis. Deductions (about 600) of extraordinary items are checked *ex post* annually.

DCF is responsible for carrying out the first-level control of EU funds under Interreg, ESPON, etc. It also conducts, among others, the second-level control (certification) of all other EU funds (control of conformity with European legislation). The General Inspectorate of Finance (IGF) serves as the audit authority for those funds. According to the European directives, EU Member States have the obligation to ensure there is a managing authority (the respective ministry)



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and a financial authority (the Ministry of Finance) that are responsible for the monitoring of European projects. The two control levels are consequently provided by the DCF and IGF, albeit they are not set out by law. The DCF and IGF are confronted not only with the continuous overlapping of their controls, but also with the fact that European legislation increasingly demands plausibility controls, which it is difficult for the two entities to carry out.

4. Financial inspection

In short, the General Inspectorate of Finance has the following compulsory missions:

- to participate in programming activities;
- to issue an opinion on all projects and proposals likely to have an impact on state finance;
- to examine the budgetary proposals of ministerial departments;
- to monitor the movement of state revenue and to control state expenditure at the request of the Ministry of the Budget, and especially to issue an opinion on unrestricted credit overrun.

As regards the optional missions of the Inspectorate, they follow from Articles 4 and 5 of the Organic Law concerning the IGF:

- to present to the government suggestions likely to generate savings, improve the organisation of state services and ensure the reasonable operation thereof;
- to examine any other issue deemed necessary by the Council of State or by a member of the government.

When it comes to projects with financial impact, the General Inspectorate of Finance is no longer limited — as set out by law — to issuing an opinion on the projects. On the contrary, at the request of the government, the Inspectorate has become an increasingly active participant in the preparatory works for such projects, as well as in the fundamental studies serving as a basis for defining government policy with regard to significant financial issues.

Finally, the missions of the General Inspectorate of Finance undoubtedly saw the most significant increase of scope with regard to the elaboration of the annual budget. In fact, the Inspectorate's task in this respect is not limited to the examination — as set out by law — of the budgetary proposals of ministerial departments, but also extends to the entire activity cycle underlying the administrative elaboration of the draft budget.

5. Ongoing and future reforms

The following topics of reflection for Luxembourg are being studied in preparation for budgetary reform.

- Reduction of *ex ante* controls by the Directorate for Financial Control (e.g. systematic controls only above a certain threshold to be defined).
- Internal audits.
 - Detailed process analysis and critical controls.
 - Elaboration of a multiannual internal audit plan.
 - Choice between:
 - establishment of an internal audit cell within each ministry (or at least within ministries conducting programs of a certain scale) — the cells would be coordinated by a unit attached to the Ministry of Finance (IGF or DCF);
 - establishment of an internal audit cell attached to the Ministry of Finance (IGF or DCF).
- Programme assessment.
 - Definition of a framework establishing rules for assessment.
 - Elaboration of a multiannual assessment plan.

- Definition of performance objectives for new policy programmes to complement the financial sheets accompanying each bill of law or measure with financial implications.
- Implementation of the multitier objectives set out in the framework of the administrative reform.
- Spending review.
 - Introduction of an expenditure review conducted in collaboration with the ministries concerned.
 - Such examination of items need not be carried out annually but only, for example, during the preparation of governmental programmes or for the investigation of measures to reduce spending in the event of a manifest crisis.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

PIC systems in Malta are the primary responsibility of the heads of government ministries and departments. Top management in ministries/departments is to ensure that proper internal controls are in place, in line with good internal control practices as well as in consonance with directives that may be issued by the Office of the Prime Minister (OPM), by the Ministry responsible for Finance (headed by a permanent secretary) or other relevant departments.

The key players in PIC in Malta are:

1. the Internal Audit and Investigations Department;
2. the National Audit Office (under the Cabinet Office);
3. the Ministry of Finance;
4. the Treasury Department.

These key players:

- ensure the proper functioning of the PIC system;
- supervise, regulate and record all government financial transactions;
- keep the money pertaining to the government and all the funds advanced by the EU to finance;
- devise programmes/projects;
- administer procurement procedures;
- provide statutory audit of both local and EU funds.

Malta's public financial control structures started to change in the early 1990s as part of a chain of reform measures in the public sector initiated by the government some years earlier. A process of reform was launched in 1989 with the publication of a Public Service Reform Commission report. The adoption and subsequent implementation of many of the Public Service Reform Commission's recommendations, including those in the area of financial management, has since resulted in significant improvements in the public service. A new public financial management act is also envisaged to embody provisions that address: the efficient and effective management of government resources; the proper harnessing and control of the public debt; and the rules on accrual accounting that will be introduced in government financial planning and accounting frameworks.

⁽¹⁾ Contributed by the Office of the Prime Minister, the Internal Audit and Inspection Board on 22 March 2011.

Another specific and important aspect of public service reform worth mentioning is that relating to the recruitment policy adopted in recent years. The new policy has led to a steady intake of graduates and professionals within the managerial and financial levels in government and its agencies. This has raised considerably the professional level of the public servants working in any particular sector.

One of the most significant thrusts of the reform of PIC in Malta was directed at the public audit function — both the external and the internal audit. In external audit, following legislation enacted in 1997, the National Audit Office was established as a completely autonomous body independent from government that reports directly to parliament. The Auditor General has extensive powers that enable the National Audit Office to function effectively. The Office is also empowered by law to perform formal inquiries which can be compared to judicial ones. Prior to the legislative changes, in 1997, the National Audit Office was an audit department that was an integral part of government.

The Internal Audit and Investigations Department (IAID), which was set up in 2000, is an independent body operating under the responsibility of the Cabinet Office. It reports to the Internal Audit and Investigations Board that is chaired by the Secretary to the Cabinet of Ministers. The role of the IAID is to provide assurance on the implementation of the government's procedures and controls through internal audits and financial investigations.

2. Public internal control environment

The national budget is so far cash based. A specific team within the treasury periodically carries out adjustments so as to be able to draw up an accrual-based end of year financial statement. Malta also adopts a centralised government-wide accounting system.

The central concepts of PIC are those of managerial accountability and functionally independent internal audit. PIC is preventive in nature and aims to ensure that adequate systems are in place to thwart as much as possible the occurrence of public funds mismanagement and fraud and corruption.

The National Audit Office (the state external auditor) and the Internal Audit and Investigations Directorate (the state internal auditor) are the main bodies responsible for assessment of PIC. The Ministry of Finance and the Treasury Department are responsible for the control of PIC. The Management Efficiency Unit — which is the government's in-house management consultancy organisation with the primary function of facilitating the improvement of government services and falls under the Office of the Prime Minister — may also introduce new government processes that would improve PIC, as part of its functions.

There is no legal definition of PIC. However, the National Audit Office (Malta) Audit Manual defines internal control as 'all the policies and procedures conceived and put in place by an entity's management to ensure:

- the economical, efficient and effective achievement of the entity's objectives;
- the adherence of external rules (laws, regulations, etc.) and to management policies;
- the safeguarding of assets and information;
- the prevention and detection of fraud and error; and
- the quality of accounting records and the timely production of reliable financial and management information.'

The NAO and IAID provide recommendations whenever shortcomings in PICs in government operations are detected. The Ministry of Finance, the Economy and Investment and the Treasury Departments issue guidelines and directives, through circulars, on financial management and accounting matters. A task force was set up with members from both the National Audit Office (NAO) and the Internal Audit and Investigations Directorate (IAID) in order to identify good practices in cooperation between NAO and IAID.

As is done at present, we will continue recommending improvements to PICs whenever PIC weaknesses are detected. Increased emphasis may be placed on the upkeep of fixed asset registers

and arrears of revenue due to government. In view of the introduction of accrual accounting over the next two or three years in the Malta government accounting system and financial reporting, more emphasis will be placed on balance sheet items and certain income and expenditure items of an accrual nature that are presently not recorded in the Government Financial Report but which will start being recorded with the introduction of accrual accounting.

3. Concept of public internal control

3.1. Managerial accountability/responsibility

Managerial accountability/responsibility is understood as the need to make public officials responsible not only for making financial decisions but also to respond periodically to questions concerning their activities and to be held responsible and answerable for exercising the authority given to them.

The following section explains how the top officials assume their responsibility for establishing an adequate internal control system across the public administration in Malta in line with good internal control practices as well as in consonance with directives that may be issued. Reference is made to the five interrelated components of the Committee of Sponsoring Organisations (COSO) framework, which is the basis for the International Organisation of Supreme Audit Institutions (INTOSAI) guidelines for internal control in the public sector.

Implementation of the control environment

The Public Service Management Code (PSMC) brings together, in concise form, all standing regulations, circulars and policies in the public service. Its provisions aim to uphold the core values of the public service as announced in the Public Administration Act (PAA). The Principal Permanent Secretary has assigned to the PSMC the legal status of a directive in terms of the PAA by virtue of Directive No 1 issued under the Act. This directive confirms that the provisions of the PSMC are binding on public officers and makes the PSMC enforceable in terms of Article 15(2) of the PAA, which states that: 'Public officers shall comply with all applicable directives issued by the Principal Permanent Secretary, and officers who fail to comply shall be liable to proceedings under the disciplinary regulations.' A comprehensive code of ethics exists, as a schedule to the PAA covering public officers.

With regard to public entities there is a corporate governance framework and a separate code of ethics. Top officials at each and every level are accountable for the observance of the code of ethics and have the responsibility to ensure that such codes are being followed accordingly by all the employees within their remit and to report any violations and malpractice. The Principal Permanent Secretary may also issue directives and guidelines aimed at upholding and ensuring compliance with the code of ethics and, with the concurrence of the minister responsible for the particular board or commission, he may also issue such guidelines with respect to boards and commissions.

Top managers are also accountable for ensuring that clear job descriptions drafted in conjunction with the Directorate for Corporate Services are maintained and updated when necessary. All public organisations follow this procedure and make certain that each and every individual is aware of his/her duties and responsibilities. This is essential so that relevant tasks are carried out and hence operations run efficiently.

The heads of every unit also have the responsibility to formally review and evaluate the performance of all the staff falling within their remit at least annually against pre-set objectives. In the event of any specific performance issues, adequate action is taken.

Risk management

Having identified risk management as being a weak area within all government organisations, several documents, including the Risk Management Guidelines and the Policy and Procedures Manual, have been introduced to serve as a coherent set of guiding principles. Although not compulsory, permanent secretaries are encouraged to assume the responsibility of ensuring that



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such processes are given due importance and ultimately integrated into their ministry in line with the established policy.

Control activities

Control activities occur throughout the organisation, at all levels and in all functions in the form of supervisory checks and second signatures, separation of duties and delegated limited powers of authorisation. It is the duty of each head of unit to ensure that such controls are observed and maintained to guarantee adequate control and that the predetermined objectives are achieved.

The head of each unit carries out an annual performance-management procedure with the officers under his/her remit in order to measure their effectiveness, productivity and training needs. This procedure is repeated with each public officer.

Moreover, permanent secretaries, directors-general and directors are requested to carry out the performance reviews of 'Category A' officers whose appointment is regulated by a performance agreement in order to assess the overall performance against targets and objectives sets.

Information and communication

Reports on progress against objectives are carried out annually through the performance agreement.

Monitoring

Top managers have the responsibility to comply with and respond adequately to the recommendations on internal controls provided by the internal auditors in order to ensure that objectives are achieved.

Furthermore, top management works hand in hand with the Risk Management Assurance Unit, which forms part of the Internal Audit and Investigations Department (IAID), to provide the necessary training and facilitation on internal controls to all their staff.

While all employees are responsible for the quality of their internal controls, the Internal Audit and Investigations Department (IAID) assists management in their oversight and operating responsibilities through independent audits and consultations designed to evaluate and promote the systems of internal control.

Managerial accountability is not only exercised by top administrative managers. While they have a significant impact on an organisation's system of internal control, every employee of the organisation has a responsibility and a role in ensuring that the system is effective in achieving the organisation's mission. Hence, it is the responsibility of every permanent secretary, director-general, chairman, chief executive officer and/or head of department to ensure that an effective internal control system is in place in order to safeguard accountability, transparency and delivery. These positions are filled by administrative managers as opposed to political appointees.

Delegation of responsibility and of authority is moderately practised within Maltese government organisations. Formally, the following procedures are in place to ensure that decision-making powers are clearly laid out.

The Public Service Agreement (PSA) is signed by every ministry. This agreement aims to chart in a more direct manner the outputs expected from each ministry and identifies the people responsible for the achievement of such objectives.

The Performance Agreement for top management positions originates from the Public Service Agreement and is cascaded down to, at least, assistant director level. This agreement outlines the objectives and goals of top management and their decision-making powers.

For officers in positions, a performance contract identifies the functions and objectives of the position. For all officers in the general service grades (with the exclusion of officers in the managerial class) who are not on a performance agreement, a performance management procedure (PMP) system has been introduced to measure their effectiveness, productivity

and training needs. Job descriptions are also used to outline the roles and responsibilities of each officer.

The cabinet (prime minister and ministers) is responsible for policy development and has the general direction and control of the public administration. The cabinet is responsible to parliament and is responsible for any business of the government of Malta, including the administration of any department of government.

The ministers, when charged with the responsibility for any department, exercise general direction and control over that department and, also, the department would be under the supervision of a permanent secretary.

The Principal Permanent Secretary is responsible for the implementation of the public policy and may, with the concurrence of the prime minister, delegate any of his functions under this article to one or more permanent secretaries or heads of department. The Principal Permanent Secretary shall:

- provide leadership to the public service;
- uphold and promote the public administration values and the code of ethics and monitor the compliance of public employees therewith;
- take measures to improve the performance of the public service;
- assume overall responsibility for human resource management and development within the public service;
- take measures to ensure coordination between departments, agencies, government entities and local councils and to ensure that agencies and government entities are complying with the key policy objectives and management priorities of the government;
- provide leadership and direction to permanent secretaries;
- set performance targets for permanent secretaries and monitor their performance following consultation with the relevant minister;
- advise the prime minister on matters relating to the public service and the wider public sector, including the appointment and termination of appointment of permanent secretaries and heads of department; and
- perform any other function that may be assigned to him by or under any law.

A permanent secretary may give directions to and set targets for a head of department on any matter in fulfilment of his duties and he shall monitor and assess the head of department's performance in relation to such directions and targets.

Ministries are divided into a number of departments, one of which is Corporate Services which would also include the financial function. Therefore, the Director of Corporate Services would be responsible for assisting and advising top managers on financial aspects.

Corporate objectives are set according to the Public Service Agreement (PSA). These are cascaded down to each and every ministry/department/entity. In order to ensure the smooth running of the organisation, directors/heads of each level have the responsibility to identify ministry/departmental and entity-related objectives and ensure they are aligned in accordance with the aims set by the PSA.

Top management positions in each ministry, including permanent secretaries, director-generals, directors and assistant directors together with other important professional officers, enter into a performance agreement exercise, whereby the performance of each objective is assessed on an annual basis in order to establish the current status of delivery.

Similar to objectives, budget plans cascade naturally from the organisation-wide plans and then are allocated to the various centres in order to reflect the ministerial/departmental/entity aims and objectives.



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On a monthly basis, line ministries and departments submit revised estimates of revenue and expenditure to the Budget Affairs Division. Such statements assist top managers in identifying budgetary risks and thus facilitating the initiation of timely corrective action as may be necessary.

Moreover the regular updates form an integral part of that ministry's ongoing financial assessment process, enabling the monitoring of the budgetary position at an aggregate service-wide level. This procedure enables line ministries and departments to adjust their budget plans accordingly.

The main objectives of the internal control system in Malta are based on the principles of the COSO framework and can be categorised as follows:

- effectiveness and efficiency of operations;
- reliability of financial reporting;
- compliance with applicable laws and regulations.

The internal control strategies that have been designed focus on transparency, both in terms of clear lines of responsibility and in terms of harmonised methodology and standards.

Clear reporting lines are laid down in the Constitution and the Public Administration Act, reflecting particularly the positions and responsibilities of top public officials. Furthermore, job descriptions are used to outline reporting lines for all officers. As part of the reporting system, a statement on internal control is in the process of being adopted across the public administration in Malta in order to ensure further accountability and responsibility. This shall include a declaration that the internal control system supporting the achievement of the ministry/department/entity's policies, aims and objectives has been put in place, and that public funds and all organisations' assets are being safeguarded. Moreover, it will also comprise an affirmation that a risk management system designed to identify and prioritise the risks to the achievement of the ministry/department/entity's policies, aims and objectives has been implemented. Top management positions will be expected to sign this statement on internal control at the end of each year for the organisation they manage as part of the annual report.

Moreover, government departments, ministries and entities are currently required to submit an annual report detailing the activities carried out, as well as an action plan outlining what activities are to be undertaken.

3.2. Internal audit

The Internal Audit and Investigations Department (IAID) was set up in the year 2000. It is a self-contained independent unit within the Office of the Prime Minister. The department is organised in a central manner and caters for all government departments and entities falling under the supervision of permanent secretaries, for the purpose of assisting them in the effective discharge of their duties. In 2003, the responsibilities and powers of the IAID were entrenched in the Internal Audit and Financial Investigations Act (Chapter 461 of the Laws of Malta).

One of the reasons for enacting the Internal Audit and Financial Investigations Act was to provide the directorate with strict functional independence from ministries, other departments and divisions. The law made it completely clear that the IAID is answerable to the Internal Audit and Investigations Board, headed by the Secretary to Cabinet.

IAID auditors abide by the Code of Ethics for Accountants of the Malta Accountancy Board which is applicable to all local accountants and auditors. Additionally, Section 2.4 of the Internal Audit and Investigations Manual refers to standards of professional conduct; the manual stipulates that the listed principles (adopted from the Code of Ethics of the Institute of Internal Auditors) have to be followed by the internal auditors within the IAID. The principles to be upheld are integrity, objectivity, confidentiality and competency.

The IAID is free to report on reviews undertaken. In fact, Article 14 of the Internal Audit and Financial Investigations Act stipulates that once an internal audit is concluded, the director (IAID) should transmit the resulting audit report to the permanent secretary under whose supervision the auditee falls. The director (IAID) may also transmit a copy of the report to the auditee. Within one month of receipt of such report, the permanent secretary shall give such instructions

to the auditee as may be necessary to remedy any shortcomings and shall inform the director accordingly. As per Section 8.1.3 of the IAID Manual, the objectives of individual audit reports are to provide independent assurance on the areas examined and to initiate management action, and also to highlight specifically the cause of weaknesses and related action thereto.

The charter of the IAID specifies that the primary objective of internal audit is to assist permanent secretaries in the effective discharge of their duties; internal audit provides permanent secretaries with analyses, recommendations, counsel and information concerning activities reviewed and/or investigated. The charter encompasses also the following areas: independence, authority of the IAID, role and scope of IAID, responsibilities, reporting and relationship with the National Audit Office.

Article 17 of the Internal Audit and Financial Investigations Act provides that where the director or the board consider that there would be a conflict of interest if the director himself were to conduct an internal audit or a financial investigation, the board may appoint a senior public officer from amongst the officers of the directorate to conduct that investigation as a replacement. It is the duty of every officer of the directorate who has any form of conflict of interest in any internal audit or financial investigation he is assigned to work upon, whether such conflict is direct or indirect, to immediately disclose to the director his interest and refrain completely from involvement in that particular case.

Any officer of the IAID who knowingly acts in contravention of this requirement will be guilty of an offence and is liable to a fine and disciplinary proceedings as provided for in the Public Service Commission (Disciplinary Procedures) Regulations.

IAID auditors have to undertake a minimum number of hours of training (CPE activities) every year to maintain and improve their professional competence and skills in accordance with the Continued Professional Education (CPE) Regulations of the Malta Institute of Accountants (MIA) (which comply with IFAC's International Education Standard (IES) 7, Continuing Professional Development). The IAID endeavours to facilitate on a continuous basis the participation of its officers in CPE activities. Not only does the IAID finance the costs involved with regards to participation in certain training taking place both locally and abroad (course fees, flight expenses — where applicable, etc.), but it also organises CPE activities for its officers on a regular basis.

The IAID reports to the Internal Audit and Investigations Board (IAIB), whose chairman is the Secretary to the Cabinet. The internal audit reports are sent to the respective permanent secretaries within the various ministries. Audits which are performed by the Internal Audit Services fall under Legal Notice 434 of 2004, entitled 'Types of internal audit regulations 2004' which specifies the following different types of audits to be carried out by the IAID: financial audits, compliance audits, operational audits, performance/value for money audits, comprehensive audits, information technology/information systems audits, management audits, programme audits (European Union), joint audits (European Union-related audits) and follow-up audits.

Article 15 of the Internal Audit and Financial Investigations Act (Chapter 461 of the Laws of Malta) states that the director (IAID) shall, after an internal audit and if deemed necessary, conduct follow-up reviews. In fact, it is the policy of the IAID to follow up all significant issues and recommendations arising from the IAID's audit reports — Chapter 9 of the Internal Audit and Investigations Manual. Furthermore, Article 16 of the Internal Audit and Financial Investigations Act requires any entity that has reason to suspect any irregularity and/or suspected case of fraud of public funds to refer the matter to the director (IAID), and is authorised to provide to the director (IAID) all information in his/her possession relating thereto. Article 18 of the Internal Audit and Financial Investigations Act gives the authority to the director (IAID) to inform the Attorney General when suspicions of irregularities and/or suspected cases of fraud can be firmly established with respect to the responsibilities of the auditee under review. Such an irregularity would constitute a criminal offence.

Article 3 of the Internal Audit and Financial Investigations Act distinguishes between internal audits and financial investigations and stipulates that these are two separate and distinct functions.



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3.2.1. Internal audit's relations with external audit

The National Audit Office (Malta) as the supreme audit institution (SAI) is headed by the Auditor General and is responsible for the external audit of central and local government on behalf of parliament. The Office, which is an autonomous body and independent from the executive branch of government, was established in 1997. The mandatory and primary objective of the Office, in terms of the Constitution and the Auditor General and National Audit Office Act 1997, is to provide independent information, assurance and advice to parliament on the way the treasury, government departments and certain non-central government entities (including local government) account for and use taxpayers' money. Another objective, in terms of the Act, is to establish whether public funds have been expended economically, efficiently and effectively. In evaluating the effectiveness of internal control, the NAO can use the work of the IAID, which forms part of the internal control structure, and is well placed to provide the NAO with guidance as to the effectiveness of the systems that are in place. The NAO has the responsibility for the overall conclusion drawn, based on the examination of the systems in place, the quality of the internal audit unit and the attitudes towards internal control and risk management of the entity under review. To allow the work of the internal audit to be effectively assessed, the NAO has to understand the purpose (role), procedures and methods of the internal audit's work, as well as consider the quality of staff and the independence and objectivity that they bring to their work. Investigations or other special audits can be undertaken as may be decided upon by the Auditor General himself/herself or as may be requested by the Minister for Finance or by the Public Accounts Committee. The director-general (IAID) liaises with the Auditor General and provides him/her with the IAID's annual audit plan upon its approval by the Internal Audit and Investigations Board.

3.2.2. Audit board and audit committees

Article 6 of the Internal Audit and Financial Investigations Act appoints the Internal Audit and Investigations Board as the independent and objective body that monitors the PIFC function in Malta and to oversee the work of the IAID. Furthermore the Board aims to safeguard the continued independence of the director (IAID) and officers of the IAID. Other functions include the endorsement of plans, budgets and schedules as proposed by the director for the proper administration of the directorate and the setting of policies, procedures and methods for the proper functioning of public internal audit and for the carrying out of financial investigations. The board is appointed by the prime minister and is composed of the Secretary to Cabinet as chairperson; the director; the Permanent Secretary in the Ministry of Finance; a person of a recognised standing in the accounting and/or auditing profession who is not a public officer; and one other member. The board is required to meet at least quarterly. The decisions of the board are taken by a majority of votes and the chairperson has both an original and a casting vote in case of an equality of votes.

The 'Corporate Governance Framework for Public Sector Entities' issued by the Office of the Prime Minister, in November 2008, established corporate governance best practices including the setting-up of audit committees within public entities.

3.3. Coordination of public internal control

The Risk Management and Assurance Unit (RMAU) has been set up purposely to assist the entrenchment of PIC as the basis for monitoring and controlling public finances. This unit is acting as the central harmonisation unit within the public sector with respect to the coordination of internal control, being a decentralised system. The RMAU is a sub-unit forming part of the Internal Audit and Investigations Department and reports directly to the director-general (IAID), who in turn reports to the Secretary to the Cabinet.

The objective of the RMAU is to assist ministries, departments and entities to re-engineer their internal control environment and enable them to upgrade public sector control systems in line with international standards and EU best practice through the issue of relevant policies and procedures, facilitation and training. With this in mind, the RMAU has prepared and finalised a risk management survey through the use of a questionnaire. The results of the survey have made it easier for the unit to risk assess all the government ministries, divisions, departments and directorates, and identify the public service risk areas. Results derived have been incorporated into the

IAID's audit plan, which in turn aims to ensure the correct prioritisation of its work plan for the forthcoming three-year period.

Furthermore, two twinning projects with the UK and Ireland have been undertaken in order to guide the RMAU in the risk management implementation process.

The RMAU has continued to promote the reform of risk management in public administration as follows: the enactment of a corporate governance framework together with codes of ethics introduced a system of accountability targeted towards public entities. The public service structure was already catered for substantially and was further reinforced by specific provisions in the PAA.

A requirement for an annual statement of internal control stipulated in a guideline issued by the Principal Permanent Secretary encouraged permanent secretaries to sign for the adequacy of their internal control structure.

A requirement for risk registers stipulated in a guideline issued by the Principal Permanent Secretary encouraged continuous assessment of internal controls by government ministries, divisions, departments and directorates.

Apart from facilitating the overall risk assessment of all public sector organisations through training, seminars, onsite reviews and research, the RMAU is required to analyse the risk management progress from a horizontal point of view in line with the COSO model in order to put forward recommendations to address common weak areas across the public service. Furthermore the RMAU has issued relevant policies and procedures to serve as guidance for management when installing or enforcing their ministries, departments and entities' internal control structure. The facilitation process is currently in its initial phases, implying that regular reviews by the RMAU of risk registers and the overall risk management progress pertaining to each ministry, department and entity should start in the imminent future. Progress reports are issued monthly and addressed to the director-general (IAID). Ad hoc reports are issued when requested, generally also addressed to the director-general (IAID) who in turn may forward them to the appropriate authorities.

4. Financial inspection

Administrative financial investigations fall under the remit of the Internal Audit and Investigations Department, which falls directly under the responsibility of the Secretary to the Cabinet. The Financial Investigations Unit has the remit to conduct financial investigations in government departments and in any other public or private entity which in any way is a beneficiary, debtor or manager of public funds, including EU funds, for the purpose of protecting such funds against irregularities and fraud or otherwise to assess such public or private entities' liability to contribute to such funds. This unit is also the designated interlocutor for the European Anti-Fraud Office (OLAF) and is the Anti-Fraud Coordinating Service (AFCOS) for Malta. This implies that this unit can conduct joint investigations with OLAF, with respect to EU funds availed of by Malta. The unit reports irregularities to OLAF on a quarterly basis with respect to Pre-accession Funds, Transition Facility Funds, Structural Funds, Cohesion Funds and Agricultural Funds. The unit also provides substantial contributions, including feedback, to various sub-units within OLAF, all in charge of protecting the EU financial interests under different facets. An anti-fraud and corruption strategy has also been drafted to complement this unit's *ex post* function.

As part of its investigation, the Financial Investigations Unit carries out in-depth examination of all circumstances relative to irregularities and cases of suspected fraud, including the corruption of public officers and, in that regard, the acquiring of records and/or information and the carrying out of related assessments, analyses and recommendations. Investigations relate to inquiries aimed at uncovering the hidden facts and establishing the truth. They imply a systematic tracking down of information and include probing.

A financial investigation may be carried out in terms of the provisions of the Internal Audit and Financial Investigations Act. The Act stipulates that if an entity has reason to suspect an irregularity and/or a suspected case of fraud of public funds, it shall refer the matter forthwith to the director (IAID). The entity would have to supply all information in its possession relating to the matter, in line with the same Act.



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The Internal Audit and Investigations Department is divided into four units. These are Internal Audit, EU Audit, Financial Investigations and the Risk Management Assurance Unit. Internal Audit, EU Audit and Financial Investigations provide for financial management monitoring and control, namely *ex post* controls. *Ex post* controls are intended to check whether statutory provisions are completely applied and whether public spending is in compliance with the requirements of the enabling acts.

The Risk Management Assurance Unit provides for *ex ante* controls, through the establishment of a risk management programme for the public administration. The Risk Management Assurance Unit acts as the central harmonisation unit for PIC and facilitates the implementation of an integrative risk management process within the public administration, with the aim of formalising risks into risk registers.

Internal Audit, EU Audit, Financial Investigations and the Risk Management Assurance Unit fall within the same department and are coordinated by the director-general. The department falls under the direction of the Internal Audit Board. The board is responsible for overseeing the department's operations, serves as an independent and objective body to monitor the PIFC function in Malta and sets policies, procedures and methods for the proper functioning of the department.

5. Ongoing and future reforms

The public administration is in the process of introducing a risk management system for the public service entrenching ministries' responsibilities for the implementation of risk controls. Guidelines in this regard were issued and became effective in March 2011 and a risk management policy, a risk management procedure, a risk register template and a template for the statement on internal control have been developed. Simultaneously, the Risk Management Assurance Unit is being strengthened with the recruitment of additional staff.

The guidelines stipulate that a risk management process is to be set up for each ministry level cascading down to all organisations. This process should address all the risks which affect the achievement of the ministry's objectives. The following actions are planned to carry out this process:

Modifying the Financial Management Act

A committee was set up by the Ministry of Finance, the Economy and Investment to modify the Financial Management Act. This law is being modified and updated to include management tools relating to PIFC, risk management and public performance mechanisms. The introduction of such tools should help to further strengthen the accountability and transparency within the public administration.

The introduction of accrual accounting within the government ministries

Over the past years the government has implemented measures for the smooth transition from cash accounting to accrual accounting within its operations. Measures undertaken include:

- the provision of training;
- the introduction of standard forms and schedules;
- the preparation of ministerial/departmental financial statements;
- the setting-up of the accrual accounting working group;
- the setting-up of a board for the purchase of financial management and performance;
- mechanisms IT software: General Treasury Department.

All these will enable a smooth transition from cash-based to an accrual-based system of accounting.

The introduction of risk registers

The Risk Management Assurance Unit within the Internal Audit and Investigations Department has been assigned the responsibility to develop, promote and oversee the implementation of policies on risk management and internal control through the adoption of risk registers. In this manner objectives set by the government would become clearer and more visible; any threats to these objectives would be identified and addressed in a manner that mitigates these same risks. Such a process would also improve transparency, accountability and probity, whilst reasonable assurance would be achieved as to the effectiveness of the internal controls in place. The principal tool used for recording and managing risks within a public organisation is the risk register. Registers are developed and deployed at corporate public organisational and sectional levels. The risk register is an important document in risk management because it identifies risks, rated according to their importance. This information will then enable appropriate responses to be developed, implemented and monitored.



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The provision of continuous training and facilitation

The Risk Management Assurance Unit is responsible for facilitating internal control and risk management within the public administration by presenting the general principles to all the ministries, departments and entities so that wide coverage would be achieved in a relatively short time.

Strategic risk management will also be provided through training initiatives. In this respect the RMAU has prepared intensive training modules. The first course is entitled 'Enhancing management control within the public administration' and focuses on effective frameworks for taking informed decisions about risk and internal control, and how to manage them at strategic and operational levels within one's unit/department both from a theoretical and a practical point of view, by means of workshops. This training course aims to initiate a risk management and internal control culture across the public administration in order to provide departments with basic knowledge of best practice principles, processes and approaches to risk management and internal control. This course provides an understanding and practice in identifying internal controls using the COSO (Committee of Sponsoring Organisations) framework, a widely used tool used by the US government and the European Commission. Both the theory and practical aspects of the COSO framework will be covered. The second course, entitled 'Fundamentals of risk management for the public administration,' provides a comprehensive introduction to practical risk management and its application. This course will introduce the concept of risk and how risk impacts an organisation's objectives. The course will also focus on how risk management can be used to understand, communicate and deal with risk. This can be achieved through an understanding of the risk management process which can then be incorporated into the organisation's strategies and operations.

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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

1.1. Point of departure

1.1.1. Dutch public sector: basically decentralised — policymaking rather centralised

The Dutch public sector is basically decentralised, based on historical tradition. The regional governments (provinces) and the local governments (municipalities) take charge of their own affairs, including independent financial management. The external control is applied by their own democratic councils. Supervision by central government is limited and indirect. Nevertheless, policymaking is rather centralised. The central government determines the social and political objectives, the instruments and the budget, but policy performance is largely decentralised to regional and local governments and external agencies.

1.1.2. Dutch political system: coalition government

In the Dutch political system parliament is normally constituted of about a dozen political parties. After elections some parties will — in principle for a four year period — form a coalition government based on a majority in parliament (more than 75 deputies). The new administration is based on a coalition agreement. It is an enumeration of:

1. the agreed policy programmes;
2. the fiscal constraints (budgetary framework and tax burden conditions):
 - the midterm objective (MTO) for the general government deficit, based on the EU's budgetary stability programme for the Netherlands (at present a structural EMU balance not exceeding a deficit of - 0.5 % to a surplus of + 0.5 % GDP and the EMU debt standard not exceeding 60 % GDP);
 - the tax burden.

In the first or constituent meeting of the Council of Ministers a decision will be taken on the fiscal rules, the rules necessary to respect the fiscal constraints. In fact the start of a new administration is the beginning of a new (four-year) FMCS cycle.

⁽¹⁾ Contributed by the Ministry of Finance on 31 March 2011.

1.2. Developments since the mid 1980s

There are four outlines in the development of the Dutch PIC system.

1.2.1. Enhancement budget right of parliament

The Ministry of Finance (MoF) has played the leading role in close cooperation with the supreme audit institution (SAI) and the Committee for the Budget of parliament (Second Chamber). A better and faster information provision to parliament about the annual budgets, the annual budget adjustments and the financial reports (financial accounts) needed to be found. For that purpose some important changes were carried out in central government in the period 1985–95.

- Introduction of a new budget and accounting system, not only cash based, but also commitment based.
- Automation and digitalising of the financial accounting systems.
- Enhancement of the financial function: the financial economic affairs departments (FEAD) of the ministries transformed from a pure accounting function to a broad financial control function; managers became wholly responsible for policy performance and for financial management, the FEAD for respecting the planning and control cycle, budget control, policy advising, including advising about effectiveness, efficiency and the economy (the three Es).
- Enhancement of the audit function: every ministry was given their own internal audit department; this IA department became responsible for the annual statement of assurance with regard to the regularity of the financial management.

1.2.2. Public administrative reforms (PAR): since the beginning of the 1990s

The MoF has played the leading role.

- Creation of (at the moment more than 40) internal agencies for policy performance and operational management. Internal agencies are relatively independent in performing policy and operational management activities. They are steered and controlled on output and quality; they are using an accrual accounting system instead of the combined commitment-cash system. To finance the activities they are not merely dependent on the budget mechanism, but they may use an internal borrowing facility for investments at the Ministry of Finance (treasury). Internal agencies are operating under the political rule of full accountability for the minister concerned, the same as goes for ordinary ministerial departments.
- Creation of (at the moment several hundred) law-based external agencies. External agencies are operating under the political rule of limited accountability for the minister concerned; the minister is only responsible for the control system and the legal framework within which the external agency is operating and not for the daily operations of the agency.

1.2.3. Public expenditure management (PEM): since the mid 1990s

The MoF has played the leading role.

- Enhancement of budget control since 1994: fiscal policy based on structural economic forecasts and the application of budget rules based on frameworks for expenditures and revenues. The applied budget standards are based on the EU standards for the budget balance (EMU deficit) and the EMU debt.
- Introduction of a PPB (planning, programming and budgeting) system since 2000: the ministerial budgets are constructed and presented mainly as an output budget and to a limited extent as an input budget.
- Presentation of the annual budget laws and presentation of the annual financial reports are more focused on the results of the policy performance (output accountability). A policy agenda was introduced in the budget laws and a policy report in the annual financial reports. However, parliament is more and more interested in input information about staff. Therefore, there is political pressure for more input information in the budget laws and financial reports.

1.2.4. Public operational management reforms (POMR): since 2007

The Ministry of the Interior is playing the leading role. There is development towards a more horizontal integration of processes through the creation of shared service centers (SSCs) with regard to:

- operational (non-financial) management of the ministries for staff management, office-housing, office ICT and internal audit (merging of IA departments in a central government audit directorate (GAD));
- policy performance of the ministries (e.g. with regard to granting subsidies);
- supervision and inspection on policy performance of external agencies;
- policy advising (merging of planning offices).

For an overall view of the Dutch FMC system, including aspects of the PIC system, we refer to the diagram attached to this contribution.



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2. Public internal control environment

2.1. Budget and accounting system

► *For the central government:*

- by the ministries — a combined financial commitment and cash-based system is applied;
- by the (approximately 40) internal agencies (as units of the ministries) — a public accrual accounting system is applied;
- by the external agencies — a private accrual accounting system is applied;
- by state-owned enterprises — a private accrual accounting system is applied.

► *For the decentralised governments:*

- by regional and local governments — a public accrual accounting system is applied.

2.2. Budget presentation and presentation of the annual financial reports (to parliament)

Since the year 2000, the budgets of the ministries are in principle output based. In the general part of the budget presentation the ministers focus on their main policy objectives (policy agenda). In the explanatory part the ministers present their budget items. Every budget item is structured through one general and more operational objective. The financial policy instruments (e.g. subsidies, loans, guarantees, staff, investment programmes) are linked to the operational objectives. Therefore, the budgets are linked to the policy instruments.

2.3. Mandate system (taking decisions and performing actions on behalf of the minister)

The minister is the top manager.

Within a ministry we distinguish three levels of control:

- the top management/strategic level — minister, state secretary, secretary-general (SG) and directors-general (DGs), who are responsible for the strategic planning;
- the middle management/tactical level — the heads of the directorates (directors), who are responsible for the development of the policy programmes and the operational management;
- the executive management/operational level (activity and transactions) — the heads of the departments, units and internal agencies, who are responsible for policy performance and operational management activities.

The minister or the state secretary takes the strategic decisions, after consulting the top management (level one). Decisions that are not taken by the minister or state secretary have been mandated to the SG and sub-mandated to the DGs; they have been authorised to act on behalf of the minister. A further sub-mandate is given to level two (directors) and sometimes to level three (head of departments, etc.) depending on the nature of the activities. The minister, however, remains totally accountable to parliament for all decisions taken either by him/her or on his/her behalf.

2.4. External audit by the supreme audit institution (SAI, Court of Audit)

2.4.1. (Line) ministries and external agencies

The Dutch Court of Audit audits at the ministries:

- the regularity of the policy programmes and the operational management, especially the financial regularity of the financial transactions (financial and compliance audits);
- the performance of the policy programmes and the operational management — effectiveness, efficiency and economy (the three Es).

Officially independent from the IA directorates (IAD/GAD), the SAI performs its audits at the ministries. In practice the IADs/GAD perform the financial and compliance audits and — for efficiency reasons — the SAI makes use of the audit results. External audit includes reporting: the SAI provides the minister, the external agency and the parliament with information resulting from the audits. Regarding the external agencies, the SAI's audit is limited to the public or legal tasks of the agencies, to the public money involved and to the functioning of the legal framework.

2.4.2. Local and regional governments

The SAI is not authorised to audit the public household of local/regional governments. With regard to the performance of national policy by the local and regional governments the SAI can only perform audits by means of data, documents and other data carriers in possession of the ministry involved. The SAI has no access to the offices and accounting systems, etc. of local and regional governments. There is only one exception to this no-entry rule: the SAI is authorised to audit local and regional governments in the case of the spending of European subsidies/subventions. Based on a long historical tradition of decentralisation, local and regional governments are responsible for organising and regulating their own external audit. Normally these audits are performed by a local SAI or a public accountancy firm.

2.5. Fight against fraud and/or irregularities

2.5.1. Fraud

There is no special organisational unit within the financial management and control system for the fight against fraud (no financial police). There is a general organisational structure (Government Investigation Service/*Rijksrecherche*) within the Ministry of Justice. Whenever there is a case of fraud this GIS will be called in. The IAD/GAD and the SAI will stipulate the fraud in their audit findings.

2.5.2. Irregularities

In the case of irregularities, the IAD/GAD and/or the SAI will stipulate these in their audit findings. These could have a negative influence on their statements of assurance. In the case of irregularities deliberately committed by officials, disciplinary sanctions will be applied by the management. In most cases, irregularities are committed by mistake; in this situation, the management has to take steps to prevent the same mistakes being made in the future.

3. The concept of public internal control in the Dutch administration

3.1. Characteristics/elements of managerial accountability/responsibility

In the Dutch political system, ministers are individually responsible and accountable to parliament. There is no collective responsibility of government. Government promotes the unity of policy; a decision of government is finally always a decision for which the minister concerned is responsible to parliament. The control and accountability relations in the Dutch FMCS are relations between a minister and parliament (external control and accountability) and between a minister and his ministerial officials/managers (internal control and accountability). There is no accountability relationship between parliament and ministerial officials.



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3.1.1. Political control versus ministerial accountability (external) and ministerial control versus managerial accountability (internal)

Within the FMC system external and internal control are distinguished, as well as *ex ante* control and *ex post* control. The external control is the political control by parliament of the political manager(s)/ministers: parliament monitors the ministers or government *ex ante* through enacting the budget laws and *ex post* through accepting the annual financial report/statements. Parliament annually explicitly discharges the ministers. All other control is internal control (managerial control); control within the central government by the ministers and the departmental management. Management control can be divided into internal control (first and second line) and external management control (second line).

The first line internal management control is executed by the minister and the subordinated managers (SG, DGs, heads of directorates, departments, etc.), sometimes by special (*ex post*) control units. The second line internal management control is the control by the head of the FEAD. He/she supports the (first line) management. The head of the FEAD is organisationally independent of the management. He/she has the authority to inform and advise the SG and the minister directly.

The second line external management control is executed by the MoF and on his/her behalf by the Directorate-General for the Budget (Budget DG).

3.1.2. Policy performance and policy development (including policy adjustments)

The FMC/PIC system is in principle applied both to policy development and policy performance by the ministries, but in practice the focus is on policy performance. Policy performance is carried out by (1) ministerial performance departments, (2) internal agencies, (3) external agencies and (4) local and regional governments. The PIC system is totally applied to the organisational structures of (1) and (2), because the minister concerned is totally accountable to parliament. The control of the minister with regard to (3) and (4) is limited, because he/she has limited accountability to parliament. The external agencies and local and regional governments have their own PIC system, regulated through special legal frameworks.

The managers charged with policy performance (1) and (2) are responsible for the system of AO and IC (administrative organisation = the Organisation of the Internal Information Provision and Internal Control). In the system applied, in general they take into account the five INTOSAI guidelines. The managers can request the IA directorate for an operational audit on their AO and IC system.

3.1.3. Politically appointed managers

Managerial accountability is exercised by top administrative managers (SGs, DGs, etc.). Only the ministers and state secretaries are politically appointed. Therefore, during a political change the administrative top managers remain in place. Nevertheless, in case of vacancies in the administrative top management, government will take the political background of the candidates into account.

3.1.4. Delegation of responsibility and authority

See Section 2 for the Dutch mandate system (taking decisions and performing actions on behalf of the minister). The mandate system is much decentralised. Regular decisions on policy

performance are — within the existing frameworks — taken rather low in an organisation. In case of exceptional decisions or actions/transactions, for which the minister has given no clear policy lines, it is up to the middle or top management to assess whether the minister should be involved in the decision.

3.1.5. Support from the FEAD (financial officers): see 'Second line internal control' in the table below

3.1.6. Determining objectives

The strategic, social and political objectives and operational objectives — in general the policy programmes — are set by the government. There is more management freedom for establishing more detailed operational objectives for policy performance: in general, more freedom for external agencies, less for internal agencies and the lowest for ministerial performance departments; the more ministerial accountability, the less management freedom.

3.1.7. Objectives and scope of internal control

The control objectives are:

- respecting budgetary and financial frameworks (EMU balance, EMU debt);
- respecting the three Es (effectiveness, efficiency and economy);
- respecting financial regularity.

The operational management activities, and especially those with financial consequences, are the scope of the internal control at the level of policy performance by ministerial performance departments and internal agencies. These can be divided into the following.

- Periodic financial operations:
 - entering into financial obligations (contracting, subsidising);
 - paying expenditures (payments);
 - imposing levies/taxes/tariffs (imposing claims);
 - collecting (tax and non-tax) revenues.
- Special financial operations, for example payment of advances, balancing of debts, payment in kind, remission of debt, securing valuables (cash, credit cards, bank cards, bank warranties, etc.).
- Balance sheet operations (treasury activities, managing financial assets and managing financial liabilities).

3.1.8. Reporting system

The IAD/GAD gives, for every annual financial report, a statement of assurance in a report of findings. Yearly, there are 27 budget laws, so also 27 annual reports (including the financial statements) and 27 statements of assurance. The statements of assurance are the result of the financial and compliance audits and are submitted to the ministers concerned and to the SAI. The content of the financial and compliance audits comprises:

- auditing whether the financial management is regular, orderly, verifiable and efficient;
- auditing whether the financial information in the annual reports is congruent with the financial records;
- auditing of the realisation of policy information in the annual reports.

The SAI makes use of the statements of assurance of the IAD/GAD. The SAI issues annually a statement of approval regarding the financial statements included in the central government's annual financial report. The SAI's statement also relates to the central government's trial balance. This statement is submitted to parliament and to government.

3.2. Internal audit

3.2.1. Internal audit function performed by the IA directorates (IAD)

3.2.1.1. Audits performed (including statements of assurance)

The IAD has two main task fields.

- The law-based task: financial and compliance audits — auditing of the financial regularity of the financial management, the financial information and the realisation of policy information in the annual reports resulting in the annual statement of assurance. This is the main element of *ex post* audit.
- The consultative task: operational audits — advising the manager at his request — about the operational management systems/procedures (staff, procurement, ICT, materials/equipment, organisation, finances, housing). A statement of assurance can be the result. Operational audits are not an element of *ex post* audit.

The IAD's financial and operational audit is applied upon three organisational levels within a ministry: the strategic level (management control level), the operational level and the activity and transaction level (as the lowest level).

3.2.1.2. Reporting

The IAD reports the results of the annual financial and compliance audits to the minister. Therefore, the internal audit includes the reporting of the results. The annual financial and compliance audit reports of the IADs/GAD are sent to the SAI, so the SAI can make use of the results of this audit (matter of efficiency of the audit process). This obligation has been legally regulated in the Government Accounts Act (*Comptabiliteitswet*). However, the SAI is constitutionally independent. It has the authority to decide itself to do any supplementary (financial or policy) audit.



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FMCS		<i>Ex ante control/supervision/verification of budget and financial management</i>	<i>Ex post control/supervision/audit of budget and financial management</i>
External control = political/parliamentary control	Political control	<i>Control of ministers/government by parliament through:</i> (a) annually enacting the budget laws; (b) setting the general budgetary and financial framework through enacting the Organic Budget Law/PFIC-law (<i>Comptabiliteitswet</i>).	<i>Control of ministers/government by parliament through:</i> (a) annually voting the (financial) ministerial reports; (b) discussing the audit reports of the SAI/CoA.
	External audit		<i>Independent audit by the SAI/CoA for parliament:</i> (a) annually auditing the financial reports and the financial management of the ministries; (b) periodically performing efficiency audits.

FMCS		<i>Ex ante control/supervision/verification of budget and financial management</i>	<i>Ex post control/supervision/audit of budget and financial management</i>
Internal control = ministerial and managerial control (management control)	First line internal control	<i>Supervision:</i> (a) by the minister of the managerial board (SG/DGs; strategic level); (b) by the managers (policy performers) of the staff members (operational level); (c) supplemented with self-control by the (performing) staff members and with testing by colleagues.	Sometimes, risk based <i>internal verification by a verification department</i> , through order of the manager (for example in case of large-scale granting of subsidies).
	Second line internal control	<i>Setting budgetary and financial frameworks, internal regulation and advising within a line ministry by FEAD.</i> Supplemented with <i>limited preventive control by FEAD</i> for special cases/situations/operations/ activities (mandatory financial second opinion).	
	Second line external control	<i>Setting government broad budgetary and financial frameworks and regulations by the MoF/Budget DG.</i> Supplemented with <i>limited preventive control by the MoF/Budget DG</i> for special cases/situations/operations/ activities (mandatory financial third opinion).	
	Internal audit		Audit by the internal auditor. Financial, compliance and operational audits. Independent of the manager/policy performer, but subordinated to the minister.

3.2.1.3. Organisation

There are 11 ministries, five of which have an IAD. There are two shared service centers (SSC) for internal audit, one SSC for two ministries (the IAD of the Ministry of Economic Affairs, Agriculture and Innovation for that ministry and the Ministry of General Affairs) and one SSC (Government Audit Directorate/GAD) for four ministries (Ministry of the Interior, Ministry of Finance, Ministry of Health, Welfare and Sport and, partly, the Ministry of Infrastructure and Environment). The director of an IAD is hierarchically directly subordinated to the SG and the minister; so he is functionally independent of the policy directorates.

For efficiency reasons all IADs will merge into the GAD in 2012. The GAD is hierarchically directly subordinated to the SG of the Ministry of Finance and the Minister for Finance, but functionally directly subordinated to the SG and the minister concerned. The GAD is not a central audit directorate in the hands of the MoF. The results of the audits and the audit certificate are submitted directly to the minister involved. Therefore, although the audit function is still decentralised, the organisation form is centralised.

3.2.1.4. Regulation

The tasks of the IAD are regulated in the Government Accounts Act 2001 and the Royal Decree Task Internal Audit Directorate.

3.2.1.5. Audit charters

The use of audit charters is not yet common in central government. The most important elements of a charter, like independence, scope, responsibilities, authority and standards of the internal audit, are regulated in by-laws. Elements such as mission, objectivity and authorities are laid down in the professional rules of conduct. Nevertheless, within the GAD the first steps are taken to formalise an audit charter. The acceptance of duties outside the scope of the financial, compliance and operational ^(?) audits is legally not permitted. Operational audits are, after consultation, performed on request of the management. Acceptance of the request depends on the audit capacity available and these audits are planned in the annual audit schedule.

3.2.1.6. Audit training

Public (internal) auditors are obliged to undergo continuing professional education (CPE). Therefore they have to score every year a minimum of CPE marks. They have the opportunity to follow self-chosen training and courses given by certified educational institutions.

3.2.1.7. Follow-up procedure to internal audit reports

Concept findings of the auditor are discussed with the managers. The final conclusions and recommendations are discussed in the audit committee. Subsequently the minister will take the decision to act on the recommendations.

In case of irregularities the IAD/GAD and/or the SAI will stipulate these in their audit findings. This could have a negative influence on their statements of assurance. In case of irregularities deliberately committed by officials, disciplinary sanctions will be applied by the management. In most cases irregularities will be committed by mistake; in this situation the management has to take steps to prevent the same mistakes being made in the future. In case of suspicion of fraud the Government Investigation Service will be called in. The IAD/GAD and the SAI will stipulate the fraud in their audit findings. In the Netherlands we have no special financial inspection (financial police).

3.2.2. Internal audit's relation with external audit

Coordination between internal and external audit

The annual financial and compliance audit reports of the IADs/GAD are sent to the SAI so the SAI can make use of the results of this audit. This obligation has been legally regulated in the Government Accounts Act 2001. Since the SAI is constitutionally independent, it has the authority to decide on any supplementary (financial, compliance or operational) audit.

Furthermore, the SAI participates, as an observer, in the monthly meetings of the internal audit directors of the ministries in the so-called IODAD consultation. Apart from that, there is regular consultation between the president of the SAI and the Minister for Finance (charged with audit policy) about matters of audit policy (e.g. about audit standards or the presentation of financial information in the annual financial reports).

^(?) In Dutch we use the English term operational audit for what in English is called a performance audit.



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3.2.3. Audit boards or audit committees

3.2.3.1. Audit board

We do not have a regulated permanent audit board. From time to time the government installs a temporary committee for giving advice on the internal audit function within government (ministries). The SAI, some IA directors and some representatives of the Budget DG participate in this temporary committee.

3.2.3.2. Audit committees

In each ministry an audit committee advises the minister and/or the SG on:

- recommendations of the IAD/GAD and SAI;
- operational management affairs and risk management; and sometimes about
- the (programming of the) annual audit plan of the IAD.

It is a functional (not hierarchical) body, composed of the members of the top management (DGs, SG), the head of the FEAD, the head of IAD and some external members with special expertise in FMC affairs or broad public management expertise. The function of the audit committee has been regulated in a by-law. There is the intention to regulate the legal basis for these committees in the Government Account Act (basic budget law).

3.3. Coordination of public internal control

In the Dutch central government we distinguish between the following.

1. Policy control — the CHU ⁽³⁾ is partly the MoF, partly the Ministry of Justice.
2. Budget control — the CHU is the MoF.
3. Control of operational management:
 - financial control — the CHU is the MoF;
 - internal audit — the CHU is the MoF;
 - non-financial control (staff, housing, ICT, procurement of equipment, facilities) — the CHU is the Ministry of the Interior.

3.3.1. Methods of coordination of internal control

- Frame setting through regulation (laws and by-laws) by the Budget DG.
- Regular meetings between the Budget DG and directors of the FEADs of the ministries — in the so-called IOFEZ consultation — for policy matters of budget and financial control. For more technical matters there is an interministerial working group of deputy directors of the FEAD.
- Regular meetings between the Budget DG and directors of the IADs of the ministries — in the so-called IODAD consultation — for audit policy matters. For more technical matters there is an interministerial working group of deputy directors of the IAD.
- Information provision and transfer of knowledge from the CHU through manuals, conferences, training, etc.

⁽³⁾ Central harmonisation unit.

3.3.2. Central coordination or harmonisation unit: the Budget DG

The Budget DG — and more specific the Budget Affairs Department (BAD) — is the central harmonisation unit for PIFC and for internal audit through frame setting for budget control and financial control, on the one hand, and for internal audit, on the other hand. The frame setting is formalised in regulations (law and by-laws). Before issuing regulations of the Minister for Finance, there are (institutionalised) consultations between the Budget DG and the FEADs and the IADs of the line ministries. Within the set frameworks the ministries (ministers/policy managers) are relatively autonomous with regard to budget and financial management. The Budget DG supervises in particular whether the frameworks are respected. Therefore, delegated preventive (*ex ante*) financial control with respect to financial transactions by the Budget DG can be very limited and is in general only applied to guarantees (warranties).

As the technical tool of budget control, the ministries are obliged to use the central budget accounting system of the Budget DG. The Budget DG does not assess the set-up and functioning of the financial accounting systems of the ministries. Such assessments are performed by the IAD and the SAI. The IAD reports to its minister, the SAI to the minister concerned and to parliament.

The Budget DG supervises/monitors the information output of the budget and financial accounting systems of the line ministries during the year by means of periodic and occasional information provided by the FEADs. The Budget DG has the authority to demand all the (financial) information necessary for their supervision. The FEADs are legally obliged to supply that information. These authorities and obligations were laid down in the Government Accounts Act 2001 ⁽⁴⁾.

With regard to internal audit, the ministers are legally obliged to submit the results of the financial and compliance audits (including the statement of assurance) to the Budget DG. This obligation was laid down in the Government Accounts Act 2001. The Budget DG/BAD does not assess the set-up and the functioning of the internal audit systems of the ministries nor does it monitor the results of the internal audit. The SAI reviews periodically the functioning of the IADs and reports to the minister concerned and to parliament.

3.3.3. Decentralised coordination of budget and financial control within a line ministry: the FEAD

The main tasks of the FEAD within a ministry are:

- coordinating the annual budget process and the multiannual financial estimates;
- monitoring the budget performance;
- organising the budget accounting (accounting of the financial estimates) and the financial accounting;
- advising (independently from the policy managers) the minister on all issues with financial consequences;
- coordinating the multiannual policy evaluations;
- organising the payment process, the assignments of the cashiers (= managers/administrators of the bank accounts) and securing the valuables (cash, credit cards, bank cards, bank warranties, etc.).



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⁽⁴⁾ In the Netherlands the Government Accounts Act 2001 is a fusion of the Organic Budget Law, the PIFC (or FMC) Law, the Internal Audit Law and the External Audit (or SAI) Law.

4. Financial Inspection

There is no special organisational unit within the financial management and control system for the fight against fraud (no financial police). There is a general organisational structure (Government Investigation Service/GIS) within the Ministry of Justice. Whenever there is a case of fraud this GIS will be called in. The IAD/GAD and the SAI will stipulate the fraud in their audit findings. These could have a negative influence on their statements of assurance.

5. Ongoing and/or future reforms

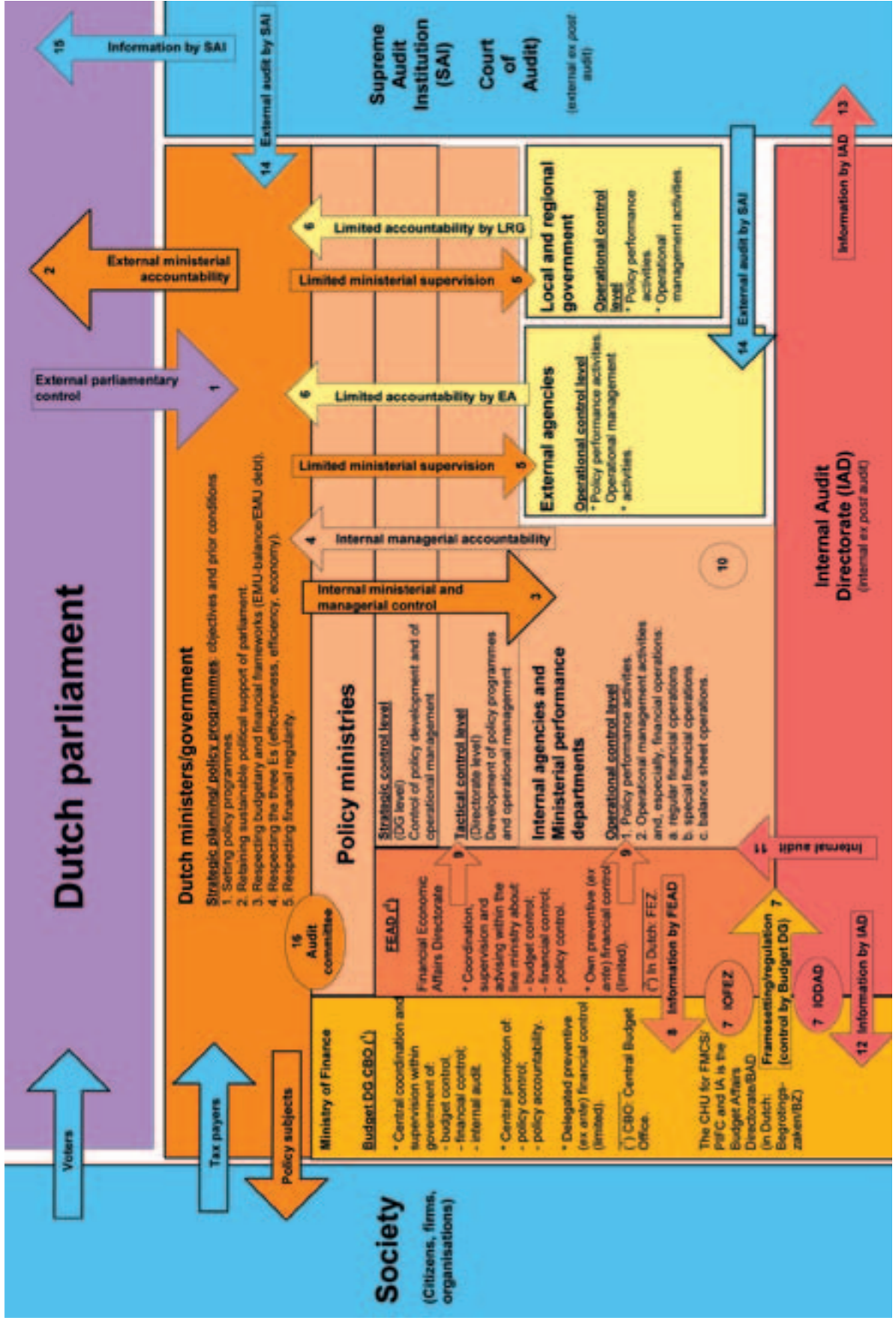
Horizontal integration of processes through the creation of SSCs⁽⁵⁾

The present government focuses on a more compact central government. The policy is to promote more horizontal integration of processes through the creation of shared service centers and other organisational forms of cooperation between ministries, especially in the field of:

- non-financial operational management (staff management, office housing, office ICT and internal audit; the merging of all IA departments into a central government audit directorate/GAD);
- policy performance of the ministries (e.g. with regard to granting subsidies);
- supervision and inspection of policy performance of external agencies; and
- policy advising (merging of planning offices).

⁽⁵⁾ See Section 1, Developments, point 4 (Public operational management reforms (POMR)).

Governance system of central government in the Netherlands from a financial perspective (GSCG-f)





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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The PIC system was introduced in Poland in accordance with the amendment to the Act of 26 November 1998 on Public Finance passed on 27 July 2001, which came into effect on 1 January 2002, as the result of the pre-accession negotiation process. The act was based on the Principles for introduction of the PIFC system in the Polish public administration (strategy paper) approved by the Committee for European Integration in December 2001. The objective of the PIFC system was to ensure appropriateness and efficiency of collection and disbursement of public means.

Organisational activities.

- In March 2002, in the Ministry of Finance, the Polish central harmonisation unit, called the Financial Control and Internal Audit Coordination Department, was set up.
- On 26 November 2002, the general internal auditor was employed through a competition in accordance with the provisions on civil service.
- In public financial sector entities, enumerated in Article 35d(1) of the abovementioned act, units or posts for internal audit were created.
- At the request of the heads of public financial sector entities, the Minister for Finance allocated and transferred financial means from the state reserve in the amount of PLN 40 million for the year 2002, destined for support for the building of a financial control and internal audit system — mainly for financing personnel costs.
- In the state budget for the fiscal year 2003, a special purpose reserve to the amount of PLN 3 million was foreseen, which was destined for strengthening of auditing personnel in institutions managing financial means coming from the EU assistance funds.
- On 29 October 2002, on the basis of the decision of the Minister for Finance, the examination board was appointed for carrying out exams for candidates for internal auditor posts.

The key role in the implementation and coordination of the system was entrusted to the Minister for Finance, who fulfilled the tasks with the assistance of the General Internal Auditor and Financial Control and Internal Audit Coordination Department situated in the Ministry of Finance.

The Minister for Finance, in line with Article 35o(2) of the abovementioned act, determined and propagated financial control standards and internal audit standards, collected and analysed information including plans and reports from internal audit, cooperated with foreign institutions

⁽¹⁾ Contribution from the Ministry of Finance on 6 April 2011.

and performed an assessment of internal audit and financial control in public financial sector entities. To ensure a high-quality internal audit staff the Minister for Finance appointed for the four-year term the examination board. The members of the examination board were recruited from among the employees of the Ministry of Finance, relevant academics and scientists and the representatives of private internal audit associations. The board carried out the examination in order to verify the theoretical and practical competence of candidates for the post of internal auditor. The examination covered issues related to audit methodology, audit standards, public administration, public finance, microeconomics and risk assessment. Between 2003 and 2006 over 2 000 internal auditors passed the exam and obtained the national certificates.

Since 2002 the Act on Public Finance concerning PIFC has been updated three times (2005, 2006 and 2009). The current act came into force in January 2010.

In accordance with the amendment to the Act on Public Finance which came into force in 2006, the General Internal Auditor post, the examination board and the national certification process were abolished. Types of qualifications and certificates entitling internal auditors to work in public finance sector entities were broadened in the act and enumerated as follows.

1. Certificates: Certified Internal Auditor (CIA), Certified Government Auditing Professional (CGAP), Certified Information Systems Auditor (CISA), Association of Chartered Certified Accountants (ACCA), Certified Fraud Examiner (CFE), Certification in Control Self-Assessment (CCSA), Certified Financial Services Auditor (CFSA) or Chartered Financial Analyst (CFA).
2. Completed an audit traineeship and passed an audit examination before the examination board appointed by the President of the Supreme Chamber of Control.
3. Qualification examination for fiscal control inspector.
4. Qualifications of a certified comptroller.
5. National internal auditor certificate.

The current list of requirements for internal auditors and types of entitlements which enable someone to work as an internal auditor is presented in Section 3.2.

Also, since 2006 the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors have been directly adopted as the Internal Audit Standards in the Public Finance Sector Entities.

Due to the reorganisation within the Ministry of Finance since 2008 the Financial Control and Internal Audit Coordination Department has been renamed the Department of Public Finance Sector Audit (see Section 3.3.).

2. Public internal control environment

2.1. Budgetary system

Poland currently has a traditional budget system that is primarily based on organisational units and control of inputs.

The constitution of the Republic of Poland, the new Act of 27 August 2009 on Public Finance and the standing orders of the parliament regulate the fundamental aspects of the parliamentary budget process. The Minister for Finance submits to the council of ministers the assumptions of the draft budget for the subsequent year, taking into consideration the assumptions adopted in the multi-year financial plan of the state and the guidelines for actions included in the convergence programme adopted by the council of ministers. The council of ministers passes the budget bill and submits it together with the reasons behind it to the Sejm (lower chamber of the Polish parliament) by 30 September of the year preceding the relevant budget year. The Sejm adopts the state budget for a fiscal year by means of a budget (budgetary statute). The right to introduce legislation concerning a budget, an interim budget, amendments to the budget or a statute on the contracting of public debt, as well as a statute granting financial guarantees by the state, belongs exclusively to the council of ministers.

The council of ministers, within the five-month period following the end of the fiscal year, presents to the Sejm a report on the implementation of the budget together with information on the condition of the state debt. The Sejm considers the report presented to it and, after seeking the opinion of the Supreme Chamber of Control, passes a resolution on whether to grant or refuse to grant approval of the financial accounts submitted by the council of ministers.

Currently Poland is in the process of introducing a new budget system: the performance-based budgeting (PBB) system, which will be working in parallel with the traditional system. The dual system is planned to be in place in 2013 (see Section 5).

2.2. External control and audit of public administration

External control and audit of public administration in Poland is performed by the Supreme Chamber of Control (NIK) — the supreme audit institution. The NIK's organisation and functioning are set out in the Constitution of the Republic of Poland and the Act of 23 December 1994 on the Supreme Chamber of Control. The basic task of the NIK is to audit the activity of government administration bodies, the National Bank of Poland (NBP), state legal persons and other state organisational entities. The NIK can also audit the activities of local government bodies as regards their legality, sound management, efficacy and integrity. The NIK may also audit the activity of other organisational units and economic entities (entrepreneurs), to the extent in which they use state or public property or resources or fulfil financial obligations to the state. The NIK undertakes audits ordered by the Sejm or its bodies, at the request of the president, the prime minister or on its own initiative. The supreme audit institution submits to the Sejm the analysis of the state budget execution and monetary policy guidelines.

2.3. Body responsible for independent audit and control of the EU funds

The body responsible for independent audit and control of the EU funds is the General Inspector for Treasury Control who is the Audit Authority for Structural Funds and the Certification Unit for the Common Agriculture Policy. He/she is also the Government Plenipotentiary for Combating Fraud against the Republic of Poland or the European Union (see Section 4).

3. The concept of public internal control in Poland

3.1. Managerial accountability/responsibility

3.1.1. Management control in the public finance sector

The Ministry of Finance continues the establishment of an efficient system of managerial accountability within the public administration. The Department of the Public Finance Sector Audit of the Ministry of Finance (previously Financial Control and Internal Audit Coordination Department) supports managerial accountability (financial management and control) and functionally independent internal audit.

The Act of 26 of November 1998 on Public Finance introduced into law the term 'financial control'. After a few years of the use of this term in legislation, financial control was questionable and mistakenly associated only with the financial sphere. The Act of 27 August 2009 on Public Finance introduced the management control definition, which replaced financial control and in principle is equal to internal control in the meaning assumed by the COSO model.

In accordance with the provisions of the Act of 27 August 2009 on Public Finance, management control comprises a general set of activities undertaken in order to ensure the implementation of objectives and tasks in an effective, economical and timely manner compliant with the provisions of law. The key references for management control are objectives and their achievement as the basic criterion for assessment of effectiveness of the solutions adopted in the entity. It has to be emphasised that in public finance sector entities many elements of management control functioned and function, such as structure of the entity, delegation of entitlements, internal procedures, external and internal communication, etc. Therefore, the purpose of introducing management



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control is to put in order and systematise, in accordance with international best practices, the structures and principles existing already in the entities rather than to reorganise them entirely.

The objective of management control is to ensure in particular: compliance with the provisions of law and internal procedures, efficiency and effectiveness of operation, credibility of reports, protection of resources, observance and promotion of rules of ethical conduct, efficiency and effectiveness of information flow and risk management.

The persons responsible for ensuring adequate, efficient and effective management control are as follows.

- The minister in government administration branches ⁽²⁾ (hereinafter a 'branch') — he/she is in charge of: a commune foreman, a mayor, a chairman of the management board of the local government unit (so-called secondary level of management control).
- The head of the entity (so-called primary level of management control).

In comparison with previous provisions of law, the Act of 27 September 2009 on Public Finance broadens the extent of control, taking into account not only a single entity but also a group of entities supervised by the minister which he/she is in charge of (a branch) or by the executive organ of the local government. It relates to the opinion that complete decentralisation of management within the public administration is pointless and not consistent with its essence; it includes common objectives and principles, which should be followed by public administration entities.

3.1.2. Annual activity plan and statement on the condition of management control

By the end of November each year, the minister in charge of the branch draws up an annual activity plan for the following year for the government administration branch which he/she is in charge of. The annual activity plan includes in particular a specification of objectives within individual budget tasks together with an indication of sub-tasks for achieving the objectives and measures specifying the extent of objective implementation and the planned values thereof. By the end of April each year, the minister in charge of the branch draws up a report on the execution of the annual activity plan and submits a statement on the condition of management control for the preceding year covering government administration branches which he/she is in charge of. The minister in charge of the branch may oblige the head of the entity in the branch to draw up an annual activity plan for the following year for this entity and also prepare a report on the execution of the action plan and submit a statement on the condition of management control for the preceding year covering the entity he/she is in charge of.

The annual activity plan, the report on the execution of the annual activity plan and the statement on the condition of management control shall be published in the Public Information Bulletin, which is available on each ministry and entity website.

In order to ensure effective management control in public finance sector entities the Minister for Finance:

- specified in the form of a communication, published in the *Official Journal of the Minister for Finance*, the Management Control Standards for the Public Finance Sector Entities consistent with international internal control standards;
- specified in the form of a communication, published in the *Official Journal of the Minister for Finance*, the Detailed Guidelines on Self-assessment of Management Control in the Public Finance Sector Entities.

The Minister for Finance may specify in the form of a communication and publish in the *Official Journal of the Minister for Finance* detailed guidelines on management control for the public finance sector. The minister in charge of the branch may specify detailed guidelines on management control for the government administration branch he/she is in charge of.

⁽²⁾ Government administration branches (in Polish: 'działy administracji rządowej'). The English translation for the term has been adopted from the translation of the constitution available at the website of the Sejm: <http://www.sejm.gov.pl/prawo/konst/angielski/kon1.htm>. Some 35 branches have been defined and described within the provisions of the Act of 4 September 1997 on Government Administration Branches. The branches are substantial fields of activity of central government administration.

3.2. Internal audit

3.2.1. Law and regulatory basis

The basic issues concerning internal audit in the public finance sector are regulated in the Act of 27 August 2009 on Public Finance and proper regulations to the act, the Internal Audit Standards in the Public Finance Sector Entities (the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors are invalid), as well as in the guidelines included in the Internal Audit Manual, the Charter of Internal Audit in Public Finance Sector Entities and the Code of Ethics for Internal Auditors in Public Finance Sector Entities.



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3.2.2. The aim of the internal audit and its place in the entity's structure, its independence and reporting

In accordance with the provisions of the Act of 27 August 2009 on Public Finance, internal audit is an independent and objective operation the aim of which is to support the minister in charge of the branch or the head of the entity in order to implement objectives and tasks by systematic assessment of management control and consulting activities. The assessment refers to the adequacy, efficiency and effectiveness of management control in the government administration branch or in the entity.

The head of the entity (in the office of government administration — the director-general) ensures conditions required for carrying out the internal audit procedure in an independent, objective and effective manner and, inter alia, organisational independence of the internal audit function and continuity of the internal audit procedure in the said entity.

The heads of public finance sector entities are responsible for the implementation and functioning of internal management and control mechanisms, procedures and internal regulations, such as an internal audit charter. The head of the internal audit unit reports directly to the head of the public finance sector entity and, in the government administration offices, within the remit specified in a separate statute, to the director-general. Any termination of the employment contract or any amendments to the payment and work conditions of the head of the internal audit unit require the approval of the competent audit committee.

3.2.3. Requirements for internal auditors

In accordance with the provisions of the Act of 27 August 2009 on Public Finance an internal auditor should meet the requirements listed below.

1. Have citizenship of a Member State of the European Union or any other state of which citizens are entitled to work in the territory of the Republic of Poland under international agreements or the provisions of Union law.
2. Possess full capacity to effect legal transactions and fully enjoy public rights.
3. Have not been sentenced for an intentional offence or an intentional fiscal offence.
4. Have a higher education diploma.
5. Have the following qualifications to carry out internal audit:
 - a. one of the certificates: Certified Internal Auditor (CIA), Certified Government Auditing Professional (CGAP), Certified Information Systems Auditor (CISA), Association of Chartered Certified Accountants (ACCA), Certified Fraud Examiner (CFE), Certification in Control Self Assessment (CCSA), Certified Financial Services Auditor (CFSA) or Chartered Financial Analyst (CFA); or
 - b. between 2003 and 2006 have passed an exam for an internal auditor qualification before the examination board appointed by the Minister for Finance; or
 - c. qualifications of a certified comptroller; or
 - d. a two-year track record in internal audit and a graduation diploma of a postgraduate course in internal audit issued by the organisational unit authorised, under separate statutes, to confer the degree of doctor of economics or law on the day on which the said diploma was issued.

3.2.4. Training measures for internal auditors

The Ministry of Finance is taking steps to ensure proper training for auditors. During the training on performance budgeting, organised by the Ministry of Finance in 2008–09, 323 internal auditors and 180 heads of public finance sector entities were trained. The Department of the Public Finance Sector Audit also organises regular, monthly meetings for internal auditors of public finance sector entities for about 100 participants each time. During the meetings key matters for internal audit and management control and good practice examples are presented and discussed.

3.2.5. Types and mode of internal audit assignments

Internal audit performed in the public finance sector entities covers both declarations of assurance and consultancy assignments. The methodology of declarations of assurance is described in detail in the provisions of the Regulation of the Minister for Finance (1 February 2010) on carrying out and documenting internal audit as well as in the Internal Audit Standards in the Public Finance Sector Entities. Both are published by the Minister for Finance. The internal audit methodology implemented by auditors enables them to perform various types of assurance assignments (including financial audit, compliance audit and performance audit). The CHU encourages managers and auditors to plan more performance audits. The methodology of consultancy assignments is also described in the abovementioned regulation and standards.

Within 14 days after having received the audit report the manager of the audited unit shall inform the management of the public finance sector entity and the internal auditor which recommendations are considered well founded and appropriate, when and how they will be implemented and who is responsible for implementing them. If the manager of the audited unit refuses to take action, the head of the public finance sector entity is obliged to set out when and how the recommendations considered valid will be implemented and who is responsible for implementing them. The internal auditor shall monitor the execution of engagement results. After the time limit for the implementation of recommendations he/she shall ask the manager of the audited unit about measures used to implement the recommendations and to what extent recommendations were implemented.

There is no unified formal procedure in the public finance sector entities as to how to inform the managers of the unit if indications of fraud and/or irregularities are identified during the course of an audit. In each case, internal audit standards require the auditor to report fraud risk to management of the entity.

3.2.6. The internal audit and the Treasury Control — separation of duties

The internal audit function in the public finance sector entities is, in general, independent from the Treasury Control — centralised government financial inspection (described in Section 4). There is only one important exception from that principle. In accordance with the provisions of Articles 293 and 294 of the Act on Public Finance, the General Inspector for Treasury Control may commission internal audit engagement on EU funds in both central government entities and local government entities. His/her service may also assess the internal audit procedures and audit engagements in the field of EU funds, in the abovementioned type of entities.

Notwithstanding that, (external) audit performed by the Treasury Control in the programmes co-financed from European Union resources (see Section 4) should be compliant with the International Standards for the Professional Practice of Internal Auditing issued by the Institute of Internal Auditors.

The Treasury Control shall control purposefulness and manner of use of public funds in the public finance sector entities where internal audit is performed (see Section 4). This means that the same activities of the units may be audited and controlled in parallel. The difference between both activities lies in the methodology used by auditors and inspectors: internal auditors are focused on assessment of the management control system of the unit. The Treasury Control may inspect every organisation, both public and private, where public funds are used.

3.2.7. Internal audit relations with external audit

The duty of cooperation between internal audit and the Supreme Chamber of Control (NIK) is determined in the Act of 23 December 1994 on the Supreme Chamber of Control.

The Internal Audit Standards in the Public Finance Sector Entities also determine the duty of cooperation between internal and external functions. This is also regulated in the Charter of Internal Audit in Public Finance Sector Entities, which states that the internal auditor cooperates in performance of his/her tasks with external auditors, including, in particular, the NIK.

The coordination of cooperation between the NIK and the Internal Audit Unit is usually effected by the Head of the Internal Audit Unit (i.e. the Chief Audit Executive). The reports of the internal auditor are available to the NIK. The NIK's auditors and the Head of the Internal Audit Unit should inform each other of any serious suspicion of bad management or fraud. The Head of the Internal Audit Unit should ensure duplication of the NIK and Internal Audit Unit activities is avoided. The Head of the Internal Audit Unit also assesses coordination of the NIK and the Internal Audit Unit in terms of costs and effectiveness.

3.2.8. Audit committees

Currently there are 17 audit committees in the public finance sector in Poland, which corresponds to the number of ministries. All the committees were established in 2010. The committees were established for the reasons described below.

Until 2010 the concept of internal control was implemented at the primary level of the public finance sector. Internal auditors assessed the internal control system only within their entity. The information given by the auditors was useful only for the managers at the abovementioned primary level. The Act of 27 August 2009 on Public Finance implemented in 2010 developed a new concept of management control and accountability at the higher (secondary) level of the management — the minister in charge of the government administration branch. Newly established audit committees should strengthen the internal audit function in its task of assessment of management control throughout the entire branch. The audit committee may inform and give advice to the minister about risks connected with implementation of his/her objectives throughout the entire branch.

The aim of the audit committee is to provide consulting services with a view to ensuring adequate, efficient and effective management control and providing an efficient internal audit to the minister in charge of the branch. It should be emphasised that the scope of the audit committee guidance covers the functioning of the management control and internal audit in all units supervised by the relevant minister.

One joint audit committee may be established for the branches managed by one minister. For example: the Minister for Finance established one joint committee for three branches: Budget, Public Finance and the Financial Institutions. The minister in charge of the branch shall appoint the audit committee with his/her internal regulation.

Currently there is no legal obligation to establish audit committees for local government.

The goals and tasks of the audit committees, scope of activity, number of members and requirements for members have been described in Articles 288–290 of the Act of 27 August 2009 on Public Finance and in the Regulation of the Ministry of Finance of 29 December 2009 on the Audit Committee.

The members of the audit committee

The audit committee shall comprise a minimum of three members, including:

1. a person with the rank of secretary or undersecretary of state, designated by the minister as the chairman of the committee;
2. at least two independent members — people not employed in the ministry or in organisations of the branch.



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In the opinion of the Ministry of Finance the optimal size of the audit committee is composed of five to nine persons (including the chairman). This size of audit committee gives all the members a chance to actively participate in the deliberations and effectively perform the tasks of the committee. The Ministry of Finance recommends that independent members shall make up at least half of the audit committee. It is also recommended to maintain a constant size of the audit committee. Independent audit committee members should jointly have the knowledge, skills and experience to perform their tasks competently and effectively. The Minister for Finance defined, within the provisions of the Regulation of 29 December 2009 on Audit Committees, the qualifications of the independent members, the requirements, the rules of procedure the audit committee should meet and the method of determining the remuneration of the independent members. The organisation and the mode of operation of the audit committee shall be specified by the internal regulation of the Ministry on request of the chairman of the committee.

Tasks of the audit committee. Annual report of the audit committee.

The tasks of the audit committee shall include the following, in particular:

- indicating material risks;
- indicating material weaknesses in the management control of the branch and proposing measures to improve them;
- setting priorities for annual and strategic internal audit plans;
- reviewing material results of internal audit activity and monitoring the implementation thereof;
- reviewing statements on the execution of the internal audit plan and on the assessment of the management control;
- monitoring the effectiveness of the internal audit, including reviewing results of internal and external assessments of the internal audit activity;
- giving permission for the termination of employment contracts and any change in salary and employment conditions of the chief internal audit executives ⁽³⁾ in organisations within the branch.

By the end of February each year, the audit committee shall submit a report on the implementation of tasks in the preceding year to the minister in charge of the branch and the Minister for Finance. The report on the implementation of tasks shall be published in the Public Information Bulletin on the website of the relevant ministry. The first reports were submitted to the Minister for Finance in 2011.

3.3. Coordination of public internal control

The Minister for Finance is the person responsible for the coordination of the management control and internal audit system. In performing these tasks, he/she is assisted by the Department of the Public Finance Sector Audit which serves as a central harmonisation unit (CHU). The CHU is supporting managerial accountability (financial management and control) and functionally independent internal audit. According to the new Act of 27 August 2009 on Public Finance in the scope of coordinating internal audit procedures in public finance sector entities, the Minister for Finance fulfils the tasks specified below:

- commissioning the internal audit procedure, excluding the units referred to in Article 139(2) of the said act ⁽⁴⁾ and regional and local government units;
- assessing the internal audit, excluding the units referred to in Article 139(2) of the said act — and regional and local government units;

⁽³⁾ As defined in the International Standards for the Professional Practice of Internal Auditing.

⁽⁴⁾ The abovementioned institutions are offices auxiliary to the supreme institutions of the state, inter alia: the Chancellery of the President of the Republic, the Chancelleries of both chambers of parliament, the Constitutional Court, the Ombudsman Office, the NIK, the Supreme Court.

- disseminating the standards referred to in Article 273(1) of the said act — the Internal Audit Standards in the Public Finance Sector Entities;
- issuing guidelines;
- cooperating with domestic and foreign organisations;
- cooperating with audit committees.

In accordance with the Act of 27 August 2009 on Public Finance, the Minister for Finance defines by regulation the detailed methods and modes of carrying out and reporting on the progress and results of the internal audit. Internal audit in Poland follows internationally recognised standards and is carried out on the basis of an annual internal audit plan prepared by the end of each year for the subsequent year, although additional internal audits may be carried out outside of the scope of the audit plan in justified cases. By the end of January each year, the internal audit unit shall also prepare a statement on the execution of the annual audit plan for the preceding year. Both the plan and statement on the execution have the status of public documents. The reports of the internal auditors are also available to the NIK.



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4. Financial inspection

4.1. The Treasury Control

The Treasury Control (TC) is an inspection service subordinated to the Minister for Finance. The legal basis for the performance of the service is the Act of 28 September 1991 on the Treasury Control (including later amendments). The essential elements of control procedure performed by the TC (including powers of the controllers) are contained in the relevant provisions of the Act of 29 August 1997 Tax Regulation as well.

The organisational units of the service are 16 TC offices and the Ministry of Finance that comprises three (out of its 39) departments subordinated to the General Inspector of Treasury Control. The higher-rank authority over the directors of TC offices is the General Inspector for Treasury Control who usually is also the Undersecretary of State within the Ministry of Finance (The Minister for Finance is the supreme TC authority).

As was stated in Section 2.3 the General Inspector for Treasury Control is the Government Plenipotentiary for Combating Fraud against the Republic of Poland or the European Union. His/her tasks are, inter alia, coordination of activities of relevant central government bodies and establishing current and correct exchange of information about irregularities among relevant central government bodies.

4.2. Main goals and tasks of the TC

The goals of the TC are:

- to protect the interests and property rights of the state treasury;
- to ensure effective execution of tax obligations and other dues which constitute the revenue of the state budget or state earmarked funds;
- to examine the compliance of the management of assets of other state legal persons with the law;
- to prevent and reveal the offences specified in Articles 228–231 of the Penal Code (i.e. offences against institutions of the state, as well as regional and local government, mainly corruption) among the personnel of organisational units under supervision of the Minister for Finance.

Among the numerous activities of the TC the following ones linked with assessment of the use of budgetary funds/detecting irregularities in use of budgetary funds should be mentioned:

- inspection of the use of budgetary and European funds — control (inspection) of the purposefulness and legality of the management of public funds and funds from the European Union and international financial institutions ⁽⁵⁾;
- audit of the EU funds and funds from other foreign resources (the General Inspector for Treasury Control is the audit institution for the cohesion policy operational programmes of the Cohesion Policy 2007–13 and with the assistance of the Department for Protection of EU Financial Assistance within the Ministry of Finance plays the role of the certification unit for the common agricultural policy);
- examination, while making decisions, of the purposefulness and legality of the use and management of state property, examination of the use of property received from the state treasury for the purpose of performance of public tasks;
- examination of correctness of the state treasury property privatisation;
- controls (inspections) connected with fulfilment of obligations resulting from guarantees granted by the state treasury.

4.3. The Treasury Intelligence

The activity of the TC includes the performance of the specialised sub-units of the organisational units of fiscal control (both in the offices and the ministry) — the Treasury Intelligence. The Treasury Intelligence may carry out some of its tasks in the form of operational and detective activities that include, inter alia, obtaining information in secret and fixing traces and evidence in secret.

4.4. Initiative for controls (inspections)

The basis for performance of the TC organisational units is their control plans. The plans are authorised by directors of TC offices in accordance with the tasks defined by the General Inspector of Treasury Control. The performance of the TC may be carried out beyond the control plan, on the basis of information or materials obtained and analyses conducted.

4.5. Coordination of activities of the TC and internal auditors/other control staff

In accordance with the provisions of law all state and local government administration authorities and other state, regional and local government administration organisational units are obliged to cooperate with and provide gratuitous information and assistance to the TC authorities, inspectors and employees in order to enable execution of the tasks of the TC.

There is no formal obligation of coordination of tasks and engagements among the TC and internal auditors/comptrollers/inspectors with the following exception: in accordance with the provisions of Articles 293 and 294 of the Act on Public Finance the General Inspector of Treasury Control may:

- commission internal audit in organisations of central government and regional/local government when relating to EU budget funds;
- assess the internal audit procedure in organisations of central government and regional/local government when relating to EU budget funds.

The CHU, as well as other departments of the Ministry of Finance, may submit proposals to the draft TC control plan.

⁽⁵⁾ The TC must not perform control of the purposefulness and the manner of the use of the budgetary funds and state property for 'special purposes' in the units supervised by the Minister for National Defense; in the Internal Security Agency and the Intelligence Agency; in the Office of Government Protection; in the police, the frontier guard and the state fire brigades.

5. Ongoing/future reforms

5.1. Implementation of the new shape of the public internal control system

The Act of 27 August 2009 on Public Finance redefined the essential components of the PIC system. The reform aimed at strengthening the risk management and assessment of the managerial system in the branches of government administration. Currently the central government administration deals with the implementation of the reform.

At the end of 2010 the ministers in charge of the branches authorised and published their annual activity plans for the first time. The ministers are obliged to determine fundamental objectives to be achieved by the branch within a year. Appropriate indicators should also be specified to measure the level of achievement of set objectives. The annual activity plan is a fundamental reform in ministers' performance; such a firm designation of objectives had not previously existed. Until the end of April 2011 the first statements on the state of management control in the branches of government administration should be signed by the ministers and published on the website. The top managers in many ministries established formal systems and procedures that should provide the ministers with reasonable assurance on the state of management control in the branches. Such systems were coordinated by a team or person dedicated to that task and usually included, inter alia, a subsystem of risk management, self-assessment by the units, results and recommendations from audit and inspection engagements. Individual statements of this kind are also new to the Polish administration.

Newly established audit committees are expected to:

- deliver valuable information and advise on risk connected to the implementation of goals and tasks indicated by the ministers in their plans;
- strengthen the role of internal audit in assessment of the management control system in the branches of government administration.

The key challenge for the top managers in line ministries is still how to connect the cycle of risk management with programming and monitoring the tasks formulated in the performance budget (both from a yearly perspective and for the midterm framework of the Multi-Year Financial Plan of the State).

5.2. Public expenditure management: ongoing implementation of performance budgeting in the public administration

The crucial issue within the sphere of public expenditure management is ongoing implementation of a new budget system: the performance-based budgeting system (PBB) that will be working in parallel with the traditional system. From 2008 the justification of the draft budget acts has comprised a part with task-related expenses which are in accordance with Polish performance budget methodology prepared by the Ministry of Finance. Multiannual programmes (including some public investment programmes) and plans of executive agencies, earmarked funds and state legal entities are prepared in accordance with performance planning methodology as well. The new Multi-Year Financial Plan of the State was prepared in 2010 according to the new PBB structure and covers the functions of the state along with the objectives and related measures.

Many of the elements of the new budgeting system are still to be designed or developed. Such elements comprise: management of funds in the line ministries, development of the evaluation tool for the system and technical issues such as development of accounting and reporting systems, development of the supporting IT system and ongoing work on defining and improvement of objectives and indicators.

5.3. New governmental development strategies

The ministries are currently working on nine midterm government development strategies that are based on the long-term and midterm development strategy for the country (the first out of nine strategies — the National Regional Development Strategy 2010–20 — was accepted by the council of ministers and published in July 2010). The shape of the system of programming,



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implementation and assessment of development strategies was defined in the Act of 6 December 2006 on the Rules of Development Policymaking. The abovementioned strategies should cover the coherent set of goals and objectives for the government to be implemented by the public administration and mirrored in budgets and all programming documents.

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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

For almost a decade, from the late 1990s to the mid 2000s, Portugal experienced structural budget deficits and problems of unsustainable growth of primary current expenditure. To improve this situation, the government undertook comprehensive structural reforms of the public sector including a large public administration reform, reorganising and streamlining of government departments and agencies, restructuring the civil service to make it more flexible and responsive and pension reform to enhance the long-term sustainability of public finances. The process also includes the new Integrated System for Management and Performance Assessment of the Public Administration (Siadap) reform. This will reinforce efforts to improve performance, avoid overlaps or conflicts between reform efforts and reduce excessive paperwork for the line ministries.

Also, a Restructuring Programme for the State's Central Administration (PRACE) has involved the redesign of structures, roles and responsibilities to consolidate organisations and reduce the numbers of managers; accordingly, general directorates, public agencies and top and mid-level managers were reduced by around 25 %. In parallel with these important changes, the Portuguese budget system is undergoing significant reforms in order to further improve fiscal discipline and the efficiency and effectiveness of public spending, also through the recent amendment (Law No 23/2011 of 20 May) of the current Budgetary Framework Law (Law No 91/2001 of 20 August, revised by Organic Law No 2/2002 of 28 August, by Laws Nos 23/2003 of 2 July, 48/2004 of 24 August and 48/2010 of 19 October and recently by Law No 23/2011 of 20 May).

2. Public internal control environment

It is seeking to evolve from a traditional legalist and highly input-oriented system, which concentrates on controlling expenditure through very detailed oversight of budget execution, towards a more streamlined performance-oriented system. Over the past three years, a number of improvements to the budget process have already been introduced, notably in terms of the quality, availability and timeliness of the public accounts. There have been significant improvements in the coverage and timeliness of the budget execution data.

The existence of internal control procedures is also mandatory for all budget users according to Article 58 of the Budgetary Framework Law. Indeed, *ex ante* financial control was mainly focused on centralised administrative/desk review and based on the formal verification of a sequence of authorisations. With the budgetary reform, in Portugal there was an important transition from *ex ante* control to the internal control procedures, more focused on correct financial

⁽¹⁾ Contributed by the Ministry of Finance.

management control systems in the operational units (Article 58 of the Budgetary Framework Law, as mentioned above) and on the spending managers' responsibility.

The key objectives of the reform were to allow for much better monitoring of budget implementation and execution as well as the introduction of proper monitoring of the quality and usefulness of expenditure and an economical, efficient and effective use of resources. However, it is totally clear that the robustness and the reliability of the internal control systems require an effective management commitment, but at the same time, it is very important that the Ministry of Finance continue developing the appropriate tools to ensure a stronger emphasis on a more global oversight, monitoring and analytical review of the overall budget.

A pilot plan to implement accrual accounting across government was launched. The reform process is ongoing. Future changes are under consideration by both the government and the Committee for Programme Budgeting (COP) of the parliament, including an expenditure rule, a medium-term expenditure framework (MTEF) and the details of the performance budgeting framework. Given the effects of the international financial crisis, it is vital that the Portuguese budget process continue to reform, within the overall framework of the programme budgeting initiative.

To promote these changes and those envisaged by the programme budgeting initiative, the role of the Budget DG must shift from detailed control of execution to a more global oversight and analysis. The streamlining of financial management, the shift to programme budgeting and changes in the role of the Budget DG pave the way for delegating responsibilities to line ministries, who should take primary responsibility for programme management and budget execution. At the same time, it is important for ministries to have the necessary capacities and accountability structures in place. Each ministry has its own budget office, responsible for overall budget execution and financial oversight on programme budgeting within the ministry, to serve as the Budget DG counterpart in that line ministry.

Within the context of a medium-term expenditure framework, each line minister should be primarily responsible for any spending overruns within his/her own ministry. The adoption of a more performance-oriented approach to budgeting and management has been very important for Portugal. However, a multi-stage approach is under preparation for the comprehensive implementation of this reform:

- the first stage is the development of a programme budget and a medium-term expenditure framework;
- the second stage involves the development of meaningful performance information for programmes and ministries, and the design and implementation of the necessary information systems;
- the third stage is the gradual integration of performance information into budgetary decision-making processes.

It should be clear that this reform is a long-term process. Despite the fact that important steps have been taken, it is, however, essential that these reforms continue and are fully implemented in practice. This is especially important given the current unfavourable international economic climate.

3. The concept of public internal control in your administration

3.1. Managerial accountability

Taking into account the need to follow the budgetary reform and that the efficiency and effectiveness of the fiscal consolidation effort should go beyond the annual measures, the Portuguese government approved recently (new version of the Budgetary Framework Law of May 2011) the revision of the current fiscal framework, in line with international good practices, in order to guarantee a credible consolidation of public finances over the coming years. In particular, the council of ministers has approved a draft law, to be presented to parliament, which revises the Budgetary Framework Law establishing:

- a multiannual framework with expenditure and budget balance rules;
- an enlarged universe to which the law applies;

- the strengthening of the programme budgeting approach;
- an independent Council for Public Finances.

This draft law, recently approved by the parliament (April, 2011), is also fully aligned with the reinforced mechanisms of economic policy coordination in the European Union and the European semester of policy coordination. Within the new framework, the government will present to the parliament a multiannual budgetary plan — to be updated annually — which includes the definition of and commitment to expenditure ceilings for the years to follow.

The revised budgetary framework is extended to include all entities that are part of general government, based on national accounting rules applied by the National Statistics Office. In addition to their explicit inclusion in the yearly budget reports and multiannual plans, full compliance with intra-annual information requirements is applied to all entities, thus further reinforcing the control of budget execution.

The Council of Public Finances — which will be created as an independent body — will assess the consistency between macroeconomic and budgetary scenarios and objectives, as well as the consistency with the multiannual expenditure and budget balance rules. In addition, the government is about to approve the setting up of a new system to continuously monitor and control large investment projects. This will include PPP and concessions, paving the way for an approach that is geared to rolling out projects that are technically and financially sustainable.

Finally, the effort to increase transparency and discipline in management of state-owned enterprises (SOEs) will continue, with some measures already in place:

- net borrowing thresholds defined in the Stability Programme 2010–13 — 7 % in 2010, 6 % in 2011, 5 % in 2012 and 4 % in 2013;
- a wage cut, thus contributing to the 5 % reduction in wages in the public sector at large;
- a decrease of 15 % in operating costs;
- cutting back on transfers to the SOEs by consolidating measures geared to rationalisation and financial sustainability.

All these modifications will contribute to improving budget execution and government management. The move to a results-oriented programme budget requires, as said before, the delegation of budget responsibility to programme managers and/or ministries, together with a need to reduce the old detailed budgetary oversight and increase the flexibility of programme managers. Ministries, and in particular agencies, should have primary responsibility for programme management and for budget execution, which means that detailed and routine *ex ante* control procedures mainly focused on compliance and regularity, with no concerns about the quality of the expenditure (it could be legal and regular, but is it really needed and useful?), were no longer able to help managers face their new responsibilities.

Accordingly, a reform of internal control was developed in order to monitor and guarantee compliance with all relevant legislation and procedures and to protect and safeguard the value of public assets and liabilities, but also to ensure an economical, efficient and effective use of the available resources according to the principles of sound financial management, as well as to monitor and ensure the achievement of policy aims, priorities, targets and objectives. At the same time, internal control procedures are key aspects for the provision of adequate, complete and accurate information to the management (Article 58 of the Budgetary Framework Law).

The development in Portugal of a public internal audit system must, of course, be understood in line with all the abovementioned reforms. Accordingly, and in line with the overall improvements introduced in government management policy, the Portuguese government decided to develop an internal audit function as well.

Accountability for results: performance budgeting and management

However, it must be made clear that those initiatives to develop meaningful performance information take time. It is important to see this reform as the first step in a long-term process which involves learning by doing. It is also important to have an independent review or audit of performance information to ensure quality and credibility. This is especially the case for Portugal, since



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the Siadap proposes to link performance results to pay. While this linkage creates incentives to achieve targets, it would also generate incentives to manipulate information and might affect its integrity and reliability.

An independent role is also performed by the General Inspectorate of Finance (IGF), which reports directly to the Ministry of Finance; IGF audit and control responsibilities encompass all central and local public administration, including state-owned enterprises, municipal enterprises, foundations and even private companies when using or receiving public funds. In addition, the Court of Auditors also has a role in reviewing the annual state accounts.

3.2. Internal audit and coordination of public internal control

Traditionally, Portugal had a system of financial inspection based in the Ministry of Finance in a General Inspection of Finance Department. In line with the budgetary reform, the Portuguese government decided to reform its PIFC arrangements by adopting internal audit and revising the role of financial inspection. However, some internal audit units already existed in some public organisations before this reform started. Internal audit units now exist in all line ministries and throughout most of the public sector in Portugal, with the main exception being in smaller organisations.

There is a central harmonisation unit that is based in the IGF of the Ministry of Finance. Financial inspection remains but has been refocused to examine serious irregularities and investigations and for policy review. The IGF mandate includes different functions, like financial, system, performance/value for money and IT audits, programme and department performance evaluation, technical advice to the Ministry of Finance and methodological standard setting (in the framework of the CHU functions, related to the functioning of the Portuguese public internal audit system).

The IGF has also been the European Commission counterpart on audit and financial control issues since 1986 when Portugal became a Member State and, accordingly:

- IGF is the current audit authority (2007–13, with the closure audit work to be carried out until 2017) for the all the Structural and Cohesion Funds, as well as for the Fisheries Fund and for the recent Justice and Home Affairs Funds (IGF also carried out a similar role in the past programming periods, 1989–93, 1994–99 and 2000–06);
- for the Agriculture Funds, IGF has also been the certifying body of the paying agencies' annual accounts since the clearance of accounts procedure was approved in 1996.

The context for the reform of the traditional financial control and inspection system with the introduction of internal audit was the budget reform. The government undertook a reform of the public sector organisational arrangements to make the civil service more flexible and responsible and to enhance the long-term sustainability of the public finances. Included in these reforms was the development of internal audit. At the same time the government decided upon a reform to the Portuguese budget system. The aim was to improve fiscal discipline and the efficiency and effectiveness of public expenditure. The objective was to move from a system which concentrated on controlling expenditure through very detailed oversight of budget execution towards a more streamlined performance-oriented system. This reform process is still ongoing. The strategy behind the development of internal audit in Portugal was based on two main critical factors: first, the clear commitment, leadership and ownership by the Ministry of Finance and second, a step-by-step approach. The second factor meant that the next step would be taken only after having reasonable assurance that the previous steps were assimilated by the different stakeholders.

The whole process was managed by the Ministry of Finance, through the General Inspectorate of Finance, which has a leading and pivotal responsibility, as the law concerning the Internal Audit System (Law No 166/98, of 20 June) defines IGF as the strategic level body, with a specific coordination and networking responsibility. For the effective functioning of the system, an Internal Audit Coordination Council was created, chaired by the director of the Ministry of Finance internal audit unit. The members of the council are also the directors of other line ministries' internal audit units (second level) and the council consists of 15 members, which is the current equivalent to the number of ministries.

The objective of the first step was to establish what actions had been taken by the different ministries to introduce internal audit. Therefore, a horizontal assessment was undertaken to understand what the actual situation looked like in the different line ministries. This assessment was carried out by a task force, set up by the IGF of the Minister for Finance as the system strategic coordinator, which carried out interviews in all ministries; it also reviewed the reports of the few already existing internal audit units as well as the reports of the traditional inspections with the objectives of creating a better understanding of the real differences between inspection and internal audit techniques adopted by the different ministries and identifying areas where audit techniques were consistent with internal audit standards and were already in place.

After three months, and following this assessment, a report called *The White Book — Internal Audit in the Public Sector* was issued and all the ministries were grouped in three different areas:

- the white area (no internal audit unit at all);
- the grey area (low-capacity internal audit units, not well developed, but with at least some skilled people who could work with the CHU as counterparts to develop internal audit); and
- the green area (where the internal audit concept and function was known and already operating, even if with different levels of professionalism).

The White Book report was issued by the IGF as the CHU and presented to the Minister for Finance, who approved it after a discussion at the council of ministries. As a development of White Book recommendations, the IGF as the CHU then prepared a ‘roadmap’ with a proposal for the coherent development of a decentralised internal audit function throughout the public sector. Accompanying this was the development of a network function with the line ministries’ counterparts. These counterparts would function in each ministry as in-house drivers for the development of internal audit.

A special ‘coaching’ approach was also developed, to ensure that specific problems identified by the different ministries could be properly addressed. A task force was created in the IGF, which reported directly to the Minister for Finance (the information obtained from the assessment of internal audit reports and inspection reports — referred to earlier — was used to better target the roadmap, the CHU guidance and the specialist coaching arrangements).

The second step was devoted to monitoring the roadmap implementation, in order to ensure that specific support to each internal audit unit was designed in accordance with that unit’s own particular situation and needs, without losing the horizontal view needed to ensure that the overall internal audit system was developing in a coherent and consistent way. A lesson learned from this implementation experience was that overcoming the resistance is a very demanding task, and requires a very effective, professional and practical coordinating structure (CHU), able to intervene both quickly and pragmatically to solve or to help in solving a very specific and detailed range of problems.

Some problems affected more than one ministry and therefore required considerable effort on the part of the CHU to properly address them. This experience of the CHU demonstrated the high level of commitment required, and that implementation demanded a full-time commitment with the continuing direct support of the Minister for Finance. It also demonstrated that a very professional and pragmatic IGF coordination function (CHU) is also a key success factor. To achieve the objective, the CHU has to gain the professional respect of the other counterparts and all persons involved. At the same time as the roadmap was launched with the monitoring of its implementation, a programme of management training was introduced to both develop management awareness on the importance of the internal audit function and to explain the distinction between internal audit and inspection as tools to secure financial control and, more widely, the protection of national financial interests.

These two issues — management awareness of the role and benefits of internal audit and the difference between inspection and internal audit — are significant cross-cutting issues, and in retrospect it was vital that both issues were given such high importance from the very beginning of the reform programme. Indeed, the diffusion and dissemination of these aspects paved the way for the smooth development and understanding of the internal audit function and helped to remove remaining opposition and negative reactions.



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Finally, the third step was devoted to the strengthening of the functioning of the internal audit system as a real system. This meant strengthening individual internal audit organisations, their capabilities and the network itself (with the network meaning relationships between the different internal audit units and with the IGF as the CHU). Audit units were in place, with skilled staff, and the challenge was then for the CHU to ensure that the whole internal audit process became fully effective. To help it perform this task, four technical committees were created under the Coordination Council. These committees are:

- Planning and Monitoring Committee;
- Training Committee;
- Methodological Committee;
- Evaluation Committee.

4. Financial inspection

Despite the development of an internal audit function, IGF kept a financial inspection capability amongst its responsibilities, which also includes the evaluation of services, activities and programmes, as well as technical advice to the Ministry of Finance. Concerning the financial inspection branch, we also have undergone an important transition to modernise the function. Indeed, financial inspections were traditionally more transaction/operation oriented, and can now refocus on more risky areas, whilst internal audit should focus on the reliability and efficiency of internal control systems and value for money.

There is thus no risk of overlapping or duplication of functions, because inspections are mainly an investigative activity, whereas internal audit is a management advisory function; its activity programme should be discussed with the management, with the aim of improving the internal control systems. The change in the Portuguese inspection functions took account of the fact that inspection is now operating in an environment in which:

- the spending departments themselves should be taking more responsibility for ensuring the proper and efficient financial management and control of the programmes and projects which they manage; and
- the internal audit function is examining how the spending departments are operating in practice and also raising management awareness, based on their wide experience, on how to improve their systems and operations.

5. Ongoing and/or future reforms

However, the budgetary reform still requires some changes that can be summarised as follows.

- Streamline budget execution and financial control processes. Indeed, shifting to a results-oriented programme budget requires the delegation of budget responsibility to programme managers and/or ministries. Ministries, and particularly agencies, should have primary responsibility for programme management and for budget execution.
- Transfer primary responsibility for budget execution to spending units. The Budget DG should provide clear guidance to the agencies on budget execution requirements and deadlines for budget reports. Amongst this guidance, they are organising training for ministry/spending unit staff on delegated budget responsibilities. The Budget DG should also shift its focus from detailed monitoring of transactions to analysis of budget execution anomalies and reviews of programme financial performance.
- Strengthen accountability of line ministries. Ministries need to be held more accountable for how they fulfil their new delegated responsibilities. Before delegation occurs, it is important for ministries to have the necessary capacities and accountability structures in place. Each ministry has a budget and finance office that takes responsibility for budget execution and provides oversight on programme budgeting within the ministry. This office should be under the supervision of the financial controller who should report directly to the minister.



ROMANIA

ROMANIA

Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The organisation of public administration on the basis of principles underlying the present-day concept of a PIC system has a long tradition. The Romanian public finance school made an important contribution to the establishment of the modern state and produced great personalities who contributed to the drafting of legislation with a strong impact on the economy in general and on public finance in particular.

Starting from 1990, Romania's transition to a market economy and the country's efforts to join the European Union (EU) included concerted actions aimed at reforming public management and increasing its performance based on the values of private management through the introduction of private management working tools in the field of public administration.

In this context, PIC was approached from a pragmatic perspective; in the framework of the general good practice principles constituting the EU *acquis*, its meaning was associated not only with verification operations, but also with the managerial function. By implementing PIC, the management assumes responsibility for identifying any deviations of the achieved results from the planned objectives, for analysing the causes thereof and for taking the necessary preventive and corrective measures.

Prior to its accession to the EU, Romania integrated the EU *acquis* regarding Chapter 28 'Financial Control' in its entirety, harmonised national and EU legislation and developed the institutional infrastructure necessary for its implementation. The Ministry of Public Finance (MoPF) took on the task of integrating the reforms in the field of PIC.

In the domain of public administration, the MoPF implemented the components of public internal control, that is, internal audit, managerial control, managerial responsibility and accountability and management/internal control standards. The state surrendered a part of its control tasks, which were transferred to the management of public entities, and concentrated the forms of control exercised in public institutions by independent structures, shifting emphasis to management systems, internal audit and actions ensuring effective public services.

2. The public internal control environment

The reform of the internal control system means in fact the reform of the public management system. The existing systems that are relevant for the PIC environment include the following.

⁽¹⁾ Contributed by the Ministry of Public Finance on 22 March 2011.

2.1. The general consolidated budget

The budget is the document containing each year's set and approved revenue and expenses, or the expenses only, as applicable, in accordance with the financing system for public institutions.

Law No 500/2002 on public finance, supplemented by Law No 69/2010 on tax and budgetary responsibility, introduces in the budgetary construction the notion of a general consolidated budget, which represents the ensemble of budgets composing the budgetary system, aggregated and consolidated to form one whole.

The current coordinates of the budgetary construction are founded on:

- the consistency of the macroeconomic policies mix, which is to contain an adequate dosage for each component in order to maintain financial stability and to ensure the sustainable relaunch of economic activity;
- the main objective of the annual budgetary construction, aligned to the Fiscal Budgetary Strategy established for a medium time span, as set out by Law No 69/2010, which consists of the gradual reduction of the budgetary deficit so as to achieve by 2012 the level stipulated in the Maastricht Treaty;
- the continuation of fiscal consolidation, meaning that the general budget has to meet the two-year compulsory deficit targets set out in the Fiscal Budgetary Strategy.

As regards the budgetary programming mechanisms, Romania can be considered to have made significant progress through: the introduction of multiannual programming; the programme-based approach to the budget (momentarily, the budgets of the main authorising institutions are not fully covered by programmes); the possibility for the main authorising institutions to conclude legal agreements for multiannual actions, thus strengthening discipline in the allocation of budgetary resources; the possibility of using, next to internal resources, resources from non-reimbursable external financing; the establishment of the institutional, conceptual and procedural framework for the coordination, implementation and management of structural instruments and pre-accession funds; the strengthening of administrative capacity for the operational management of Romania's contribution to the composition of the own resources in the EU budget.

2.2. The accounting system

According to the regulations in force in the field of public finance — Law No 500/2002 — and in the field of accounting — Law No 82/1991 — public accounting includes: budgetary revenue and expenditure accounting, reflecting the settlement of revenue and the payment of expenditure in a financial year; state treasury accounting; general accounting, based on the principle of establishing rights and obligations and reflecting the evolution of the financial situation and of the assets, including the surplus or deficit of assets; and cost analysis accounting for approved programmes.

Moreover, public accounting provides information on the assets under the administration of public institutions, the execution of the revenue and expenditure budget, the result of the budgetary execution, the situation of assets and liabilities and the cost of approved programmes. Revenue and expenditure are registered in the accounting records of public institutions according to the rules of accrual accounting. Thus, the effects of transactions and other events are recognised when the said transactions and events take place as of fact, not when cash amounts or equivalents are cashed in or paid, and are consequently registered in the accounting records and reported in the financial statements of the corresponding periods.

The financial records of public institutions, which are drawn up in the form of double-entry accounting, provide information to the users not only on past transactions that involved collections and payments, but also on future payment obligations and on the resources corresponding to future proceeds. The accounting of revenue is performed based on types of revenue by nature and source, and the accounting of the revenue and expenses for the general budget is carried out according to the structure of the budgetary classification in force.

Under Law No 500/2002, based on the financial statements presented by the main authorising institutions, the accounts regarding the cash implementation of the state budget, the state social

insurance budget and the special funds budgets, drawn up by the authorities legally entrusted with this task, and following the analysis and verification thereof, the MoPF drafts the state budget general annual implementation account and the state social insurance budget implementation account, to which the special funds budget annual implementation accounts and the budgets of the main authorising institutions, including annexes thereto, are attached, which are then submitted to the government. Following the verification by the Court of Audit (CoA), the implementation accounts are approved by the parliament.

Under Law No 82/1991, the MoPF drafts the annual balance sheet of public institutions. The information in the financial statements of public institutions is used for drafting financial reports by the MoPF, the National Bank and the National Institute of Statistics; the reports are submitted to the Statistical Institute of the EU (Eurostat) according to the European system of national and regional accounts in the Community (ESA 95), and to the International Monetary Fund.



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2.3. External audit

External audit is carried out by the CoA, which audits the constitution, management and use of state and public sector financial resources. The audit function of the CoA is exercised by means of public external audit procedures set out in audit standards drafted in accordance with the generally accepted international audit standards.

Within its tasks established by law, the CoA carries out specific activities with regard to all public entities. The specific activities of the CoA consist of control and public external audit. Public external audit mainly includes financial audit and performance audit. Additionally, the CoA has the task of assessing the own financial control and the internal audit activities of the legal persons falling within its competence.

In order to fulfil the obligations in the field of external audit devolving upon Romania as an EU Member State, an audit authority was established and functions for non-refundable pre-accession and post-accession EU funds granted to Romania by the EU. The audit authority is the only national authority in charge of the public external audit of non-refundable funds granted to Romania by the EU, in accordance with international and national legislation.

The CoA drafts an annual public report that is submitted to the parliament and which includes: observations on the budget implementation accounts subject to its control; the conclusions drawn based on the controls ordered by the Chamber of Deputies or by the Senate or performed on autonomous companies, wholly or predominantly state-owned companies and other legal persons subject to the control of the CoA; the infringements found and the coercive measures taken; and other aspects considered relevant by the CoA. The CoA also drafts an annual report on the degree of implementation of the internal control system in the controlled public entities.

2.4. Fight against fraud and/or irregularities

The European Anti-Fraud Office (OLAF) cooperates with the national control points. In Romania, the control point is the Department for the Fight against Fraud (Departamentul pentru Lupta Antifrauda, DLAF), an entity without legal status which is subordinated to the prime minister. The Department for the Fight against Fraud ensures the protection of the financial interests of the EU in Romania, coordinates the anti-fraud activities at national level and has the following main tasks: carrying out the on-site control for projects financed from European funds; coordinating all the national institutions involved in anti-fraud activities; cooperating with OLAF.

3. The concept of public internal control in Romania

For the purpose of promoting good governance, PIFC was implemented in the public sector and includes:

- internal/managerial control system;
- internal audit; and
- centralised coordination and harmonisation of the two components above.

3.1. Managerial responsibility and accountability

The existing legal framework describes managerial responsibility as a process in which managers at all levels are responsible for the decisions made and actions taken in order to achieve the objectives of the public entity of which they are part. This involves the accountability of the managers for good financial governance and the legality of public funds and/or public asset management.

Managerial responsibility at the level of public entities includes the management of the entity or component thereof, within the boundaries of internal or external determinations, in order to achieve the established objectives efficiently, effectively and in accordance with the legal provisions; transparent communication in this regard; and accountability for the non-fulfilment of managerial obligations, according to their respective type of legal responsibility.

Responsibility is an essential obligation for all the managers in the public sector and is regulated, in all cases, by legislative acts such as laws, government decisions, authorities' rules and regulations, etc. In organising the management activity based on the concept of managerial responsibility, the managers take the following premises into account:

- the general manager/authorising officer is responsible for the optimum organisation and operation of the internal control system;
- the internal control system of the public entity shall be based on verifications and corrective measures, on the one hand, and on independent internal and external assessments, on the other hand;
- the general manager/authorising officer is responsible for achieving the objectives of the entity;
- the general manager/authorising officer may delegate authority/competence without being exempted from general accountability;
- managerial accountability may not be invoked in the absence of the corresponding authority/competence;
- responsibility requires transparency and accountability.

Managerial responsibility and accountability in the field of public management are regulated mainly as follows.

Fiscal budgetary responsibility, regulated by Law No 69/2010, includes as its main objectives: to ensure and maintain the fiscal budgetary discipline, transparency and sustainability of public finances, in the medium and long term; to establish a framework of principles and rules based on which the government ensures the implementation of fiscal budgetary policies leading to good financial management of the resources; to manage public funds effectively so as to serve the public interest in the long term.

The law mentioned above establishes the responsibilities in the field of the government, the MoPF and the main authorising officers.

Thus, the law introduces into government practice the accountability statement, signed by the prime minister and the MoPF, which certifies the correctness, completeness and legality of the information in the fiscal budgetary strategy, the targets or the limits for fiscal rules and the observance of the fiscal responsibility principles. The accountability statement is presented to the parliament together with the fiscal budgetary strategy and the legislative proposal for approving the limits specified in the fiscal budgetary strategy.

The cited law also introduces the conformity statement, signed by the prime minister and the MoPF, which confirms the conformity of the budgetary construction with the rules and targets established in the fiscal budgetary strategy. The statement is presented to the parliament together with the annual budget.

An important actor in the budgetary process is the Fiscal Council, an independent authority in charge of providing support to the government and parliament in the drafting and development of the fiscal budgetary policies and which answers to the parliament for the correctness and

accuracy of the analyses/studies/opinions and recommendations elaborated in accordance with its responsibilities.

Each year, the MoPF initiates a draft law on the approval of limits for the indicators specified in the fiscal budgetary framework, which accompanies the fiscal budgetary strategy for the following three years, setting ceilings such as:

- ceiling for the balance of the general consolidated budget, expressed as a percentage of the gross domestic product (GDP);
- ceiling for the personnel expenses in the general consolidated budget, expressed as a percentage of the GDP.

Such indicators are fundamental elements for the managerial control of public finances exercised by the government through the MoPF, under the responsibilities arising from the existing legal framework.

The categories of authorising officers (managers), their roles and responsibilities are defined by Law No 500/2002 on public finance. The law also stipulates that the main authorising officers may delegate their competence to their rightful delegates or to other persons authorised for such purposes.

The government has the duty to submit to the parliament an annual budget that observes the fiscal responsibility principles, fiscal rules, fiscal budgetary strategy and any other applicable legal provisions, together with a statement certifying such conformity, signed by the prime minister and the MoPF. The draft budget, which falls within the specific responsibilities of the MoPF, is elaborated based on the budgetary expense proposals of the main authorising officers, in accordance with the fiscal budgetary strategy and with the methodology for the elaboration of the annual draft budget.

In accordance with the current legal provisions, the top management assumes responsibility for the establishment of objectives at all levels and for the planning of the budget in accordance with the allocated budget.

The laws amending the state budget for the current year are based on modifications made to the state budget following changes in the evolution of macroeconomic indicators, the approval of legislation leading to the modification of budgetary revenues and/or expenses or as a result of the policies entered into by the government.

Any amendment to the state budget, the state social insurance budget and the special fund budgets takes into account the conclusions of the biannual report on the economic and budgetary situation, drawn up before the end of July by the MoPF, as well as the opinion of the Fiscal Council on that report. No more than two budget amendments may be approved in one budget year, and no such amendments may be promoted within the first six months of the year.

Under Government Ordinance No 119/1999 on internal control and financial preventive control, the MoPF is responsible for the elaboration and implementation of policy in the fields of internal/managerial control and financial administration. The MoPF offers methodological guidance, coordinates and supervises the implementation of internal/managerial control systems and the assurance of sound financial management in the use of public funds and in the management of public assets.

Internal/managerial control comprises the ensemble of control mechanisms exercised at the level of the public entity, including internal audit, established by the management in accordance with its objectives and the legal provisions in force, in order to ensure an economical, efficient and effective fund management; this also refers to the organisational structure, methods and procedures.

Internal/managerial control verifies the achievement of the following general objectives:

- the regular, effective, economical and efficient accomplishment, at a reasonable quality level, of the tasks of public institutions, as established in accordance with their mission;
- the protection of public funds against losses due to errors, misuse, abuse or fraud;
- compliance with laws, regulations and management decisions;



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- the development and maintenance of systems for the collection, storage, processing, updating and dissemination of financial and management data and information, as well as of public information systems and procedures by means of periodic reports.

Government Ordinance No 119/1999 regulated the internal/managerial control on the use of public funds and the efficient, effective and economical management of public assets and set out the responsibilities in this area of the public institution manager. Furthermore, it regulated the responsibility of the managers of specialised departments that initiate operation projects as regards the reality, regularity and legality of the operations whose supporting documents are certified by their signature. The persons entitled to perform the financial control are accountable, according to their respective responsibility, for the legality, regularity and compliance with the ceilings of the budgetary appropriations or accrual appropriations, as applicable, of the operations for which they granted the *ex ante* financial control approval. The financial control of operation projects having patrimonial implications at the level of public entities takes the form of own preventive financial control, which falls within the scope of managerial responsibility.

In half of the main authorising institutions, preventive financial control is also exercised by delegated comptrollers from the MoPF. Preventive financial control on behalf of the MoPF at the level of these main authorising institutions comprises a low volume of operation projects, which nevertheless imply a significant risk. The number and value of operation projects that are re-verified by comptrollers of the MoPF is decreasing from one year to the next.

The strategy for the development of PIFC in Romania for 2010–13 (hereinafter referred to as the ‘strategy’) sets out as a major objective the gradual integration of preventive financial control within the scope of managerial responsibility, to the extent that management control is capable of increasingly eliminating the risks in the administration of public funds.

In accordance with Government Ordinance No 119/1999, pursuant to a legislative initiative concluded at the end of 2010, the top management of each public entity has the responsibility to draft an annual report on the internal/managerial control system. The report is meant to increase the awareness of institutional managers at all levels as regards their responsibilities in the implementation of internal control standards.

A regulatory level subsequent to the abovementioned ordinance is represented by the Order of the MoPF No 946/2005 approving the Internal Control Code, comprising the internal control standards for public entities and for the development of managerial control systems. Moreover, the standards constitute a reference system for the assessment/reassessment of internal control systems and the identification of risk areas and necessary changes.

At the level of each public institution, a structure was established that is usually managed by the secretary-general and is in charge of drafting/updating the development programme of the managerial internal control system, which comprises the objectives of the public entity, the actions, responsibilities, deadlines and other components of such measures.

Another example of the application of the managerial responsibility principle at the level of public entities, in accordance with Order No 946/2005, is the development of formalised procedures, which include a distinct chapter on the respective responsibilities of the different management levels involved in the process.

Managerial responsibility is also regulated by Law No 82/1991. Under this law, the responsibility for the organisation and management of the accounting devolves upon the administrator, the authorising officer or any other person entrusted with the management of the respective entity. As a rule, the accounting is organised and managed within separate departments and run by the economic director, the accountant-general or any other person authorised for the position; accountability for any misapplication of the accounting regulations devolves upon such persons and their subordinates.

The annual financial statements are accompanied by a written statement of the persons responsible for the organisation and management of the accounting, in which they assume responsibility for the drafting of the annual financial statements and confirm that: the accounting policies applied for the drafting of the annual financial statements are in accordance with the applicable accounting regulations; the annual financial statements provide a clear overview of the financial

position and financial performance; the legal person carries out its activity in conditions of continuity.

The general regime for the legal relations between public officers and the state or the local public administration, generically referred to as work relations, is regulated by Law No 188/1999 on the status of public officers. Public positions are assigned general tasks and responsibilities common to all public authorities and institutions, as well as tasks and responsibilities that are specific to some public authorities and institutions.

In general, within public institutions, the top manager or the secretary-general in charge of elaborating the policies, in conjunction with the economic manager, represents the competence level to which the endorsement of the following works is assigned: the draft budget, the revenue and expenditure budget, the organisation of the *ex ante* control, budgetary programming and implementation, the modification of financial indicators, the financial statements, the payrolls, etc. Thus the top manager or the secretary-general elaborates the policies regarding the institution's budget, based on the supporting activities carried out by the economic manager.

The objectives, activities, tasks and main responsibilities of the management and personnel participating in the achievement of institutional objectives are established by the regulation on the organisation and operation of the institution and are set out in the job descriptions. Accountability, as regulated by Law No 115/1999, refers to the political accountability of the government as a whole and of each of its individual members.

The government is politically accountable only to the parliament, pursuant to the confidence vote it received upon investiture, and each member of the government may be held politically accountable, together with other members, for the activity and actions of the government.

Besides political accountability, the members of the government may be held accountable from a civil, contraventional, disciplinary or criminal point of view, according to the general legislation in the field, notwithstanding derogatory provisions.

Internal control, organised at the level of the public authority or institution, also includes the legality notice issued by the legal adviser for documents of a legal nature prior to their approval by the manager of the public institution, which is regulated by Law No 514/2003 on the organisation and practice of the profession of legal adviser.

3.2. Public internal audit

The public internal audit of public entities is defined by Law No 672/2002 on public internal audit, in accordance with the definition of the Internal Auditors Institute (IIA), as follows: 'Internal audit in public entities is a functionally independent and objective activity, which endorses and counsels the administration personnel for a good management of public revenue and expenses, improving the activities of the public entity; it helps the public entity to achieve its objectives through a systematic and methodical approach, which evaluates and improves the efficiency and effectiveness of the management system based on risk management, control and administration processes.'

Public internal audit in the public sector of Romania is organised as follows:

- Public Internal Audit Committee (PIAC);
- Central Unit for the Harmonisation of Public Internal Audit (CHU PIA);
- public internal audit structures within public entities.

Public internal audit structures/departments are established within each public entity and are directly subordinated to the manager or the collective management body. Their tasks, as set out by law, mainly include the assessment of risk management systems, control and good governance, as well as the follow-up on the transparency and conformity with the legality, regularity, efficiency and effectiveness rules.

For local public entities that are not subordinated to other public entities and have an annual budget of up to the equivalent of EUR 100 000, public internal audit is limited to the regularity audit, performed by the territorial internal audit branches of the MoPF.



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The draft legislation for the amendment of the public internal audit law, currently under parliamentary debate, stipulates that the CHU PIA should also carry out the internal audit function, based on a protocol, for central public entities having an annual budget of up to RON 5 000 000 and that, at a local level, it should coordinate and offer guidance to the public entities in implementing the cooperation system for ensuring the public internal audit function.

The independence of the internal audit structure is ensured by means of: distinct organisation of the internal audit department, under the direct subordination of the public entity top manager; non-involvement of the internal auditors in the control/inspection activities and in the audited activities; appointment/dismissal of the head of the internal audit structure by the top manager of the public entity, only with the approval of the CHU IA.

According to the legislative framework in force, the internal audit department shall not be involved in the operations/processes/systems that may be subject to auditing, that is, all the activities carried out within a public entity, including the activities of its subordinated entities.

According to the Order of the MoPF No 1.702/2005, besides assurance engagements, internal auditors may also perform advisory missions, at the request of the management.

3.2.1. The Internal Audit Charter

The CHU for PIA drafted general rules on exercising the public internal audit activity, based on the Standards of the Internal Auditors Institute (IIA), including the Internal Audit Charter. The Internal Audit Charter regulates the role and objectives of internal audit, the status of the internal audit department, the principles applicable to the internal audit department and to the internal auditors and the methodology and conduct rules governing the internal audit activity. Based on these documents, each public internal audit structure elaborates its specific rules for the performance of the internal audit, including its own internal audit charter.

3.2.2. Training and certification

According to the current legislative framework, internal auditors have the duty to continuously improve their professional knowledge; the head of the public internal audit department or the management of the public entity has the responsibility to provide the conditions necessary for such professional training; the period allocated for this purpose is 15 days per year.

In accordance with the draft legislation for the amendment of the public internal audit law, internal auditors have the obligation to obtain a national certification within five years from the entry into force of the law. The national system for the certification of internal auditors, administered by the CHU PIA, is based on the recognition of the competences, capabilities and values acquired by the auditors during their basic training and lifelong professional training, within the nationally acknowledged higher education institutions, in accordance with the 'Competence framework of public sector internal auditors', as approved by the PIAC.

3.2.3. Reporting and recommendations

The results of the internal audit missions, that is, the findings and recommendations presented by the internal auditors, are materialised in internal audit reports, which are submitted for endorsement to the top management of the public entity, accompanied by a summary of the main findings and recommendations.

The internal audit structures within public entities submit an annual report to the CHU PIA on the entire public internal audit activity performed and compile an activity report for such purposes. Based on the reports, the CHU PIA drafts the annual report on public internal audit activity, which is submitted to the government and the CoA. The report, together with the annual national report on internal control, is also submitted to the EC.

3.2.4. Types of audit

The internal audit activity, as regulated by law, comprises assurance engagements and advisory missions (counselling). Within assurance engagements, the following types of audit are performed: regularity (conformity) audit; system audit; performance audit.

Given the shift towards the consolidation of the implementation of the public internal audit function in public sector entities, the number of performance audit missions has now increased.

3.2.5. Follow-up on the implementation of audit recommendations

The internal audit reports, endorsed by the top management of the public entity, are submitted to the audited structures, which subsequently draft the 'Action plan for the implementation of recommendations and the implementation timetable'. Based on this document, the internal auditors schedule the follow-up on the implementation of the recommendations.

Where the management of the public entities does not assume a part or the whole of the internal audit recommendations, the current legislative framework stipulates that the public internal audit structure should inform the CHU PIA or the hierarchically superior body on the recommendations that were not assumed by the management of the audited public entity and on the consequences of their non-implementation.

Where, during internal audit missions, the internal auditors identify irregularities or possible damages, they report them immediately to the management of the public entity and to the authorised internal control structure, as they are not authorised to investigate them. Internal auditors follow up the manner in which the competent authorities investigate the irregularities, analyse the causes and results of such irregularities with a view to addressing them and propose measures for the implementation of internal control.

3.2.6. Separation of tasks between public internal audit and inspection

The distinct organisation and the functional independence of the public internal audit department, as set out by the legislation in force, allow for a clear separation of the internal audit tasks from any of the tasks exercised by the personnel of the public entity, including in relation to the implementation of the control/managerial system.

3.3. The relationship between public internal audit and external audit

One of the tasks of the CHU PIA, as set out by Law No 672/2002, is to cooperate with the CoA and with other authorities and public financial control bodies from Romania and abroad, including the European Commission. The CoA is in charge of the external evaluation of the public internal audit activity of the verified legal persons. The opportunities for cooperation and collaboration between public internal audit and external audit are valorised through a protocol concluded between the MoPF and the CoA. While safeguarding the independence and objectivity of the public internal audit and external audit, the protocol regulates the relations between the two institutions according to the complementarity principle with regard to increasing the efficiency of the audit activity, aligning the methodological framework, ensuring the professional training of the auditors and exchanging information.

3.4. Audit committees

In Romania, the PIAC operates, in accordance with Law No 672/2002, as a consultative body organised under the CHU PIA that carries out actions with a view to defining the strategy and improving the public internal audit activity in the public sector.

The main tasks of the PIAC are: to endorse the strategic development directions of public internal audit in the public sector; to endorse the draft legislation in the field of internal audit; to endorse the annual reports on public internal audit activity and submit them to the government; to issue an opinion on the reports of internal audit activity assessment missions, as well as on the reports of intersectoral audit missions that are significant at a national level; to assess the consequences of the non-implementation of the recommendations that were not assumed by the management of the public entities; to assess the cooperation agreements between public internal audit and external audit, as well as the common programmes for the professional training of auditors.

The new draft law provides for the establishment, at the level of those main authorising institutions within the public central administration that have an annual budget exceeding



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RON 2 000 000 000, of audit committees made up of three to seven members, with tasks similar to those of the PIAC within the MoPF.

The Law on public internal audit has been modified to allow for audit committees that focus on supporting the specific roles of the internal auditor. It is expected that in 2012 ACs will be operational.

In 2010 Romania started introducing the function of internal audit at the level of local administration (town halls in rural areas) on the basis of audit partnerships. The first form of partnership was among members of the Romanian Association of Communes (RAC). In practice this means that a number of town halls that are members of the RAC decide to cooperate by establishing an internal audit structure to serve them. At the moment of writing this contribution there are already 12 such partnerships operational. The new Law on public internal audit aims to cover also communes that are not members of the RAC.

3.5. Coordination of the public internal control system

The manager of the public entity has the task of ensuring the elaboration and development of internal/managerial control systems, as well as of ensuring an independent and functional internal audit. The coordination and harmonisation thereof is assigned to the MoPF, through its two specialised structures, namely the Central Unit for the Harmonisation of Financial Management and Control Systems (CHU FMC) and the CHU PIA.

By establishing the CHU FMC the MoPF enabled the assurance, methodological guidance, coordination and supervision of the implementation of internal/managerial control systems, by means of: defining a unitary strategy in the field of financial management and internal control; elaborating internal control standards; harmonising the implementation rules with financial implications through the incorporation of control procedures, in order to ensure a sound financial management of public funds and assets; coordinating the professional training system of the specialists involved in internal control; developing the system for reporting the results of the internal control activity.

The management of public entities takes the necessary measures for the elaboration and/or development of the internal/managerial control systems within the respective entities. Such measures mainly consist of: elaborating and/or updating the programme for the development of the entity's own internal/managerial control system; setting up the structure in charge of the monitoring, coordination and methodological guidance of the own internal/managerial control system; elaborating and/or updating formalised procedures for activities; following up on the implementation of the measures included in the development programme; performing analyses on the development of the internal/managerial control system and on the monitoring, coordination and methodological guidance actions carried out by the authorised structure.

The stage of the implementation and development of internal/managerial control systems, as well as the special situations identified during the monitoring, coordination and methodological guidance actions performed by the constituted structures, are reported in quarterly/annual statements, which are communicated to the hierarchically superior public entities. In the case of public institutions exercising the function of main authorising officer for the state budget, the state social insurance budget or any special fund budget, the reports are submitted to the CHU FMC.

As of 2011, the management of each public entity elaborates an annual report on the internal/managerial control system, which represents a statement of conformity of the public entity's internal/managerial control system with the internal/managerial control standards. The MoPF, via the CHU FMC, issues and submits to the government an annual national report on internal control, which reflects the progress in the implementation of the internal/managerial control system at the level of public institutions exercising the function of main authorising officer for the state budget, the state social insurance budget or any special fund budget, including their subordinated public institutions. The report, together with the annual report on the public internal audit activity, is also submitted to the European Commission.

For purposes of regulation, coordination and monitoring in the field of public internal audit in the public system, the CHU PIA was set up within the MoPF as a structure directly subordinated to the minister. The CHU PIA is responsible for the: elaboration, management and application

of a unitary strategy in the field of public internal audit and in the national monitoring thereof; development of the legislative framework in the field of public internal audit; development and implementation of uniform procedures and methodologies, based on international internal audit standards; development of the system for reporting the results of public internal audit activity; elaboration of the annual report on the public internal audit activity for the public sector; performance of audit missions of national interest; assessment of the compliance with the rules, instructions and Conduct Code for Internal Auditors by the public internal audit structures; coordination of the recruitment and professional training system in the field of public internal audit; endorsement of the appointment/dismissal of the heads of the public internal audit structures within public entities; cooperation with the CoA and other public institutions in Romania and from abroad. The PIAC operates under the CHU PIA, which carries out its activities within the MoPF. The functioning and main tasks of the PIAC are presented under Section 3.2.



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Assessment of the public internal control system

The assessment of the PIC activity performed within the public sector falls within the responsibilities of the CHU PIA. The assessment represents an objective source of information on the stage of implementation of public internal audit at national level and forms a basis for the improvement of public internal audit activities.

The verification of the compliance with audit rules and with the Conduct Code for Internal Auditors is carried out based on the General Guide for the Assessment of the Public Internal Audit Activity, issued by the CHU PIA. The assessments are performed by the CHU PIA according to a schedule, based on a five-year cycle, for the public entities within the central public administration and, respectively, by the territorial internal audit units of the MoPF, in accordance with the tasks delegated by the CHU PIA, for the entities within the local public administration. The results of the assessments, compiled at a national level, are made available in the annual report on the public internal audit activity.

The scope of public internal audit comprises all the activities carried out by public entities to achieve their objectives and includes the assessment of the internal control system. The internal public audit carries out an in-depth assessment of the internal control system in order to establish whether it functions in an economical, efficient and effective manner, highlights the significant shortcomings of the control mechanisms and proposes recommendations for improvement.

4. Financial inspection

In Romania there is no institution with legal status in charge of general inspection and responsible for the fight against fraud or irregularities by means of financial inspections. Nevertheless, inspection/control tasks are assigned to the following structures: the Control Body of the Prime Minister; National Agency for Fiscal Administration; general inspection is organised within the MoPF, at departmental level; National Authority for Regulating and Monitoring Public Procurement; Labour Inspection; Social Inspection; Competition Council; National Authority for Consumer Protection; National Office for Prevention and Control of Money Laundering; National Environment Guard; State Construction Inspectorate; National Sanitary-Veterinary and Food Safety Authority.

5. Ongoing and/or future reforms

In the immediate future, a series of amendments to the legislation governing PIC are envisaged as a result of continuing the process of the reform of state administration.

The reform of public administration aims at continuing the administrative decentralisation, especially in the fields of culture, education, youth, sport, health and agriculture. The purpose of decentralisation is to consolidate administrative and financial autonomy, in the context of improving the general legislative framework and aligning it to the rules of the Council of the EU and of the European Commission.

The reform of public expenditure management involves the development by the MoPF of an efficient management of financial resources, which would contribute to macroeconomic stability and the increase of general prosperity.

Short-term priorities: qualitative consolidation of public finance by improving efficiency, transparency and responsibility in the use of public resources; establishment of a compulsory fiscal and budgetary framework in the medium term; consolidation of the administrative capacity for the management of EU non-reimbursable financing; ensuring the necessary conditions for the achievement of sustainable economic growth and the maintenance of macroeconomic stability; improvement of revenue management by reforming the fiscal administration and reducing collection costs.

The strategy for the reform of PIC aims primarily at achieving the following main objectives: development of methodologies and procedures for PIC in the sense of aligning them to European standards and international good practices in the field; concerted action for organising and ensuring the efficient functioning of financial management and control structures; the gradual integration of preventive financial control in the scope of managerial accountability to the extent that managerial control ensures the elimination of risks in the administration of public funds; periodic performance of a rigorous assessment of the implementation of internal/managerial control standards in public entities; increasing the degree of implementation of internal audit within the assessment of the internal audit activity in central and local public entities; and improving the professional training of the personnel involved in financial management and control systems, including personnel with internal audit tasks.

Attachment: Legal basis

General legislative framework on public internal control

1. Law No 82/1991 on accounting, republished.
2. Law No 94/1992 on the organisation and functioning of the CoA, republished, as subsequently amended and supplemented.
3. Law No 115/1999 on ministerial responsibility, republished, as subsequently amended and supplemented.
4. Law No 672/2002 on public internal audit, as subsequently amended and supplemented.
5. Law No 500/2002 on public finance, as subsequently amended and supplemented.
6. Law No 69/2010 on tax and budgetary responsibility.
7. Government Ordinance No 119/1999 on internal control and preventive financial control, republished, as subsequently amended and supplemented.
8. Government Ordinance No 79/2003 on the control and recovery of EU funds, as well as of related misused co-financing funds, as subsequently amended and supplemented.
9. Government Decision No 235/2003 approving the rules for the nomination of members in the PIAC.
10. Order of the Minister for Public Finance No 38/2003 approving the general rules for exercising the public internal audit activity, as subsequently amended and supplemented.
11. Order of the Minister for Public Finance No 522/2003 approving the general methodological rules for exercising preventive financial control, as subsequently amended and supplemented.
12. Order of the Minister for Public Finance No 946/2005 approving the Internal Control Code, including the internal management/control standards for public entities and for developing managerial control systems, as subsequently amended and supplemented.
13. Order of the Minister for Public Finance No 1.702/2006 on the counselling activity of internal auditors.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

Based on socioeconomic changes since 1989, substantial changes have occurred in the national legislation connected to the control of public expenditure. The focus of public administration is directed into two areas, financial management and the area of the obligations arising from generally binding legal regulations or obligations imposed by these regulations. Act No 10/1996 Coll. on Control in Public Administration (hereinafter the 'Act on Control') focused especially on control in the public administration and monitoring the performance thereof as well as on complaints and petitions. However, it did not fully comply with all the requirements of the unified concept of the financial control in public administration. The Slovak legal system did not regulate a uniform system of financial control, coordination, establishment of internal audit at the level of central authorities, methodical guidance of internal audit, cooperation or training of the employees performing financial control and internal audit.

Prior to 2001 the control system was aimed mainly at the performance of *ex post* financial control, and did not cover preventive actions. There was no clearly stated responsibility for *ex ante* controls. For these reasons, new draft legislation introduced the principles of *ex ante* financial control, interim financial control, *ex post* financial control and a completely new element in the system was the introduction of internal audit at the central administration level.

In accordance with the public interest pushing for enhancing the economy, efficiency and effectiveness of the public administration and with a view to the need for preparing Slovakia for accession to the European Union it was necessary to create legal conditions for designing a system of financial control that could ensure adequate and effective monitoring of management of the state budget funds, state property and the future EU and other international funds. For this reason international standards and good European practice were to be introduced. In 2000 the government adopted a policy on internal financial control (Resolution 852/2000) as a basis for these measures.

On 7 January 2001 Act No 502/2001 Coll. on financial control and internal audit came into force, defining a system of financial control in the government environment, i.e. a system of PIFC. One of the important objectives of the act is the definition of measures for increasing the accountability of management of public funds and state property. At the same time the legal basis for liaising with the control authorities of the European Commission was introduced, enabling on-the-spot controls for EU funds to be performed.

On 2 April 2008, the national council approved an important amendment to Act No 502/2001 Coll. on financial control and internal audit and amendments to certain other acts (hereinafter

⁽¹⁾ Contributed by the Ministry of Finance of Slovakia on 15 May 2011.

the 'amendment'). The amendment came into force on 1 June 2008. The amendment gives competence to the Ministry of Finance (hereinafter the 'MoF') for the programming period 2007 to 2013, for amongst other things performing the functions of the audit authority and certifying authority for operational programmes co-financed with EU funds. The amendment also refers to the establishment of the Central Harmonisation Unit for Financial Control, Internal Audit and Government Audit, based on the position of the MoF as the central authority for the activities stated in Section 7 paragraph 1 of Act No 575/2001 on the Organisation of the Activities of the Government and Organisation of the Central Public Administration. These activities include assessing the quality of implementation of financial controls, internal audit and government audit. Act No 575/2001 also introduces the possibility to establish 'audit committees' as an expert body to advise the head of a central authority. Also, new definitions have been introduced (e.g. effectiveness, risk, audited entity, audited person, audit body, central authority, government audit, audit body) and previously used terminology updated (e.g. public funds, controlled entity, financial transaction, other funds from abroad provided on the basis of international treaties binding on Slovakia) based on experience.

Other important modifications are the updating and extending of the responsibility of the head of public administration for the process of public financial management. The process of *ex ante* financial control has been modified. Given the fact that the controlled entity suggested measures to overcome deficiencies as identified by *ex post* financial control and to eliminate the causes often only formally, the rights of the control body were extended to require redesign of measures for the removal of deficiencies.

The principal change introduced by the amendment is the establishment of a new institute for 'government audit', which is aimed at verifying the legality, economy, efficiency, effectiveness and expediency of the management of public funds and at verifying the efficiency of management systems and control of public authorities that administer chapters of the state budget in order to strengthen the competencies of the MoF. The introduction of government audit does not change the penalty system compared to *ex post* financial control. Provisions for internal audit are also specified. Rules for fines on controlled entities in the case of non-fulfilment of obligations under the amendment were modified and the maximum fine limit increased from EUR 3 319.32 to EUR 33 913.92. The period for imposition of fines for failure to comply with the provisions of the act was extended from three to five years from the date of the violation of the obligations by the controlled entity. The amendment also affected some specific acts, which are also revised for the new Institute of Government Audit. It is not possible in this short summary to list all the changes and their impact on the controlled entities, audited entities and audited persons, as well as on control bodies, internal auditors and government auditors and others.

2. Public internal control environment

The objective of PIC is to create an environment that provides reasonable assurance that public funds are used to achieve the set objectives as effectively as possible. This environment should also be an effective tool to prevent corruption and fraud. The external control and supervision of PIC is performed by the national council and the Supreme Audit Office (SAO). The government is accountable to the national council for the management, implementation and monitoring of its policies and requires that the systems are in place for budgeting and accounting procedures, internal control measures and inspection services to combat fraud and corruption.

The system of PIC also has a preventive nature, its main objective being to ensure that systems are implemented to prevent irregularities, corruption and fraud. This area is also covered by the legal framework of Act No 300/2005 Coll. on the Criminal Code, for example in Title 4 — Property offences, where fraud is defined in Section 221, and Title 8 — Crimes against order in public cases, where the third part speaks of corruption.

In the case of suspected unauthorised use of funds discovered under the Act on Financial Control, the financial controllers, the internal auditors or government auditors must report to the law enforcement agencies any suspicion of criminal offence in the treatment and management of public funds, property and property rights.

In a broader sense, the term ‘public internal control environment’ is understood as the environment concerning the adaptation of the legal process and lawmaking in the PIC system to address problems identified. Even in PIC, lawmaking is a logical step to fill the gaps identified in the present national PIC system as compared to international standards and best practices.

For an overview of the most important legal acts relating to the system of PIC see the box at the end of this contribution.

3. Concept of public internal control

3.1. Managerial responsibilities

The term ‘public internal financial control system’ is defined in the Act on Financial Control as the system comprising financial management, internal audit, government audit and activities of the MoF while accomplishing the tasks of the Central Harmonisation Unit for Financial Control, Internal Audit and Government Audit.

According to the Act on Financial Control, financial management represents a set of procedures applied by the public authority in accountable and transparent planning, budgeting, use, accounting, reporting and financial control of public funds with the aim of their economical, effective and efficient use.

The head of the public authority under Section 8 of the Act on Financial Control shall be responsible for ensuring:

- creation, continuation and development of financial management;
- elimination of interventions aimed at influencing the employees performing financial control;
- mutual incompatibility and separation of decision-making powers of managers from powers of employees responsible for the performance of the financial transaction and from powers of employees responsible for accounting;
- appropriate qualification and professional competence of employees specified above for the performance of their activities;
- *ex post* financial control verification of selected financial transactions as needed by the public authority;
- adoption of measures correcting the identified deficiencies and eliminating their underlying causes;
- identification of employees responsible for identified deficiencies and measures taken with respect to them according to specific legislation;
- risk management to prevent violations of specific legislation and international treaties binding Slovakia for funds received from abroad while implementing the plans and goals of the public authority;
- monitoring activities performed by the public authority with a view to obtaining information on them, to assessing the standard of their performance, to reporting deficiencies identified in activities performed by the public authority and their elimination.

In pursuing Act No 575/2001 Coll. on Organisation of the Activities of the Government and Organisation of the Central Public Administration, the head of the public authority is the politically designated minister. The minister can authorise, based on an organisation order, the state secretary or the head of the office with the rights and duties set forth above.

While preparing and executing transactions, managers at all levels are responsible for activities carried out, not only in terms of ensuring competence, but also for financial management and control.

Draft financial transactions are verified by an *ex ante* financial control that can be divided into two stages. The first stage puts the emphasis on the verification of the draft financial operation



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before entering into an obligation (risk reduction of risk of loss) while focusing on economy, efficiency, effectiveness and expediency in terms of compliance with the approved budget, with contracts concluded with public authority or with other decisions on management of public funds (internal regulatory acts, government decrees) and whether it is in accordance with generally binding legal regulations (budgetary rules, the management of state property, public procurement, etc.). The second stage is the verification before expenditure.

In accordance with the provision of Section 9 paragraph 2 of the Act on Financial Control, *ex ante* financial control shall be performed by the manager commissioned by the head of the public authority and employees responsible for budget, public procurement, property administration and other specialised activities depending on the nature of the financial transaction.

In the case of financial transactions that have not been verified by *ex ante* financial control and/or in the case of proven deficiency in an *ex ante* financial control, the financial operations cannot be performed or continued until the deficiency has been corrected.

3.2. Internal audit

The basic legal framework for regulation of the internal audit is the Act on Financial Control setting down basic rules, objectives and ways of performing internal audit. General provisions of the Act on Financial Control oblige the heads of central authorities to introduce internal audit to be performed by their own employees (hereinafter 'internal auditors') or by independent internal organisational units made up by internal auditors (hereinafter 'internal audit units'), except where this would not be economical, effective or efficient taking into account the size of the central authority's staff, public fund's budget or organisational structure. These internal auditors or internal audit units are separate from management structures both in terms of their function and organisation. Exceptions from the obligation to establish internal audit in central authorities by their own employees shall be granted by the MoF.

The internal audit units or independent internal auditors of public authorities administering a chapter of the state budget are established pursuant to the provisions of Act on Financial Control, which forms the legal basis for the definition of internal audit.

Independence and institutional status of an independent internal auditor/internal audit unit

Regarding the independence of the internal auditor, the system is set so that the head of the audited entity (pursuant to Section 28 paragraph 4 of Act on Financial Control) must ensure that no interference that could have an adverse impact on the performance of internal audits by internal auditors is in place. Internal auditors or internal audit units may not be assigned to any duties that go beyond the scope of internal audits or that interfere with independent execution of internal audit tasks.

The internal auditor/internal audit unit:

- must have an independent position and reports directly to the head of central authority;
- is independent from the activities audited, thereby ensuring their objective assessment, which is essential for the proper performance of internal audit and impartial advice to the audited entity; and
- must have no internal, external and personal interests, and should be free from any political interference.

For these reasons, the internal auditor should not perform activities that he would later audit.

Internal audit charter

Under the Act on Financial Control, the head of an internal audit unit or an internal auditor shall prepare and submit for approval to the head of the central authority the internal audit charter of the central authority in accordance with the Code of Ethics of Internal Audit, which will define the objectives, activities and position of internal audit in central authority and its relations with other departments and organisations within the scope of central authority.

Training of the internal auditors

Training of the internal auditors is provided especially by the MoF, which organises, arranges and allows systematic specialised training of internal auditors. Special training provided by other organisations results from the character of audit tasks performed by internal audit in the special sector of public organisation. Any internal audit unit prepares a training plan to cover all necessities of this unit or its auditors on a yearly basis.

Specialised training is related to the deepening of skills in activities that the auditor performs and is carried out by means of full-time education, distance learning, self-study, electronic communication devices, specialised visits, participation in conferences, participation in workshops, attending courses and other forums.

Audit reporting

The member of the audit team shall prepare a partial report on the findings of the audit operation (hereinafter the 'partial audit report'); the report shall subsequently become an inseparable part of the report on the findings of the audit operation (hereinafter the 'audit report') in the following cases:

- if there is an urgent need to warn of an impending risk that could have an adverse impact on the activities of the audited entity;
- if there are any findings giving rise to a suspicion of criminal activity; and
- if the internal audit is performed in several audited entities within a single audit operation.

The member of the audit team shall submit a partial audit report to the head of the audited entity and to the head of the relevant central authority and, if there is a suspicion of a criminal offence, the report shall also be sent to law enforcement bodies; if there is a suspicion of the misuse of EU funds the partial report shall also be sent to the legal person through the intermediary of which EU funds are provided, and to the Central Contact Point of the European Anti-Fraud Office in Slovakia.

The internal auditor shall submit his audit report to the head of the audited entity and to the head of the relevant central authorities who are responsible for ensuring that the internal auditor's recommendations are taken into account in the correction of identified deficiencies. The internal auditor must verify whether the audited entity has taken his/her recommendations into account. Where the audit operation reveals any facts that need to be addressed by competent authorities pursuant to specific legislation, the internal auditor shall also submit the audit report to the competent authorities pursuant to specific legislation. Where appropriate, the head of the central authority shall submit the audit report also to the MoF.

The deficiencies identified in the internal audit are continuously documented during the audit operation. Findings of the audit are used as a basis for drafting reports on the findings of the audit operation (hereinafter the 'draft audit report'). The audit team leader is responsible for the preparation of the draft audit report, which is submitted for approval to the manager. Audit team members submit their documents in the draft audit report to the audit team leader within the time period determined. When the draft audit report is prepared and approved by the head of internal audit, it is recommended to submit it to the head of the audited entity for them to express their opinion. After sending the opinion, the audit team leader agrees with the head of the audited entity a date to discuss the draft audit report and during the discussion of the audit report all audit team members and the responsible employees of the audited entity are present. After discussing the draft audit report, the report is finalised and the audit report is approved by the manager. In joint negotiation, the audit team leader shall inform the head of the public authority about the results of the internal audit (main findings and recommendations).

Types of internal audit

Depending on the nature of the internal audit and on the type of activity to be assessed, the internal auditor may apply mainly the procedures of financial audit, audit of compliance, audit of performance, system audit and audit of information systems, follow-up audit and the combination of individual audits.



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Assigning of obligations arising from the Act on Financial Control to internal audit and financial control

According to Section 28 paragraph 5 of the Act on Financial Control, internal audit units or internal auditors may not be assigned any duties that go beyond the scope of internal audits or that interfere with the independent execution of internal audit tasks. It follows that an internal audit unit shall not be allowed to perform activities, including auditing the activity defined mainly in Part 2 of the Act on Financial Control, that interfere with the stated provision of Section 28 paragraph 5 of the Act on Financial Control or interfere with the independent assessment of the control system of the organisation by the internal auditor.

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3.2.1. Relationship between internal audit and external audit

According to National Council Act No 39/1993 Coll. on the Supreme Audit Office (SAO), as amended, the SAO shall adapt and apply international standards of control for the purposes of necessary quality control activities and competence. The SAO control relates to the government, ministries and other central authorities and subordinate authorities and final beneficiaries of public funds as well.

The SAO is the state authority that is independent in its control activities, regulated by its own law. The SAO audits the management of the following.

- Budgetary funds approved according to the law by the national council or by the government.
- Property, property rights, funds, obligations and receivables of state, public service institutions, the National Property Fund, municipalities and higher regional units, legal entities with capital participation of the state, legal entities with capital participation of public service institutions, legal entities with capital participation of the National Property Fund, legal entities with capital participation of municipalities, legal entities with capital participation of higher regional units and legal entities established by municipalities and higher regional units.
- Property, property rights, funds and receivables provided to the republic, legal entities or natural persons under development programmes or from other similar reasons from abroad.
- Property, property rights, funds, receivables and obligations for which the republic has taken over a guarantee.
- Property, property rights, funds, receivables and obligations of legal entities performing activities in the public interest.

The SAO also audits the following.

- The methods of levying and enforcement of taxes, custom duties, payment of contributions, fees and fines, which are income of the state budget and the budgets of municipalities and higher regional units.
- The enforcement and exercise of rights and respect of obligations arising from financial and economic relationships, resulting from the management of the funds. For the purposes of the SAO Act the EU and other funds received for the financing of projects according to international treaties are considered as funds of the state budget. The SAO as an independent public authority draws up an opinion on the proposal of the state budget, which assesses the public administration budget proposal and opinion on the draft state closing account. An opinion on the proposal of the state budget is submitted by the SAO to the national council. Based on the resolution of the national council, the SAO shall perform its control in accordance with its competence and shall submit a report on the results of control activities for the previous calendar year to the national council by the end of March. A report on the results of control activities is submitted at any time, when the national council so requests.

3.2.2. Office of the government (OG)

Based on the Act on Control, the OG as a central state authority carries out the control of tasks in the state administration and the performance thereof. The OG controls the management of public funds and takes action based on incoming petitions, notices and submissions. The OG

also controls the professional, organisational and technical requirements of the activities of the government and the government's consultative bodies.

3.2.3. Audit committee

The MoF, in the scope of performing tasks of the central harmonisation unit, coordinates the establishment and activities of committees for control and audit (AC). Relating to the establishment of the AC, the MoF issues the templates for the charter and its procedures.

The possibility of establishment of the AC is set by Act No 165/2008 Coll., which amended the Act on Financial Control. The AC is established pursuant to Section 3 of the Act on Financial Control.

At the moment one AC is established as an independent expert advisory body to the MoF. Other ministries are in the process of considering establishing ACs.

The charter of the AC defines its tasks, competences, composition of the members and rules of procedure. The main tasks of the committee are:

- assessing the standard of performance of financial control, internal audit and government audit and risk management with a view to their development, in an independent manner;
- monitoring the efficacy and efficiency of financial control, internal audit and government audit with a view to the quality of their performance; and
- providing advice and consultations to heads of central authorities and to managers.

3.3. Coordination of public internal control

The MoF coordinates the planning of financial control, internal audit and government audit and other control authorities with the SAO and OG in order to avoid duplication of controls as much as possible and to put less control and audit stress on controlled/audited bodies. The purpose of coordination is to lay the groundwork for the effective performance of internal controls, ensuring the harmonising of the internal audit plans between the supervisor and coordination participants and ensuring smooth performance of the controls. The objective of coordination is to avoid duplication or overlapping of controls in the same controlled entity and to optimise the use of the human resources of the coordination supervisor and participants with regard to the position of the ministries and other central public authorities.

The coordination is performed through:

- coordination meetings convened by the coordination supervisor;
- working meetings organised from time to time as required by the coordination supervisor;
- participants; and
- mutually agreed joint controls.

The MoF also publishes methodological guidance. In the area of control activities, the MoF established the Working Group on Cooperation in the Coordination of Control Activities (WG). The WG was established on 8 November 2007 at the meeting of the Steering Committee for the Protection of EU Financial Interests. The WG is an initiative-taking, executive and advisory/recommendatory body of the Management Committee set up for the coordination of controls and audits of all network partners^(?). Coordination of the control activities of network partners relates to the preparation of control and audit plans of the network partners covering international financial funds based on the document 'Principles of Coordination of Network Partner Controls and Audits of the network partners, version 2.0'. The head of the WG is a Section of the Audit and Control of the MoF.

(?) 'Network partners' means the structure of cooperating bodies whose main purpose is mutual cooperation in accomplishing tasks to protect EU financial interests.



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4. Financial inspection

Other than financial control, internal audit and government audit there are no other government or financial inspection services in Slovakia. This chapter includes as well a specific type of 'government audit' inspection introduced by the Amendment to the Act on Financial Control in 2008.

Financial control ensures economy, efficiency and effectiveness in the use of state funds, compliance with relevant legislation in the management of public funds and timely and reliable information to the head of public authority on the management of public funds. Financial control shall be performed as *ex ante* financial control, interim financial control and *ex post* financial control.

Ex ante financial control covers financial operations in planning, budgeting, public procurement, concluding of contracts or other acts of property ownership. It verifies draft or planned financial expenditure in two stages. The first stage focuses on the verification of the draft financial decision prior to becoming final. The second stage focuses on fulfilment of the conditions for the expenditure.

Interim financial control is carried out at the stage of preparation and performance of selected financial operations. This control verifies the completeness and conclusiveness of supporting documents relating to controlled financial transactions. The head of the organisational unit whose activity is related to the financial transaction and which is functionally and organisationally independent from the organisational unit responsible for the preparation and performance of the transaction and for the performance of *ex ante* financial control shall select the financial transaction upon a written instruction from the head of public authority. Interim financial control shall be performed by an employee of the organisational unit, who is appointed by the manager of this unit. The organisational unit responsible for preparing and performing the selected planned financial transaction and for the performance of *ex ante* control shall provide necessary cooperation in the performance of interim financial control.

Ex post financial control is performed by the public authority within its remit as the provider of EU funds. Control bodies and controlled entities shall follow the basic rules of *ex post* financial control defined by Sections 13 to 25 of the Act on Financial Control, if not otherwise stated. The basic provision is the same as interim financial control — it shall be performed by a unit functionally and organisationally independent from the organisational unit responsible for the preparation and performance of the transaction to be controlled.

Government audits carried out under this act and under specific legislation shall do as follows.

- Verify and assess:
 - compliance with specific legislation, concluded contracts, international treaties binding on Slovakia based on which Slovakia receives funds from abroad, decisions issued under specific legislation and internal regulatory acts in financial management and in other activities of audited persons;
 - cost effectiveness, efficacy and expediency in the management of public funds and use of human resources with a view to the fulfilment of the tasks of the audited person;
 - compliance with the requirements for the provision of public funds and requirements for their use;
 - efficacy and efficiency of financial management of the audited person;
 - security and functionality of information systems of the audited person and adequacy and completeness of data in the information system of the audited person considering the nature and scope of its activities;
 - implementation of measures taken to correct the deficiencies identified by government audits and to eliminate their underlying causes, and implementation of recommendations from partial reports on government audits (hereinafter 'partial reports') and from government audit reports;

- availability, accuracy and completeness of information on financial operations and financial management of audited persons;
- other facts as provided for under specific legislation.
- Identify and evaluate possible risks related to financial management and other activities of audited persons.
- Recommend improvements in financial management of audited persons and minimisation of risks.
- Perform other activities as provided for under specific legislation.

Government audit is carried out by a special institute for the MoF and its cooperative bodies to execute 'external' audit over other public bodies. It was introduced to cover especially all competences of audit authority for the 2007–13 programming period.



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5. Ongoing and future reforms

The MoF is planning to develop a new version of the Act on Financial Control that intends to harmonise the entire set of procedures to perform *ex post* financial control, internal audit, government audit and performance of control under the Act on Control in order to simplify the public control system. For this to happen there is a need for political consensus. If successful there will be a more uniform procedural approach for performing any type of control and audit.

Attachment: Major PIC-related legislation

1. Basic legislation:

- Act of the National Council of Slovakia No 502/2001 Coll. on Financial Control and Internal Audit and on the amendment to certain other acts as amended;
- Act No 10/1996 Coll. on Control in State Administration and on the amendment to certain other acts as amended;
- Act No 523/2004 Coll. on Budgetary Rules in Public Administration and on the amendment to certain other acts as amended, Act No 10/1996 Coll. on Control in State Administration and on the amendment to certain other acts as amended, Act No 440/2000 Coll. on Administrations of Financial Control and on the amendment to certain other acts as amended;
- Act No 575/2001 Coll. on the Organisation of Government Activities and of Central State Administration on the amendment to certain other acts as amended;
- Act No 498/2010 on the State Budget;
- Act No 431/2002 Coll. on Accounting as amended;
- Act No 291/2002 Coll. on the State Treasury and on the amendment to certain other acts as amended;
- Act No 583/2004 Coll. on Budgetary Rules in Territorial Self-Government and on the amendment to certain other acts as amended;
- Act No 39/1993 Coll. on the Supreme Audit Office of Slovakia, as amended;
- Decree of the Ministry of Finance of Slovakia No 21/2009 Z. z. of 21 January 2009 amending certain provisions of Act No 502/2001 Z. z. on Financial Control and Internal Audit and on the amendment to certain other acts as amended.

2. National PIC standards:

- Internal Audit Manual;
- Compliance Audit Manual;
- IS Internal Audit Manual;
- Performance Audit Manual;
- Financial Audit Manual;
- System Audit Manual;
- Internal audit charter;
- Code of Ethics of Internal Auditors;
- Procedures for the Government Audit of the Structural Funds, the Cohesion Fund and the European Fisheries Fund for the programme period of 2007–13 approved by the Government of Slovakia Resolution No 511/2008;
- Methodical guidance to Procedures for the Government Audit of the Structural Funds, the Cohesion Fund and the European Fisheries Fund for the programme period of 2007–13;
- Procedures for Government Audit of National Funds of Slovakia.



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Public internal control (1)

1. Brief history of the public internal control (PIC) system

The development of the system of internal control of public finance began in 1993, when an internal organisational unit, the Budget Inspectorate, was set up within the Ministry of Finance, pursuant to the Budget Implementation Act, to enable the Ministry of Finance to exercise control of the financial, material and accounting operations of spending units. The ministry would inform the government of the controls it performed; the government would in turn inform the national assembly. The controls related exclusively to state budgetary resources.

The first systemic Public Finance Act was adopted in 1999. This act represented the beginning of the introduction of internal auditing of spending units, including provisions relating to financial controls in the form of a system of internal controls and audits, where an internal audit was presented as an '*ex post* accounting and financial audit of efficiency, cost-effectiveness and performance'. Spending units that used state budgetary resources were obliged to set up financial services charged with preparing and implementing the budget and with performing other tasks connected with managing those state assets for which the spending units were responsible, and internal audit services under the Minister for Finance's instructions on the common bases for the procedures of work of financial services and internal audit services for the implementation of *ex post* accounting and financial audits and audits of efficiency, cost-effectiveness and performance.

This legal framework emphasised the responsibility of the head of a spending unit for the legitimacy, purpose, efficiency and economical use of budgetary resources. It also determined the division of competencies between the authorising and accounting officers, introduced a system of internal control, determined the responsibility of an accounting officer to withhold payment if it would be in contravention of the law and set out the role of internal auditing and of reporting on improvement measures to the newly established Budget Supervision Office (BSO). This office succeeded the Budget Inspectorate and was charged with scrutinising the use of budgetary resources, implementing *ex post* accounting and financial audits and audits of the efficiency, cost-effectiveness and performance of projects performed jointly by various spending units and drawing up guidelines for the implementation of internal audits at spending units.

In 2002, in order to bring the definitions of the function of internal auditing and internal controls into line with the development of internationally recognised standards and best practice, the government adopted a document entitled 'Policy of the Establishment and Development of the System of Internal Control of Public Finance in the Republic of Slovenia'. In line with the policy's 'action plan', the government established a comprehensive legal framework for a modern system of internal control of public finance which is, without major additions being required,

(1) Contribution of the Ministry of Finance on 4 April 2011.

still in force and consists of the Public Finance Act (2002), the Rules Laying Down Policies for the Coordinated Function of the System of Internal Control of Public Finance (2002), the Rules on the Issuing of Certificates for the Title of State Internal Auditor and Certified State Internal Auditor (2002), the Guidelines for State Internal Auditing (2003) and the Guidelines for Internal Controls (2004).

The legal framework provides that the head of a spending unit shall establish adequate and efficient internal control that must include internal auditing. The BSO is the entity responsible for coordinating and developing the system of internal control of public finance.

A mandatory professional title for those performing internal auditing tasks was introduced: state internal auditor or certified state internal auditor. The training programme, its implementation and the issuing of certificates for the title are the responsibility of the Ministry of Finance. The special position of state internal auditor is laid down in law, which guarantees functional independence. The organisation and operation of internal auditing of spending units are defined precisely in the Guidelines for State Internal Auditing, which include a code of professional ethics, internal auditing standards and recommended practice as adjusted to the respective environments of spending units.

To accelerate the introduction of internal control of public finance, with an emphasis on 'target-oriented budgets', risk management and the strengthening of internal auditing, the government adopted the Strategy for the Development of Internal Control of Public Finance 2005–08. The most important outcome of the strategy was the introduction of a risk register as a form of systematic risk management and an annual declaration from the head of a spending unit on the assessment of the internal control of public finance, the primary aim of which was to make heads of spending units continually aware of the importance of risk management.

All spending units have risk registers in place; however, they are not always updated.

- All spending units have ensured that internal auditing takes place in line with the standards; however, internal audit services are relatively weak in terms of staff numbers.
- All spending units complete the declaration on the assessment of PIFC based on a self-assessment questionnaire and reports submitted by internal audit services.
- All internal auditors have acquired the title of state internal auditor and the training programme for acquisition of the title has been established.
- The BSO compiles an annual report on the state of internal control of public finance for the government and the Court of Audit.
- The BSO organises meetings and workshops for internal auditors and provides prompt and ongoing support in the area of internal control.

The development and enforcement of PIFC is linked to the introduction and development of the 'target-oriented budget'.

The BSO is the entity responsible for developing internal control of public finance. It reports annually to the government and the Court of Audit on the state of internal control, highlights the weaknesses and recommends improvements. The BSO works closely with the Court of Audit, with due regard to the independence of both institutions; it also works with other institutions which have a particular impact on the control environment, such as the Commission for the Prevention of Corruption.

At the proposal of the Minister for Finance, the government has recently adopted a new strategy for the development of internal control of public finance, which was drawn up by the BSO to cover the 2011–15 period. The most important objectives are to guarantee the quality of internal auditing, introduction of joint internal audit services where feasible and economical, the development of unified IT support for the requirements of internal audit services, the improvement of the position of internal auditors within the salary system, the training of heads and all management levels in the field of internal control of public finance and the replacement of a declaration on the assessment of internal control of public finance with a 'statement of assurance'.

2. Public internal control environment

In 2009 the Slovenian government announced its objective to change the way the budget was drawn up. In future years it intends to gradually introduce budget formulation in line with the principle of a 'target-oriented budget'. The 2011 budget has been drawn up as a development-oriented budget whose content relates specifically to policies and to development programmes and subprogrammes. The programme budget consists of a midterm plan and a two-year budget. The two-year budget comprises a 'basket' in which all expenditure has been planned according to the priorities set, put into operation in subprogrammes and allocated to programmes and indicators. Expenditure has also been planned in accordance with the fiscal rule of the 'midterm scenario'. Policies that are 'outside the basket' also have a certain nominal value based on the fiscal rule. Under the midterm scenario and the fundamental breakdown of resources by policy, those entities responsible for particular policies have, in cooperation with other participating authorities, defined the main subprogrammes under the proposed programmes and the breakdown by policy. The entity responsible for a policy is responsible for coordination, annual reporting, evaluation and drafting of amended proposals. This turn towards targets and the evaluation of achievement of the targets set is connected with the introduction of the managerial principle of management within state administration (public sector reform), which will reflect positively on the introduction of risk management.

The accounting function for all national budget spending units is centralised at the Ministry of Finance. Accounting is still currently based predominantly on the principle of cash flow.

External control is provided by the Court of Audit and the national assembly's Public Finance Control Committee. Any opinion on operations submitted by the Court of Audit must be adhered to by every state body, local community body or public spending unit to whose operations the opinion relates.

The Commission for the Prevention of Corruption is an independent state body established by law in 2003. It decides on matters at sessions at which it adopts opinions on principle, positions and other types of decision. Spending units are obliged to appoint persons responsible for drawing up integrity plans and reporting annually to the commission. The professional officials, position officials (director-general, general secretaries of ministries, heads of ministry-affiliated bodies, heads of government services, directors of administrative units, municipal directors or secretaries, directors and management bodies of public sector authorities) and persons responsible for public procurement all provide details of their assets to the commission.

3. Concept of public internal control

3.1. Managerial accountability/responsibility

The head of a spending unit is responsible for ensuring that the financial management system, internal controls and internal auditing work adequately and efficiently, where financial management encompasses the establishment and implementation of budget planning and the implementation of financial plans, accounting and reporting so as to guarantee the legitimate, cost-effective and efficient use of public resources and achieve the objectives that have been set. Internal controls consist of a system of procedures and methods to control those risks that could affect the legitimacy, cost-effectiveness and efficiency of use of public resources and the achievement of the objectives set.

The head responsible for the operations of a spending unit led by a minister is the minister himself; the heads of other spending units are directors, i.e. they are not politically appointed. The tasks and responsibilities of individuals, the flow of information and coordinated operation are defined by a spending unit's act on internal organisation and the classification of posts, adopted by the government, and by the internal rules of procedure of the spending unit. The management of internal organisational units or functions are involved in preparing and reporting on budget implementation in collaboration with the financial service, which is charged with the task of coordinating the preparation of and reporting on budget implementation and with other tasks connected with the management of state assets.



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Notwithstanding the delegation of its responsibilities, the final responsibility for the operations of the spending unit, the achievement of its objectives and the maintenance of a properly functioning internal control system always lies with its head. The head also signs the annual declaration on the assessment of internal public financial control drawn up in accordance with the prescribed methodology. In the declaration, the spending unit assesses the adequacy of the internal control system in place, which includes the control environment, a risk assessment, internal controls, information flow and internal auditing and sets out the most important measures for improving the system that have been conducted in the last year and the measures the unit intends to implement in the year to come.

Spending units report to the Ministry of Finance; this in turn reports to the government and the national assembly. The annual budget implementation report is audited by the Court of Audit.

3.2. Internal audit

An internal audit is, according to the legal framework of internal public financial control, a constituent part of the internal control of a spending unit. Its organisation and operations are laid down by the Public Finance Act, secondary legislation and the Guidelines for State Internal Auditing, which are based on internationally recognised internal auditing standards. As internal auditor of a spending unit a person who has acquired the title of state internal auditor may be employed. The BSO ensures implementation of the training programme for state internal auditors, which is adopted by the Minister for Finance.

The Public Finance Act explicitly sets out the requirement to ensure the functional independence and impartiality of internal auditors.

The basis for the organisation and operation of an internal audit at a spending unit is provided by the Act on Internal Organisation and the Classification of Posts, which organisationally places an internal audit directly under the responsibility of the head of the spending unit, and the internal Act on the Organisation and Operations of the Internal Audit, which includes the competencies and responsibilities of the internal audit in accordance with the Guidelines for State Internal Auditing based on IPPF.

Among other things, the internal act ensures direct reporting to the head of the spending unit, independence in planning and implementation (with due regard to proposals made by the head of the spending unit), the right to unobstructed access to premises, persons and documentation relating to audit implementation, monitoring of the implementation of recommendations and reporting to the BSO in the event that they have not been sufficiently adhered to, the possibility of engaging an external auditor if there is a need for special knowledge or extra capacity, restrictions applying to the assumption of executive functions outside the area of internal auditing, the obligations attached to the professional title of state internal auditor and continuing supplementary education and training. The BSO conducts audits of the compliance of an internal audit at spending units with the Guidelines for State Internal Auditing and gives recommendations for improvements in reports submitted to the head of the spending unit.

Under the Guidelines for State Internal Auditing, the internal audit team reports directly to the head of the spending unit. According to the legal framework of internal control of public finance, the head of a spending unit is responsible for ensuring that the internal control system functions adequately and efficiently.

An internal audit comprises all types of audit, particularly of compliance and efficiency, and also includes advisory functions.

Under the regulations and the Guidelines for State Internal Auditing, an internal auditor must report without delay to the head of the spending unit and the BSO upon any suspicion of fraud or another criminal offence.

Internal audit is not connected with the budgetary inspection sector. Internal audit is a constituent part of the internal control system of every spending unit, while the budgetary inspection sector is a form of internal control exercised by the Ministry of Finance of the legitimacy and

purpose of use of budgetary resources at spending units. Internal auditors may take account of information provided by the budgetary inspection sector regarding irregularities uncovered when planning their work and audits.

3.2.1. Cooperation between external and internal audit

Adequate (though informal) cooperation has been established between the Court of Audit, spending units' internal auditors and the BSO. This cooperation has various forms or effects:

- the operation of external auditors is important for the creation of a positive audit environment;
- an internal auditor is the first point of professional contact for external auditors and a point of contact between them and the spending unit;
- when analysing risk, internal auditors take into account the reports provided by external auditors, which enables them to focus on the important risks and to use their own capacities more rationally;
- external and internal auditors exchange knowledge from their respective areas of expertise at conferences and workshops;
- cooperation between an internal and external auditor helps to relieve the workload of the spending unit.

The BSO and the Court of Audit regularly (and also whenever required) exchange information and opinions on issues associated with the development of the system of internal control of public finance.

3.2.2. Audit committees

The legal framework of internal control of public finance makes no mention of audit committees. In the specific environment of spending units, the role of audit committees, particularly as regards the provision of functional independence, is played by the BSO. Where internal auditing regulations have been infringed, an internal auditor may consult the BSO, which has the right to take measures where required.

3.3. Coordination of public internal control

The BSO is responsible and competent for the harmonisation and coordination of financial management, internal controls and internal auditing. The BSO therefore:

- draws up:
 - proposals for amendments to regulations on the internal control of public finance;
 - proposals for guidelines for the establishment and development of internal controls and internal auditing;
 - proposals relating to the requirements and rules applying to acquisition of the professional titles of state internal auditor and certified state internal auditor, and organises training and processes applications for professional titles.
- monitors the implementation of the regulations and guidelines referred to above, by:
 - verifying compliance of the organisation and operations of internal audit services with the Guidelines for State Internal Auditing;
 - analysing the declarations made by heads of spending units on the assessment of internal public financial control and the annual reports of internal audit services;
 - providing advice concerning risk management and internal auditing.
- drafts an annual report on internal control of public finance for the Minister for Finance, the government and the Court of Audit.



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4. Budgetary inspection

The competent authority for inspection and supervision is laid down by the Public Finance Act. Under the act in force, the authority responsible for inspection inspects and scrutinises implementation of the Public Finance Act and the regulations governing transactions with national budgetary resources. A party in inspection proceedings is a direct or indirect user of state budgetary resources, or state budgetary resources used by municipalities. Any other recipient of resources may also be inspected; like the spending units mentioned above, they are obliged to enable budget inspectors to perform inspection and scrutiny, submit all the required information, documents and reports relating to the inspection and enable the information to be processed by computer.

In matters falling within the competence of the Budgetary Inspection Sector, budget inspectors also handle reports, appeals, communications and other submissions allocated to them for resolution and inform those submitting these documents of the measures they have taken.

Two half-yearly reports are drafted on the inspections conducted and the findings and decisions of the Budgetary Inspection Sector (pursuant to Article 106 of the Public Finance Act). These reports are sent to the Minister for Finance. The Ministry of Finance submits the reports to the government and the Court of Audit; the government then sends them to the national assembly.

5. Ongoing and future reforms

In the area of internal control of public finance, the strategy drawn up by the BSO and adopted by the government sets out objectives and activities that include the following.

Introduction of a licence for the internal auditing of spending units — In light of the fact that bearers of the professional title of state internal auditor, which is one of the conditions for employment as an internal auditor of a spending unit, are also individuals who, after acquiring the title, have not performed any internal auditing, the BSO intends, by introducing a time-restricted licence to conduct internal auditing, with extension of the licence being linked to ongoing continuing supplementary training as required under the internal auditing standards and the performance of auditing tasks within a certain period of time, to ensure that individuals employed as internal auditors have the appropriate experience and knowledge and undergo continuous training.

Joint internal audit services — The establishment of joint internal audit services organised at ministry level that will perform the function of internal auditing for ministries as well as for interested indirect spending units from an individual ministry's area of activity will constitute an advance on and significant improvement of the current situation in the area of internal control of public finance. The establishment of joint internal audit services represents an organisational solution to the problem of securing internal auditing for a larger number of smaller spending units and is, from the point of view of efficient use of budgetary resources and the limited number of internal auditors available, more suitable than the independent provision of internal auditing by each spending unit separately.

Unified IT support — The internal audit services of spending units are entitled to expect appropriate IT support from the BSO as the central authority responsible for the harmonisation and coordination of internal public financial control; the BSO itself requires it in order to ensure, within decentralised internal control and auditing systems, a unified manner of operations.

Educating heads of spending units on the importance of risk management — Taking into account new recruitment, the achievements made in the area of best practice and the planned amendments to regulations, education and training must be bolstered and enable all heads of spending units, and other civil servants most closely involved with internal control of public finance, to refresh their basic theoretical knowledge and present best practice from a single source, i.e. the authority responsible for the harmonisation and coordination of internal control of public finance — the BSO.

Introduction of managerial responsibility — In accordance with best practice and the introduction of the responsibility of heads for the adequacy and efficiency of the internal control system and its prompt and ongoing adaptation to changing objectives and the operating environment,

it makes sense to replace the declaration on the assessment of internal control of public finance, whose purpose was primarily educational, with the globally recognised 'statement of assurance'.

The statement of assurance presupposes that the head or management body of a spending unit assesses at least once a year the adequacy of internal control across the entirety of operations, including the control environment, risk management, risk control and information flow. The statement of assurance places emphasis on the responsibility of the head or management body to institute all appropriate measures to ensure that the objectives are achieved, operations are efficient and legitimate, fraud and corruption are prevented and reports are made on time and are reliable.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The system of controls in Spain takes as its starting point a series of constitutional principles, which include the following:

- the principles of legality and budgetary specification (in a threefold qualitative, quantitative and temporal sense) and the principles of budgetary unity and universality;
- the guiding principles governing both aspects of public spending — an equitable allocation of public resources and the planning and implementation of public spending in accordance with criteria of efficiency and economy;
- the principle of effectiveness of the public administration.

The development of the legislation on internal controls has been influenced by the objective of making the controls of legality compatible with managing services and public expenditure in a way which fulfils the criteria of efficiency and economy cited above.

Law No 47/2003 of 26 November 2003 on the General Budget (the LGP) has been the basic legislation on internal controls for the state public sector since January 2005, repealing Royal Legislative Decree No 1091/1988 of 23 September 1988, which approved the Consolidated Law on the General Budget (the TRLGP). The rules contained in the LGP contain no substantive amendments to the rules contained in the TRLGP, since the modifications focus on harmonising the controls carried out in entities comprising the social security system with those for the rest of the state public sector.

On the other hand, it governs in detail the subsequent controls, other than the preliminary control of legality, which are grouped into two independent forms: financial permanent control and public auditing. These internal controls, in both forms, are attributed in accordance with the LGP to the Intervención General de la Administración de Estado (General Control and Audit Office — IGAE), which has responsibility for exercising functions and powers, inter alia, in this field.

It should also be noted that the LGP emphasises the principle that bodies responsible for internal controls should be independent from the authorities and entities whose economic and financial management they are controlling, as a result of the inherent nature of controls carried out by a body within the state public sector, to which the body subject to the controls itself belongs, with the result that the law must be shown to support that independence, which is essential for the objectivity and the effectiveness of the actual controls.

⁽¹⁾ Contributed by the General Control and Audit Office (Ministry of Economy and Finance) on 22 March 2011.

The new LGP lays down rules on certain general aspects of internal controls: the objectives of the controls, the scope of the exercise of controls, the principles of conduct and prerogatives, the duties and powers of the staff carrying out controls, the duty of cooperation and legal assistance and general reports on financial permanent control and public auditing.

2. Public internal control environment

The operating framework for internal controls is determined by the main rules governing the economic and financial activities of the public sector. The following rules should be emphasised.

- Royal Legislative Decree No 2/2007 of 28 December 2007 approving the consolidated text of the General Law on Budgetary Stability establishes four guiding principles which the public sector budgetary policy must observe in order to achieve economic stability and growth within the framework of Economic and Monetary Union. Those principles are the principle of budgetary stability, the multiannual principle, the principle of transparency and the principle of efficient allocation and use of public resources.
- Organic Law No 2/1982 of 12 May 1982 on the Tribunal de Cuentas (the Court of Auditors) and Law No 7/1988 of 5 April 1988 on the Functioning of the Tribunal de Cuentas, implementing the provisions of the constitution, establish that the Tribunal de Cuentas is the supreme body responsible for auditing the accounts and financial management of the state and those of the public sector and makes it directly accountable to the Cortes Generales (the parliament). The Tribunal de Cuentas is to exercise its functions in examining and verifying the general state accounts. The accounts of the state public sector are to be submitted to the Tribunal de Cuentas and are to be audited by the latter.
- The rules governing the financial relationships between the state public sector and the autonomous communities and local authorities, that is Organic Law No 8/1980 of 22 September 1980 on the Financing of the Autonomous Communities (the LOFCA), recently amended by Organic Law No 3/2009 of 18 December 2009, and Royal Legislative Decree No 2/2004 of 5 March 2004 approving the consolidated text of the Law Governing Local Authority Finances.
- Law No 47/2003 of 26 November 2003, the LGP, which is intended to govern the budgetary, economic, financial, accounting, auditing and financial control system of the state public sector. Accordingly, it identifies which bodies carry out the controls on the financial and economic management of the state public sector by drawing a distinction between two types of controls — one external control, carried out by the Tribunal de Cuentas, which is accountable to the Cortes Generales, and one internal control, carried out by the IGAE, a body that is accountable to the council of ministers, to which it submits general reports on such economic and financial management, and that has ultimate responsibility for taking decisions concerning any discrepancies detected, in the course of controls, between the IGAE and management bodies of the state public sector.

It also provides that bodies forming part of the administration of the state public sector must apply the accounting principles set out in the General Public Accounting Plan approved by the Minister for Economic Affairs and Finance, both to record all types of transactions, costs and results of their activities and to provide data and information of economic importance. For its part, the IGAE has the power to adopt implementing rules for the General Public Accounting Plan and any partial or special plans drawn up pursuant thereto and to approve the accounting directions setting out the accounting rules with which the bodies required to apply public accounting principles must comply.

The framework of internal controls also comprises the rules contained in the LGP on the budget system for the entities which make up the state public sector as well as the annual budget laws.

- Law No 38/2003 of 17 November 2003 on General Grants, which, in accordance with the principles of transparency and effectiveness in the allocation and use of public resources, governs the management instruments for public grants and assistance and the system of monitoring by means of controls and evaluation of both the procedures and the recipients of such public resources.

- Together with these, other rules, such as Law No 30/2007 of 30 October 2007 on Public Sector Procurement, Law No 6/1997 of 14 April 1997 on the Organisation and Functioning of the General State Administration and Law No 33/2003 of 3 November 2003 on the Assets of the Public Administrations, lay down requirements which influence and govern the system of internal controls in Spain.

3. The concept of public internal controls

3.1. Managerial accountability/responsibility

There is a connection between accountability and internal controls, although that link does not coincide with the elements defined by the International Organisation of Supreme Audit Institutions (INTOSAI), since the information management process and internal controls are carried out by an independent body, the IGAE. High-level decisions in public management are adopted by political decision makers, that is, public management is headed by a political decision maker. The various public policies are established by the government, which has ultimate responsibility and is also responsible for their implementation and, therefore, there is no separation of responsibilities in the development and implementation of policies.

In the Spanish administration a distinction is drawn between, on the one hand, political representatives, who draw up the various public policies, and managers, who implement those policies. In the latter case, positions are normally held by public servants with high levels of technical skills, who provide support and advice for the various actions and decisions of senior managers. Public servants must diligently perform their assigned tasks and safeguard the general interest subject to and in compliance with the constitution and other legislation, and must act in accordance with, inter alia, the following principles: objectivity, integrity, neutrality, liability, impartiality, confidentiality, dedication to the public service, transparency and effectiveness.

The different centres of management are involved in determining budgetary policies and budget objectives and are responsible for drawing up multiannual budget programmes. In this way they participate in the system of controls from its outset, at the budgeting stage.

Subsequently, during the implementation stage of these policies and at a later stage, these centres of management are subject to controls by the IGAE and by the external control body, the Tribunal de Cuentas. Thus, the entities within the state public sector are accountable in respect of their operations, whatever their nature, to the Tribunal de Cuentas through the IGAE.

Apart from the controls exercised by the bodies referred to, the information provided by the accounts of state public sector entities is essential, since it represents a system of economic, financial and budgetary information on the activities carried out by those entities. This information is provided to their governing and management bodies, to policy-making bodies, to external and internal control bodies and to international agencies with the aim of determining the costs of the public services and facilitating management and decision making. For all the above reasons and for the purpose of their subsequent consolidation, the accounts of those entities must be filed in accordance with the applicable accounting principles using a standardised form. Once the information is generated, the heads of the entities and bodies, known as *cuentadantes* (reporting officers), that is the authorities and officials who are responsible for managing revenues and carrying out expenditure and the other operations of the general state administration, submit their accounts to the IGAE for subsequent consolidation and reporting to the Tribunal de Cuentas.

With regard specifically to the issue of liability, public managers may incur three types of liability when carrying out their activities: disciplinary, criminal and financial. The LGP is concerned with the latter, in conjunction with the rules contained in the legislation of the Tribunal de Cuentas concerning accounting liability.

Financial liability relates to the obligation to compensate the public treasury for injury caused to it, while accounting liability relates to liability resulting from the accounts which must be filed by those who manage public funds (*cuentadantes*).

Accordingly, the Spanish rules provide that the authorities and other staff in the service of entities comprising the state public sector who intentionally or through gross negligence adopt



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decisions or perform acts in infringement of the provisions of that law are required to compensate the state public treasury or, where appropriate, the relevant entity for the damage resulting therefrom, irrespective of any criminal or disciplinary liability which they may incur. Thus, the legislative provisions provide that the following constitute offences:

- bringing about a deficit or making a misappropriation in the administration of public funds;
- managing resources and other interests of the state public treasury without complying with the provisions governing their assessment, collection or receipt in the treasury;
- incurring expenditure, settling obligations and ordering payments without sufficient credit to carry them out or in infringement of the provisions in that law or in the applicable budget law;
- generating recoverable payments;
- failing to substantiate the payment of funds intended for cash advances, payments to be substantiated and grants; or
- any other act or decision in infringement of that law.

Finally, it is necessary to highlight the features of the internal controls of the public sector in Spain and the objectives of the controls carried out by the IGAE, which are laid down in the LGP. As regards features, the following should be highlighted.

- They are carried out with full independence from the authorities and bodies which are subject to controls.
- They are carried out by means of the preliminary control of legality and financial controls.
- They are carried out in a decentralised manner in accordance with the powers of the body which is subject to controls.
- They take as an overall frame of reference both the legal aspect, or compliance with the legislation, and other fundamental principles relating to public sector activities, such as economy, efficiency and effectiveness.

As regards objectives, the following should be highlighted.

- Checking compliance with the rules applicable to the management, subject to controls. This relates to compliance with the law, in the traditional form of controls, based on the fact that all the activities of the administration are subject to the legal system. This is a control objective set out in the LGP, the attainment of which is provided for in the three forms of controls: preliminary control of legality, financial permanent control and public auditing.
- Ensuring the appropriate recording and accounting of transactions made and accurate and regular recording in the accounts and statements, which, under the applicable provisions, must be drawn up by each control body or entity. This seeks to establish the reliability of accounting documents relating to economic and financial management that is undertaken. The LGP requires state public sector entities to record their transactions in accounts and to file accounts with the Tribunal de Cuentas through the IGAE.
- Assessing whether the activities and procedures subject to controls are carried out in accordance with the principles of sound financial management and, in particular, those provided for in the General Law on Budgetary Stability. This means that the activity must be subject to the principles of effectiveness, efficiency and economy, verification of which is carried out using the two forms of subsequent controls, by means of an operational audit.
- Verifying compliance with the objectives assigned to expenditure management centres in the general state budget. This relates to achieving the objectives assigned to the management centre in the general state budget, in accordance with the provisions of the LGP.

3.2. Internal audit

The subsequent financial controls are defined in the LGP in their twofold form of financial permanent control and public auditing, which constitute the internal audit system, together with the financial controls of public grants and aid.

However, in the Spanish system, great importance is attached to an *ex ante* form of control called the preliminary control of legality.

The preliminary control of legality covers the control, prior to their approval, of acts of the state public sector resulting in the recognition of rights or the incurring of expenditure, and the revenues and payments arising therefrom, and the investment or general application of its public funds, in order to ensure that their management complies with the provisions applicable in each case.

The preliminary control of legality is exercised in the forms of formal and material control. Formal control consists in verifying compliance with the legal requirements necessary for adopting a decision, by examining all the documents which, compulsorily, must be included in the file. The material control involves checking the actual and effective application of the public funds.

The exercise of the preliminary control of legality includes:

- the preliminary control of acts which recognise economic rights, approve expenditure, enter into spending commitments or agree to the movement of funds and securities;
- the control of recognition of obligations and of verification of investment;
- formal control of the authorisation of payments;
- the material control of payments.

For its part, the financial permanent control includes the following measures:

- verification of compliance with the rules and procedures applicable to the aspects of economic management which the preliminary control of legality does not cover;
- monitoring of budget implementation and verification of compliance with the objectives assigned to the management centres' spending programmes and checking the balance sheet of results and the management report;
- reporting on the proposed distribution of the revenues referred to in the LGP;
- checking cash planning and management and the cash position;
- the measures provided for in the remaining titles of that law and in the other budgetary rules and rules governing the economic management of the state public sector, attributed to the delegated controls.

Analysis of operations and procedures in order to provide an assessment of their financial and economic rationale and their observance of the principles of sound management, with the aim of identifying possible shortcomings and proposing recommendations in order to correct the latter.

The financial permanent control measures to be implemented in each financial year and the specific scope determined for them is to be established in the annual financial permanent control plan prepared by the IGAE, which may be amended where the prevailing circumstances so warrant.

The aforementioned measures are documented in reports which are submitted to the body directly managing the activity subject to controls.

A comprehensive report on the results of the financial permanent control measures taken during the year is drawn up annually and sent by the Comptroller General to the heads of each ministerial department, to the Minister for the Economy and Finance and to the State Secretary for Finance and Budgets.

The public audit consists in the auditing, carried out subsequently and systematically, of the economic and financial activities of the state public sector, by applying the selective review procedures contained in the auditing rules and directions issued by the IGAE. Auditing rules in the public sector field are governed by the LGP, circulars, directions and the Public Sector Auditing Rules.



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The IGAE prepares an Annual Audit Plan which includes measures to be implemented during the corresponding financial year. Similarly, the Annual Audit Plan includes measures relating to public aid and grants.

Public auditing is carried out, on the basis of the provisions in the Annual Audit Plan, on all bodies and entities forming part of the state public sector and on the funds referred to in the LGP, without prejudice to measures relating to the exercise of the preliminary control of legality and financial permanent control and to the measures subject to private auditing under Law No 19/1988 of 12 July 1988 on the Auditing of Accounts, which are applicable to state-owned commercial companies under commercial legislation.

The IGAE may decide to carry out audits which combine auditing objectives relating to accounting regularity, compliance and operations.

To carry out the controls resulting from this plan, the IGAE may seek the cooperation of private auditing firms that must comply with the rules and directions established by the IGAE.

The results of each public audit measure are recorded in written reports and prepared in accordance with the rules approved by the IGAE, which must determine the content, the addressees and the procedure for the preparation of those reports. The public audit report is sent to the direct head of management of the relevant body.

The IGAE submits to the council of ministers, through the Minister for Economy and Finance, a general report containing the most significant results of implementation of the auditing and financial permanent control plans.

It is also necessary to emphasise the importance of the performance reports. The IGAE may prepare these reports on the basis of the recommendations and proposals for action for managing bodies contained in the annual reports of financial permanent control and the public auditing reports. Some of the following circumstances must be met:

- where shortcomings have been identified and the heads of management subject to controls fail to indicate the measures necessary to resolve them and the planned deadline for doing so;
- where they express disagreement with the conclusions and recommendations and those points of disagreement are not accepted by the control body;
- where, having agreed to do so, they fail to take measures to remedy the shortcomings identified.

Those performance reports are sent to the head of the ministry having responsibility for the body or entity subject to controls or to which that body or entity is attached and, in the event of disagreement by the head of the ministry, will be referred to the council of ministers through the Minister for Finance. Decisions to that effect adopted by the council of ministers are binding on both the management and the control bodies.

The IGAE carries out continuous monitoring of the corrective measures that have been adopted as a result of shortcomings identified in the reports.

Lastly, the following types of special public audits included in the law may be highlighted.

Audit of annual accounts

This is the method of auditing the regularity of accounts, which is intended to ensure that the annual accounts represent in all significant respects a true picture of the assets, financial position and results of the entity and, where appropriate, implementation of the budget in accordance with the applicable accounting and budgetary rules and principles, and that they contain the information necessary for their interpretation and proper understanding.

Compliance audit

The IGAE carries out a compliance audit on those bodies and entities of the state public sector that are included in the Annual Audit Plan, which audit includes selective checks on compliance with the legislation on budget management, procurement, personnel, revenues and grant management as well as any other aspect of the economic and financial activity of the audited entities.

Operational audit

The IGAE carries out an operational audit on those bodies and entities of the state public sector that are included in the Annual Audit Plan, and which has the scope laid down in that plan, through the procedures outlined below.

- **Audit of budgetary programmes:** this consists in the analysis of the suitability of the objectives and the monitoring and self-assessment systems put in place by the management bodies, the verification of the reliability of the account balance sheets and management reports and the assessment of the outcome achieved, the alternatives considered and the effects produced in relation to resources used in the management of budgetary action programmes and plans.
- **Audit of systems and procedures:** this consists in the thorough examination of a financial management administrative procedure in order to identify its possible shortcomings, or, where appropriate, its obsolescence, and to propose appropriate corrective measures or the replacement of the procedure in accordance with general principles of sound management.
- **Audit of economy, effectiveness and efficiency:** this consists in the independent and objective assessment of the level of effectiveness, efficiency and economy achieved in the use of public resources.
- **Audit of programme contracts:** in situations where, under programme contracts or other agreements between the state and entities referred to in the LGP, the amount of contributions to be made by the state is conditional on achieving certain objectives, on the amount of or change in certain financial indicators or on certain macroeconomic assumptions being met, the IGAE must carry out an audit which is intended to verify whether the settlement proposal made by the body set out in the agreement meets those conditions.
- **Audit of state tax accounts:** the audit of state tax accounts and the resources of other administrations and public bodies managed by the Agencia Estatal de Administración Tributaria (State Tax Administration Agency) are to take place annually, in accordance with the procedure established by the IGAE for that purpose.
- **Audit of privatisations:** the IGAE must audit each operation to dispose of securities representing the capital of state commercial companies that entails for the state public sector the loss of political control of such companies. This audit is to be carried out on the accounts of the financial and accounting results and the explanatory note concerning aspects of the operation, which must be issued for each disposal operation referred to above.



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3.3. Coordination of public internal control

Political and administrative decentralisation to territorial authorities in Spain (autonomous communities and local authorities) has led to a process of transfers and a resizing of the various levels of political and administrative power, which necessitates a tight system of controls and coordination and cooperation among all the entities comprising the Spanish public sector, understood in a broad sense.

This process of transfers in the area of controls has been accompanied by the replacement of a single form of internal control, carried out by the IGAE, with a model based on several organs and systems of control which are functionally independent but organically under the authority of the administration of which they form a part. The IGAE shares responsibilities for controls of economic and financial activities with the General Control and Audit Offices of the autonomous communities and the General Control and Audit Offices of the local authorities, each one acting within its own clearly delineated area of competence and territorial scope.

The constitution itself contains a number of criteria for controls relating to autonomous community bodies and to the exercise of their financial powers. In addition, it is important to highlight a number of previously mentioned legislative provisions which affect the exercise of the economic and financial powers of the various territorial authorities, such as the LGP and the law supplementary to the Law on Budgetary Stability, which, while respecting the autonomy of the autonomous communities, seeks to coordinate their economic and financial activities with the rest of the public sector.

The framework of controls in Spain is therefore characterised by the fact that within the three territorial administrations there are internal and external controls carried out by separate bodies and with the aim of coordination between them and with the state, thereby establishing, as a general rule, a budgetary, accounting and control framework similar to that of the state.

However, in Spain the model of controls seems to be determined both by political and administrative decentralisation of the state, where each territorial administration has its own control bodies, and by the fact that Spain forms part of a supranational structure, the European Union, which, in turn, also has internal and external controls. All the above requires the introduction of mechanisms for coordination in carrying out control activities which avoid overlaps and duplication.

The single audit concept includes techniques and procedures that may allow cohesive action by all the control bodies in a state, based on a wholly or partially common methodology and on mutual recognition of the results of control measures.

We advocate neither the abolition of nor a reduction in the number of control bodies, whose existence and legitimacy should not be called into question, but rather the elimination of unnecessary duplication in those cases where separate control bodies carry out their activities, with the same subject matter and scope and in respect of the same public body. In short, the ultimate aim of a single auditing system is to support in a more effective way the activity of control bodies.

On the basis of these premisses, the single audit concept observes the following three principles.

1. The establishment of a single conceptual framework for all control bodies, as well as common methodological rules for carrying out controls. In that regard, it is essential that there be technical rules for controls and auditing which allow the application of common standards for carrying out the work and issuing reports.
2. The coordinated planning of control activities, so that the control plans of controlling institutions should take into account the control planning of each institution in order to avoid possible overlaps. Coordination at that preliminary stage presupposes the existence of continuous communication and interaction between controlling bodies and the agreement of a system for determining precedence in cases where provision is made for carrying out controls on the same administrative bodies.
3. Each control body must accept the results of the work carried out by other control bodies provided that that work has been conducted in accordance with approved common methods and procedures, as well as supervision by the principal auditor of the work of other auditors involved in ensuring that the work of the participating bodies has been conducted in accordance with the established standards.

The main effect implicit in that model is the reduction and elimination of costs both for control bodies and for the bodies subject to audit activities. The removal of unnecessary elements in the implementation of control measures allows control objectives and strategies to be established in areas where such controls have not been carried out by any administrative body, a fact which requires a proper system for the recognition and planning of measures.

Among the instruments included within the single auditing framework, which are already being applied in the field of controls of EU funds, it is important to emphasise the preparation of documents for coordination between the IGAE and the control and auditing bodies of the autonomous communities, such as:

- a guide for the auditing of systems and operations;
- standard contract documents for the appointment of private auditors;
- minimum requirements to be imposed when appointing private auditors;
- a quality control guide; and
- a random sampling procedure.

Similarly, cooperative relationships have been established since the audit bodies of the autonomous communities have been provided with the directions drawn up by the IGAE for

'Declarations at the conclusion of audits for the programme period 2000–06,' which they may adopt or apply, where appropriate.

4. Financial inspection

In the Spanish public administration there is no internal inspection body to review the work done by the IGAE, which carries out independent and horizontal controls on all bodies forming part of the state public sector.

The Spanish constitution defines the Tribunal de Cuentas as the supreme auditing body for the accounts and economic management of the state and the public sector, without prejudice to its own jurisdiction, and leaving aside the auditing functions of the external control bodies of the autonomous communities. It is therefore concerned with external controls.

The Tribunal de Cuentas falls under the direct authority of the Cortes Generales and exercises functions delegated by the latter when reviewing and verifying the state's general accounts and auditing the state and public sector accounts which have previously been filed with it. It then sends the Cortes Generales an annual report in which, where appropriate, it notifies any infringements committed or liabilities incurred.

The two functions performed by the Tribunal de Cuentas when carrying out external controls of the economic and financial activities of the public sector are auditing and judicial review. The scope of the audits of the Tribunal de Cuentas and its jurisdiction are fully defined in the organic law and the law governing its operation.

The auditing function, which is external, ongoing and complete, ensures that the economic and financial activity of the public sector is subject to the principles of legality, efficiency and economy in relation to implementing revenue and expenditure budgets, ensures that it follows certain procedures and ensures that its results are set out in reports, motions or memoranda which are addressed to the Cortes Generales or, within their fields of competence, the legislative assemblies of the autonomous communities.

For its part, the judicial function consists in bringing proceedings in relation to accounting liability incurred by those who are responsible for managing public property, funds or assets. That liability is clarified and required by means of three types of judicial proceedings:

- the *juicio de cuentas* (accounts proceedings);
- the *procedimiento de reintegro por alcance* (proceedings for recovery of a deficit); and
- the *expediente de cancelación de fianzas* (proceedings for the cancellation of guarantees).

The conflicts which arise between the bodies of the auditing court and the administration or other courts are resolved in accordance with the provisions of the Organic Law on Conflicts of Jurisdiction.

5. Ongoing and/or future reforms

The controls of public sector economic and financial activity cannot be separated from the changing situation in which they take place. Hence, the changes in the economic and financial situation and the move toward the attainment of certain objectives will need to be met by adequately tailoring the controls to be carried out.

In recent years in Spain there have been several changes which have affected our administration at varying levels and which have also had an impact on developments concerning internal controls. The fields in which those changes have taken place may be defined as follows:

- political and administrative decentralisation, which has resulted in a process of transfers and in a resizing of the various levels of political and administrative power;
- the integration of Spain into the European Union, which has generated a supranationalisation process where internal controls of economic and financial activity in Spain have not escaped those influences, in a context which is also highly complex;



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- organic devolution towards implementing entities, which has favoured the proliferation of multiple forms of administrative organisation, such as state agencies, public sector foundations and interterritorial associations;
- an economic situation characterised by the intensity of the economic crisis originating in the international financial crisis and having effects on growth and employment, which has led to the adoption of a series of public spending austerity measures.

With the aim of addressing this crisis and the demands of the European Union to reduce the public deficit to 3 % of GDP by 2013 and to ensure that debt is maintained at reasonable levels, the Spanish government has been required to introduce a series of measures, such as a fiscal consolidation strategy, an austerity plan for the general state administration for the 2011–13 period and a spending review plan for 2011–13. The latter, in addition to establishing general guidelines, sets out specific measures to reduce expenditure and establishes a series of measures to strengthen controls.

Specifically, and in so far as the strengthening of control measures is concerned, it aims to highlight certain aspects of management which, although lawful, may be improved with the aim of making a larger contribution to the containment and reduction of public spending. The measures indicated below should be emphasised.

- If state public sector entities deviate significantly from the spending review plan, the IGAE will implement the mechanisms provided for in the LGP. Accordingly, the council of ministers may establish, on a provisional basis, a more rigorous system of controls and may make all or part of their measures subject to the auditing rules provided for in the LGP.
- Notwithstanding the foregoing, in all financial permanent control measures and audits carried out by the IGAE, in addition to the objectives of auditing accounts, ensuring compliance with the law and observance of the principles of sound management applicable in each case, it will review compliance with the austerity criteria. In particular, it will include specific measures concerning public procurement processes and the monitoring of staff costs.
- The Comptroller General of the state administration has issued instructions that, when carrying out preliminary controls of the legality of expenditure records, they should also be analysed from the standpoint of compliance with the measures laid down in the austerity plan.

In the IGAE's efforts to adapt the system of controls to the economic and financial situation, it is also important to emphasise its participation in drafting the royal decrees governing the new instruments adopted by the government to improve the economic situation, such as the Fondo para la Adquisición de Activos Financieros (Fund for the Acquisition of Financial Assets) and the Línea de Concesión de Avales (Guarantee Line).

In order to ensure its transparency, the Fund for the Acquisition of Financial Assets (FAAF) is subject to a twofold control. On the one hand, it is subject to parliamentary scrutiny through a management report to be sent quarterly to the Economic Committee of the lower house. On the other hand, it is subject to the controls carried out by the IGAE through the public audit, which is to be a wider audit so that the controls carried out ensure maximum transparency in the operation of that instrument.

With regard to the guarantees granted by the state to financial institutions, which are subject to preliminary auditing, the IGAE has adapted its working methods to the specific characteristics and objectives of those instruments with the aim of ensuring that the purposes for which they were created are effectively attained.

Finally, as part of this process of reforming and adapting controls to the new forms of public management, it is important to draw attention to the government's requirement, in Royal Decree No 2/2011 of 18 February 2011, for the IGAE to take further measures to strengthen the financial system. That law provides that the IGAE must first draw up a mandatory report on procedures in which the public sector is to acquire an interest in the share capital of credit institutions, procedures which must comply with European Union rules and rules on the protection of public resources.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

In its Budget Bill of 2006, the government expressed its opinion that a properly functioning internal control system in the public administration is of paramount importance for government operations to satisfy expectations from citizens, trade and industry, elected members of public assemblies and other actors of civil society. A fundamental condition for the legitimacy of and confidence in government services is the fulfilment of good governance of the public administration. The government also considered it reasonable to introduce a set of rules and regulations constituting a framework for internal control.

In order for the government to be able to issue a national declaration on the management of EU funds in Sweden it also wanted to introduce a requirement for the management of government agencies to make an assessment in the annual report as to whether the internal control is satisfactory. The idea behind the national declaration is to inform the parliament and the EU that there is a legal framework aiming at ensuring a satisfactory internal control of EU funds. In that way the internal control of those EU funds that are managed in Sweden would be strengthened and the parliament's control of the management of the government would improve.

With a view to strengthening government control of public agencies and to enhancing the requirements on the agencies' liability for government services, a committee was set up in the Ministry of Finance with the task of preparing a proposal on how to statutorily regulate internal control in government agencies. After having considered comments on the proposal given by parties concerned, the government decided to issue a new Ordinance on Internal Control and to issue an amendment in the Ordinance on Annual Reports and Budget Documentation for those agencies under the government that must comply with the Ordinance on Internal Audit. The whole set of these rules and regulations, which also apply to the Government Agency Ordinance, came into effect as of 2008.

2. Public internal control environment

2.1. The Swedish public administration

The Swedish public administration works at three different levels: the central, the regional and the local. The central governing bodies include the Swedish parliament, the government comprising the ministries and the central government agencies, some of which are represented also at regional and local level. The central government is represented at the regional level by county

⁽¹⁾ Contributed by the Ministry of Finance on 21 June 2011.

administrative boards. Parallel to this, directly elected county councils cover the same geographical areas. The municipalities are governed by directly elected bodies. It should be emphasised that PIC in the context of this compendium strictly refers to the central government administration only.

The operational power is exercised by independent executive government agencies. The government has quite substantial scope for steering the operations of government agencies. However, it has no power to intervene in an agency's decisions in specific matters relating to the application of the law or the due exercise of its authority. Collective government decision-making and the ban on instructing agencies on individual matters are expressions of the prohibition of ministerial rule, as it is often called. The parliament is responsible for monitoring to ensure that ministerial rule does not occur.

The Swedish public administration is characterised by delegation of decision-making from the government to the agencies. The custom of delegated decision-making is also usual within the agencies. Other typical features of the Swedish administrative model are the emphasis on the government's collective responsibility, public access to records and the absence of authorising officers of the state budget appointed by the Ministry of Finance.

Agencies' activities and results are followed up and evaluated. Every year the agencies submit an annual report to the government containing information about, inter alia, expenses, revenue and results. On the basis of the reports the government can follow up and evaluate agencies' operations. The annual reports together with budget requests submitted by agencies are also the basis for work on next year's national budget and appropriation directives.

2.2. The Swedish parliament

The main functions of the parliament are to pass new laws, to decide on matters relating to reforms, taxation and public finances and to comment on the government's foreign policy. A proposal put forward by a member of the parliament or a political party is known as a motion (private member's motions or party motions), while a proposal from the government is called a bill.

The members of the parliament belong to different standing committees, each dealing with a particular subject area. Examples are the Standing Committee on Finance and the Standing Committee on the Labour Market. The committees prepare matters that are then taken up for discussion in the parliament.

The Swedish parliament has a number of instruments it can use to scrutinise government activities. The Swedish National Audit Office (NAO) is one of them, and it is one of the few agencies that is directly subordinate to the parliament. These instruments constitute parliamentary control. The system for parliamentary control is designed to ensure that the government and public agencies comply with Swedish law, that they work efficiently and that the citizens feel that they can trust the way in which the public agencies exercise their powers. The primary focus of the NAO is to examine what central government funds are used for and how efficiently they are used (performance audit) and the audit of the agencies' financial statements (financial audit).

2.3. The Swedish NAO

The NAO is one of the bodies charged with exercising the powers of scrutiny vested in the parliament. The task is to audit state administration so as to contribute to the economical use of resources, and to effective and efficient administration.

One important role of the NAO is to ensure democratic transparency, i.e. to provide citizens with the opportunity to see how democratic decisions are made and implemented, how their tax money is used and whether public administration follows directives, rules and regulations and achieves the objectives set for it.

The parliament and the government are the most important recipients of the findings from the NAO's audits. The audits are used to support decisions for purposes of accountability and informed public discussion.

Since the NAO is one of the bodies exercising the power of scrutiny vested in the parliament, the independence of its auditing operations is laid down in the constitution and its audit mandate is

powerful. This enables the NAO to carry out a coherent and comprehensive programme of audits encompassing public administration as a whole.

Financial audits cover more than 250 agencies' financial statements. The NAO may also appoint auditors for state-owned enterprises and foundations. About 30 performance audits are carried out each year, and the main observations made in the overall auditing operations are reported in the NAO annual report. Financial audits are performed based on the risk for material errors in the financial statements.

3. The concept of internal control in the central government administration



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3.1. Managerial accountability/responsibility

3.1.1. The government

The government is responsible to the parliament for ensuring that state activities are conducted correctly and efficiently. Day-to-day administrative work is managed by executive agencies which, on their own responsibility, execute the parliament's and the government's decisions. The ministries concerned perform the role as the link between the executive agencies under the auspices of the respective ministry and the government. Of particular importance is the budget dialogue on policy questions that are conducted in the annual budget process. Directives to the agencies are issued by the government as a collective. The individual cabinet minister for the ministry concerned serves as the presenter at the decision-making cabinet meeting. This means that there is no formal middleman between the director-general of an agency and the government. This absence of ministerial rule has been an inseparable practice of the Swedish constitutional set-up for centuries and is regarded as a cornerstone for an impartial and independent civil service.

3.1.2. The agencies

Since 1 January 2008, a partly new and partly amended set of rules for internal control has been in force at central government agencies. The four ordinances which, in principle, constitute the rules for internal control are:

- the Government Agency Ordinance;
- the Ordinance on Internal Control;
- the Internal Audit Ordinance;
- the Ordinance on Annual Reports and Budget Documentation.

Also, other ordinances cover risk assessment and control, but they do not affect what constitutes internal control.

The Government Agency Ordinance lays down the requirements for the management of an agency. The management is responsible to the government for the agency's operations and shall ensure that operations are pursued efficiently and in accordance with current legislation and the obligations that arise from Sweden's membership of the European Union, that operations are reported on in a reliable, true and fair manner and that the agency uses government funds economically. The management of an agency shall also ensure that the agency's internal control processes function satisfactorily.

The responsibility for the agency's operations rests with the management irrespective of the activities being executed by the agency itself or by someone else commissioned by the agency to undertake them. Arrangements such as shared service or outsourcing do not alter this basic principle.

The government has made greater demands on certain agencies when it comes to internal control. For example, this applies to agencies managing EU funds, agencies having complex operations, handling huge funds, having high costs, large total assets or many employees. There are almost 70 agencies of this kind, and they cover about 95 % of the expenditure of the state budget.

The government has decided that these agencies should have an internal audit function, and should be subject to five additional requirements.

- A risk analysis shall be performed aiming at identifying circumstances that constitute a potential risk that the entity will be unable to meet the objectives within the requirements established by the government.
- If the risk analysis so requires, necessary measures shall be taken to meet, with reasonable certainty, the objectives within the requirements established by the government.
- The internal control processes should be systematically and regularly monitored and assessed. In the assessment, observations made by the external audit and internal audit shall be taken into consideration.
- The risk analysis, the control measures and the monitoring and assessment shall be documented.
- In connection with the signing of the annual report, management shall present an assessment of whether the internal control system at the agency is satisfactory.

3.2. Internal audit

The organisational set-up of the internal audit is based on the Internal Audit Ordinance. In order for an agency to establish an internal audit department it requires the mandate of the government. In 2011, there are internal audit departments at 66 agencies. There are boards of management at about half of the agencies. The boards serve as the principal of the audit departments. In the absence of a board, the director-general fulfils the function as principal. In Sweden, audit committees are not mandatory. Only agencies having a board may establish audit committees, but far from all of them have done so.

The internal audit department shall be led by a manager who is employed by the agency. An agency may coordinate its internal audit with the internal audit department of another agency, which however does not detract from the authority of its own management.

The management of the agency (the board or the director-general) should decide on:

- the guidelines (charter) for the internal audit;
- the audit plan;
- measures resulting from the observations and recommendations of the internal audit.

The internal audit department supports the agency to achieve its objectives, from the perspective of risks and materiality, by auditing and making proposals for the improvement of the agency's process for internal control. On the basis of an analysis of the risks associated with the agency operations, the internal audit department shall independently audit whether the management's process for internal control enables the authority, with a reasonable degree of certainty, to fulfil the responsibilities indicated in paragraph 3 of the Government Agency Ordinance, as elaborated in Section 3.1 of this document.

The internal audit department performs assurance assignments (financial audit, compliance audit, performance audit). The internal audit also provides guidance and support to the management of the agency, i.e. the board or director-general of the agency. Guidance and support can be given to persons other than the board and director-general if this is shown in the guidelines (charter) for the internal audit. The guidance and support which the internal audit gives does not detract from the responsibility and authority of the agency management.

The internal audit shall carry out an organisational and also, in relation to the activity which is being audited, an otherwise independent and objective auditing and advisory activity. To ensure the requirements of objectivity, independence and integrity, the internal audit unit shall be free-standing from the operative activity and shall administratively report directly to the director-general of the agency.

In the risk analysis the risk for fraud and irregularities should be considered. When the internal audit identifies indications of fraud/irregularities it should give information to the right recipi-

ents (the management of the agency). The responsibility to handle questions about fraud/irregularities lies with the board and the management.

The result of the audit shall be reported by internal audit in the form of observations and recommendations to the management of the agency (the board or the director-general). The management of the agency shall decide on measures resulting from the observations and recommendations of internal audit. At least once a year, internal audit shall submit an audit report to the management of the agency on the observations and recommendations from the audit year. This report shall include a review of how the measures relating to internal audit's observations and recommendations in previous years have been fulfilled. The management decides how the follow-up procedures for managers related to internal audit reports should be carried through.

The internal audit shall be carried out in accordance with generally accepted internal auditing standards and rules of professional ethics for internal auditors. Such standards are established in laws, ordinances, other government decisions and the regulations and general guidance issued by the Swedish National Financial Management Authority (ESV), which is the central harmonising unit and contact point for internal audit in the central government sector (see Section 3.3).

The internal audit department shall have a programme for quality assurance and quality improvement. The quality assurance programme shall include both internal and external quality assessments. The internal audit shall be carried out with competence and due professional skill. The internal audit manager shall have the necessary competence to fulfil the tasks of the internal audit as described in the Internal Audit Ordinance. The internal auditors shall improve their knowledge and skills through continuous professional development.

ESV provides guidelines with respect to questions relating to the competence and training of internal auditors. ESV has a training programme which consists of four days per year for three years. The intention is that the training shall not duplicate already existing training provided by other course organisers, for example the Institute of Internal Auditors (IIA) of Sweden. Each year ESV also arranges different network meetings and seminars.

In Sweden there are no public certification procedures for internal auditors in the central government sector. ESV encourages the government internal auditors to acquire the certificate in Internal Audit of IIA, CIA certification.

It is understood that there should be cooperation between the internal audit department and the SAI in order to benefit from fruitful exchange of knowledge and experiences. Sweden has not regulated in detail how this cooperation should function. It is generally accepted that external audit and internal audit should keep each other informed to avoid duplication of work.

Audit of EU programmes

ESV is the audit authority during the programme period 2007–13. The audit authority is responsible for performing the audit of EU funds in an efficient and appropriate way and according to the regulations and guidelines of the Commission and according to internationally accepted audit standards.

ESV carries out audits in order to be able to assess whether the management and control systems are functioning effectively and the declared expenditure is correct. ESV reports its audit findings in audit reports and in the annual control report and issues an opinion. In the annual control report ESV gives an assessment as to whether the management and control systems are functioning effectively. In February each year ESV presents an annual report to the government together with other reporting required in the letter of appropriation.

The audit authority is functionally and organisationally independent from the managing authorities executing the EU programmes. The audit authority does not take part in decisions and management of funds for the respective programmes.

3.3. Coordination of central government internal control

ESV is the central harmonising unit and contact point for internal audit (IA) and for financial management and control (FMC) in the central government sector. ESV develops and administers rules and regulations and methods to support the agencies and the government offices to attain a satisfactory internal control in the state administration. The support from ESV also



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involves analyses, training and counselling. ESV also develops and coordinates the internal audit in the central government sector. ESV develops and maintains a system of planned and orderly method development. It also makes an assessment of it in an annual report to the government. The task of ESV includes the maintenance of regulations and general counselling on the Ordinance of Internal Audit, giving support and counselling and maintaining an in-service training programme for state internal auditors. In order to support the director-general of ESV on matters relating to internal audit, ESV has established a special council.

4. Financial inspection

There is no peer institution in Sweden to the financial inspection of state budget execution. There are inspections within several areas of the central government. They are, however, principally focused on compliance with existing law, and only occasionally on inspection of internal control.

Protection of EU financial interests

The government has established the Swedish Council for the protection of the European Union's financial interests (SEFI Council), chaired by the Swedish Economic Crime Authority. The SEFI Council is designed to promote effective and correct use of EU-related funds and to coordinate measures against fraud, abuse and other improper handling of such funds in Sweden. Apart from the Swedish Economic Crime Authority, the following government agencies are represented in the SEFI Council: the National Financial Management Authority, the Swedish Board of Agriculture, the Västerbotten County Administrative Board, the Swedish Migration Board, the Swedish police, the Swedish European Social Fund (ESF) Council, the Swedish Agency for Economic and Regional Growth, the Swedish customs service.

According to Article 325 of the Treaty on the Functioning of the European Union, the EU and the Member States shall counter fraud and any other illegal activities affecting the financial interests of the EU through measures to be taken in accordance with the article. According to the same article, Member States shall take the same measures to counter fraud affecting the financial interests of the EU as they take to counter fraud affecting their own financial interests.

The SEFI Council has adopted a reporting policy for suspected EU fraud. By means of that document, the members of the SEFI Council have agreed on one joint policy, which includes the reporting of suspected acts of EU fraud to the Swedish Economic Crime Authority. The Council recommends the agencies adopt guiding principles according to the policy.

The crimes in point are covered by the Swedish Criminal Code, and are regarded as EU fraud if the deed is related to the EU's financial interests or illegitimate use of subventions. Also, attempts at fraud or gross fraud are subject to legal proceedings.

The reporting policy should serve as a support and a means of assistance to officials and management of the public agencies on questions related to suspect criminal activity connected to grants totally or partly financed by EU funds, by:

- giving guidelines on when to initiate a report on suspected crime;
- attaining uniformity and safeguarding the agencies' equal and correct treatment of suspected crimes; and
- safeguarding that a possible report on suspected crime provides adequate basis for further judicial action.

5. Ongoing and future reforms

An ambition for the development of the public administration has been to allow greater flexibility for the agencies in a number of areas. By policy statements and various reforms the government has urged the gradual diminishing of management in detail, instead making greater use of the agencies' first-hand knowledge of their operations, making management and control more efficient and effective. Also, the government has stressed the need for developing follow-up, evaluation and result analysis as instruments of control.

Another ambition is improved adaptation of activities to specific conditions influencing the individual agency. Also, there must be a mutual tuning between the government's needs of general information and feedback and the agencies' internal management. After an official report on management in 2007, the government offices focused on revising the letters of appropriation and instructions. Agencies' results are now reported as achievements in relation to the tasks indicated in the instruction of the agency. Furthermore, the structure of activities, uniform for all government activities, by which the government defined objectives for the agencies, was abolished.

In 2010 ESV was commissioned by the government to follow up on the various changes. ESV noted that the degree of change varied between different agencies, but that many agencies found the government control more explicit, more long-term oriented and more relevant.



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Public internal control ⁽¹⁾

1. Brief history of the public internal control (PIC) system

The main origins of the current system of accountability and audit date back to the major reforms of public finance and parliamentary accountability in the 1860s. The primary concepts hold true to this day, whereby the senior-most civil servant in each department is responsible directly to parliament for its effective management and the Comptroller and Auditor General (C & AG), working through his staff in the National Audit Office (NAO), remains an independent source of assurance to parliament.

Central government has always been judged on its ability to effectively implement policy. Throughout the 1960s and 1970s other important factors came to the fore such as efficiency, performance, value for money and customer responsiveness. In the 1980s there was significant structural change to government with the breaking away of service-delivery components from policy formulation to create executive agencies. This separation of policy and delivery remains a key part of the way government works today, with accountability established at each level but with the Departmental Accounting Officer expected to exercise effective oversight of any subsidiary.

From the late 1980s, in response to findings from an NAO report, the treasury established a central unit to oversee the quality and calibre of internal audit across government. It did this by establishing internal audit practice and competence standards. The Government Internal Audit Standards are still in use today, incorporating international internal auditing standards. In line with governance developments in the private sector, the focus of internal audit has evolved from a control focus to a risk-based approach as incorporated into the standards from 2001.

2000 onwards was a period of significant change across government. A high-profile programme of work was instigated aimed at strengthening risk management across government. This ran from 2002 to 2006, introducing central guidance on the principles of risk management and a maturity assessment framework to support ongoing improvement. Another significant development in 2002 was the requirement for the Accounting Officer to sign and disclose a Statement on Internal Control (SIC) in the Annual Report and Accounts. Complementary developments were occurring in the move from cash-based accounting to resource-based accounting, increasing openness in relation to financial reporting and the use of assets.

In 2005 the first Corporate Governance Code for central government departments was produced. Until this point, boards had existed only in some parts of government but the code mandated the existence of boards for all central government departments, supported by an independent audit committee. Where audit committees had already existed, they had largely been populated by

⁽¹⁾ Contributed by HM Treasury on 30 May 2011.

executive members of the organisation. The Corporate Governance Code and supporting Audit Committee Handbook made it clear that audit committees were to be made up of independent non-executive directors to provide an independent challenge to the executive and to enhance the independence and focus of internal and external audit. These changes were designed to align central government with best practice in the private sector.

Whilst different political views have influenced the size and shape of central government, the principles of good governance, control and risk management and openness and transparency have remained constant. The role of the Accounting Officer has been central to accountability in central government over the years, separating the day-to-day management of the civil service from undue political influence. The basic concepts have changed very little. Regularity, propriety and value for money remain key objectives, as do feasibility and the need to avoid waste, fraud, poor control and other management deficiencies. The treasury leads on governance and financial discipline, working hand in hand with the cabinet office on these and other policy issues, informed by the findings and advice of the NAO and the Public Accounts Committee (a bi-partisan parliamentary committee that reviews value-for-money issues across government) and developments in private sector corporate governance.

2. Public internal control environment

The internal control environment in the UK operates within a framework of governance and financial discipline designed specifically for the central government environment. It is allied to the corporate governance requirements that operate in the private sector, but has been adapted to reflect the unique accountability structures in the government sector. The duty to safeguard public funds is central to this.

The treasury

The treasury sets the ground rules for the administration of public money and is accountable to parliament for doing so. Devolved governments may use their own interpretation of these ground rules but are usually very closely aligned. Accounts are produced on a resource-accounting basis, reporting on the expenditure of central government and analysing expenditure by objectives and operating segments. Accounts are based on International Financial Reporting Standards.

The powers used to deploy public resources are a blend of common law, primary and secondary legislation, parliamentary procedure, the duties of ministers and other long-standing practice or precedent. The relationship between the government, acting on behalf of the Crown, and parliament, representing the public, is central to how public resources are managed. Ministers seek to implement government policies and deliver public services through public servants, but are able to do so only when parliament grants the right to raise, commit and spend resources. It falls to the treasury to respect and secure the rights of both government and parliament in this process.

Civil servants are also bound by ethical and behavioural rules as set out in the Civil Service Code — for example setting out the values and the standards of behaviour expected of all civil servants, such as integrity, honesty, objectivity and impartiality. There is also a Civil Service Management Code that sets out regulations and instructions to departments and agencies regarding the terms and conditions of service of civil servants and the delegations that have been made to ministers and office holders in charge of departments together with the conditions attaching to those delegations.

The standards of conduct expected of ministers are set out in the Ministerial Code. Ministers have wide powers to make policies and to issue instructions to their officials. However, specific legislation is required to authorise expenditure of public funds to pursue their objectives. Only ministers can make a proposal to parliament to raise public revenue through taxation or to commit or spend public funds to pursue their policy objectives. Taxes may be collected, and public funds may be drawn, only with parliamentary authority to do so. Parliament approves the legislation that empowers ministers to carry out their policies. It finances services when it approves requests for resources, including approval of net cash resources, year by year.

The treasury makes sure that departments use their powers only as it has intended and that revenue is raised and resources spent only within the agreed limits. The treasury controls public expenditure, therefore all legislation with expenditure implications, both primary and secondary, must have the support of the treasury before it is introduced.

Key to the central control process are the budgets and estimates. Departments are allocated budgets split into resource and capital totals. In turn each central government department allocates its budget among its own responsibilities, cascading provision appropriately to those that receive grants from it, e.g. non-departmental public bodies (NDPBs). Within the budgeting framework, a variety of mechanisms are used to encourage the wise and effective deployment of public expenditure to meet the government's objectives, including delegated authority limits and the requirement for the treasury to approve all novel and contentious spending. The budgeting framework is set out in Consolidated Budgeting Guidance.

The agreed departmental budgets do not of themselves confer authority to spend or commit resources. That requires parliamentary agreement through the estimates process. Departmental estimates containing one or more requests for resources (RfRs) are put to parliament covering one financial year at a time. In turn, departmental estimates also contain provisions for cash and other resources to finance their arm's-length bodies (ALBs) through grants or loans. Departmental select committees may examine the plans contained in departmental estimates. Once agreed, the estimates become the expenditure limits voted by parliament, set in the appropriation acts. These provide the legal authority for public expenditure within the ambit (which describes the activities on which expenditure is permitted).

Within the standards expected by parliament, and subject to the overall control and direction of their ministers, departments have considerable freedom about how they organise, direct and manage the resources at their disposal. It is for the Accounting Officer in each department, acting within ministers' instructions, to control and account for the department's business. The Accounting Officer is usually the most senior civil servant in the organisation and must be able to assure parliament and the public of high standards of probity in the management of public funds. The Accounting Officer personally signs the resource accounts, the annual report and an annual SIC.

Public bodies must provide assurance that they are appropriately managing and controlling the resources for which they are responsible. The SIC is an important accountability document in communicating these assurances to parliament and citizens. The SIC provides a transparent and accountable report of the control issues and risks faced by central government organisations. The SIC is the means by which the Accounting Officer declares his or her approach to, and responsibility for, risk management, internal control and corporate governance. It is also the vehicle for highlighting weaknesses which exist in the internal control system within the organisation. It forms part of the Annual Report and Accounts.

The SIC is a mandatory disclosure for all central government entities that comply with the treasury's Financial Reporting Manual (FRM). It is a primary accountability document. The external auditors will review the SIC to ensure that it has been prepared in accordance with government guidance and that it is consistent with the auditors' knowledge of the entity.

All organisations will have developed their own risk management arrangements and management assurances to support regular reporting and incorporation into the SIC. This will include how they ensure the efficient and effective conduct of their business and avoidance of waste and fraud. There will also be independent internal audit activity as a key component of organisational governance arrangements, providing the Accounting Officer with an objective evaluation of, and opinion on, the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. The Head of Internal Audit's opinions are a key element of the framework of assurance that the Accounting Officer needs to inform his/her completion of the annual SIC.

National Audit Office

Supported by the NAO, the Comptroller and Auditor General (C & AG) helps parliament scrutinise how public funds have been deployed in practice. Independent of the government, the



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C & AG is the external auditor of nearly all bodies in central government (the devolved governments have their own Auditors General). The C & AG has significant and far-reaching rights to inspect the books of a wide variety of public bodies. This includes financial auditing of the resource accounts of departments and NDPBs, providing assurance that resource accounts have been properly prepared and are free from material misstatements and providing confirmation that the underlying transactions have appropriate parliamentary authority. The NAO also conducts value-for-money reviews assessing the economy, efficiency and effectiveness with which public money has been deployed in selected areas of public business. The combination of these factors means that the NAO plays a key role in terms of financial discipline, propriety and efficiency.

By reporting the results of audits to parliament (the financial statements of all government departments and a wide range of other public bodies), the NAO holds government departments and bodies to account for the way they use public money. They also help public service managers improve performance and service delivery by producing approximately 60 value-for-money reports per year.

The NAO works with a range of government and non-government bodies to tackle fraud and reduce the cost of fraud to the UK economy. Stakeholders include the National Fraud Authority (NFA), the CIPFA Better Governance Forum, the Audit Commission and the Counter Fraud Champions. (See below.)

The audit rights of the NAO are vested in the head of the NAO, the C & AG. The parliamentary committee, the Public Accounts Commission, carries out oversight of the NAO (around 900 staff) and appoints the external auditors of the NAO and scrutinises its performance. These specific powers and duties are laid down in several acts of parliament, which:

- establish the NAO and the appointment of the C & AG; and
- place many of the C & AG's audits on a statutory footing, allow for the carrying out of value-for-money examinations and give the NAO wide rights of access to information for audit purposes.

Separate legislation provides the legal authority for the C & AG to audit the collection of certain taxes, duties and license fees and ascertain whether the bodies responsible for collecting revenue have framed and duly implemented adequate regulations and procedures to secure an effective check on the assessment, collection and allocation of the revenues for which they are responsible.

The NAO audit of financial statements is carried out in accordance with International Standards on Auditing (UK & Ireland) issued by the Auditing Practices Board (APB). NAO output is focused on the following three general areas:

- informed government, to encourage government to do more to base its decision-making on reliable, comprehensive and comparable information;
- financial management and reporting, to improve management of activities and to encourage the finance function in departments to make a full contribution;
- cost-effective delivery, to encourage departments to better understand the key elements in the delivery cycle and what they cost.

The SIC, a mandatory public accountability document that describes the effectiveness of internal controls in an organisation, is reviewed by the NAO as part of the audit of financial statements. To provide assurance to parliament that public bodies are appropriately managing and controlling the resources for which they are responsible, the NAO reviews SICs to ensure that they are supported by robust evidence and that the underlying controls are sufficiently reliable.

3. The concept of public internal control in your administration

3.1. Implementation of the control environment

Management accountability is clearly established in terms of governance and financial discipline. The senior-most official that heads up the department or organisation is normally appointed

as its Accounting Officer. This accountability will be clearly set out upon appointment. The Accounting Officer must establish and document a clear allocation and delegation of responsibilities amongst officials in the department, but he or she retains personal responsibility and accountability to parliament for this, independent of the minister.

The Accounting Officer is personally responsible to parliament for regularity, propriety and value for money and feasibility in respect of the use of public money. This includes ensuring that there is an effective governance structure and trustworthy internal controls. Other senior officials in a large department may be appointed as additional Accounting Officers but the Departmental or Principal Accounting Officer retains overall responsibility to parliament for ensuring a high standard of financial management in the department as a whole.

In line with Managing Public Money, it is incumbent upon the Accounting Officer to establish an appropriate control environment suitable for the nature, business and unique profile of risk faced by the organisation. Financial and functional delegations will be assigned so that the Accounting Officer is supported on the full spectrum of their responsibilities. Adequate delegations, controls and reporting arrangements must be in place to provide assurance to the board, the Accounting Officer and ultimately ministers about what is being achieved, to what standards and with what effect. In turn, these arrangements should provide the management with information to enable delivery plans to be adjusted as necessary. Similar feedback should enable ministers to reconsider their policies where the evidence shows that this is appropriate.

3.2. Risk management

It is for the Accounting Officer to determine an appropriate and sound system of internal control. This includes a robust framework of risk management. Central guidance on the principles of good risk management is set out centrally in the treasury's Orange Book. Departments and their ALBs are responsible for establishing appropriate risk management arrangements to meet their own specific governance and accountability needs. Therefore, how risk management has been implemented will vary by nature of the diverse business models and structures in place, but will follow similar principles as advocated in the Orange Book. The Orange Book makes clear that the management of risk should be led from the top and embedded in the normal working routines and activities of the organisation. The treasury has also produced a Risk Management Assessment Framework that departments can use to assess the relative maturity of their risk management arrangements.

3.3. Implementation of control activities

Control activities will vary by department depending upon the type of services delivered. Each organisation will have put in place specific arrangements and policies to control their activities, including decision-making, performance monitoring, fraud response, financial management, risk management arrangements, etc. Departments are advised to document the chain of responsibilities and the processes by which they will be delivered.

3.4. Processes to manage information and communication

Departments must have in place management information systems to secure assurance about value for money and the quality of delivery, enabling timely adjustments. They need regular and meaningful management information on costs (including unit costs), efficiency, quality and performance against targets to enable the assessment of value for money.

3.5. Monitoring of control activities and their ongoing improvement

Having established a sound system of internal control it must be regularly reviewed and reported on. Public bodies must provide assurance that they are appropriately managing and controlling the resources for which they are responsible. The SIC is an important accountability document in communicating these assurances to parliament and citizens. The SIC provides a transparent and accountable report of the control issues and risks faced by central government organisations. Although formally completed annually it is recommended that it be considered at various points during the year. The Audit Committee, made up of independent non-executive directors,



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supports the Accounting Officer with the primary responsibility of reviewing the comprehensiveness and reliability of assurances throughout the year.

On an annual basis, the Accounting Officer will sign an SIC declaring his or her approach to, and responsibility for, risk management, internal control and corporate governance. This will highlight any existing weaknesses in the organisation's internal control system, to be disclosed as part of the Annual Report and Accounts. In order to meet this obligation, there must be an evidence base underpinning the completion of the SIC. This will be in the form of stewardship reports from directors and senior managers attesting to how they have met their individual delegated obligations supported by a separate and independent opinion provided by the Head of Internal Audit. The Audit Committee will have considered the underpinning assurances and reviewed the SIC on behalf of the Accounting Officer before it is finalised. The SIC is reviewed by external auditors as part of their financial statement audit to ensure it is consistent with the financial statements and the evidence gathered during their work. Where it is not, or where it is not compiled in accordance with the relevant guidance, they will report that fact.

The above arrangements cover exchequer-funded work. Where work is subject to EU funding the additional regulatory control, audit and checking arrangements are rigorously applied.

3.6. Internal audit

3.6.1. Context

The minister is responsible for government policy, but is not an executive part of the organisation responsible for policy implementation and delivery. The senior-most executive within an organisation is usually designated as its Accounting Officer and, as well as supporting the minister, is separately and personally accountable to parliament and the public for the propriety, regularity and value for money of the funds their organisation consumes and the feasibility of the work. He/she is required to maintain a sound system of internal control in the stewardship of his/her organisation and is required to sign an annual declaration to attest to the fact that they have kept this under review, disclosing any significant weaknesses within an SIC that is incorporated into the Annual Report and Accounts.

Internal audit is not a regulatory requirement, but is enshrined as a mandatory part of governance and assurance arrangements within central policy rules. This means that every government department and ALB will have an internal audit service. The primary purpose of internal audit is to provide the Accounting Officer with an objective evaluation of, and opinion on, the overall adequacy and effectiveness of the organisation's framework of governance, risk management and control. The Head of Internal Audit's opinion is a key element of the framework of assurance that the Accounting Officer needs to use to inform his/her completion of the annual SIC. For this reason our standards state that the Head of Internal Audit must be professionally qualified.

3.6.2. The internal audit role

In order to maintain its independence within the organisation, internal audit should report directly to the Accounting Officer, independent of all other directors. It should also have a reporting line to the board, which is usually fulfilled through an independent non-executive Audit Committee. These arrangements are set out in the Government Internal Audit Standards that are issued by the treasury and incorporate the international standards of the Institute of Internal Auditors. Audit Charters set out the purpose, authority and responsibility of internal audit, addressing its independence needs, and are approved by senior management and the board. Internal auditors should not carry out duties outside their professional remit. Should they do so, such duties must be openly disclosed and associated steps must be taken to avoid compromising their objective role.

The programme of audit work requires professional audit judgement to determine what coverage is necessary to provide a sufficiently robust assurance on the framework of risk management, control and governance. Audit strategies and plans must be agreed with the Accounting Officer and the board/Audit Committee to ensure that they are appropriately targeted and resourced. This will incorporate many different types of audit including financial audit work, IT coverage,

strategic and operational work, programme and project work, security and information security and regulatory review, as deemed appropriate to the governance, structure, responsibilities and unique profile of risk of the specific organisation. The audit work will very much cover efficiency, effectiveness and economy while paying attention to the potential for fraud. Some internal auditors may carry out elements of compliance work, but we would normally expect this to be an independent part of management's own assurance arrangements, on which internal audit may choose to place reliance if it is satisfied that it has been carried out objectively and effectively.

Consultancy assignments are a recognised part of internal audit work. However, our standards go further than the international standards, stating that consulting engagements should aim to improve governance, risk management and control, that the evidence gathered should contribute to the Head of Internal Audit's opinion and that the internal auditor must maintain objectivity and not take on management responsibility.

The internal audit role is not to manage fraud risk on behalf of the organisation but to provide an assurance that risks, including fraud risk, are being managed effectively. If, during an audit assignment, internal auditors identify control weaknesses that could allow fraud, or find evidence that fraud has been, or is being, perpetrated, they will refer to local internal audit policy/procedures on handling suspected fraud and consult the organisation's fraud response plan. This will normally identify what they need to do and who they need to alert. They may need to extend the audit work and design additional tests directed towards the identification of activities which may be indicators of fraud and consider the rights of any alleged perpetrators in order to decide whether there is clear evidence of fraud to recommend an investigation. The extent of the concern would be recorded so that it can be part of the Head of Internal Audit's overall assurance. A key consideration would be at what point to alert management (e.g. staff with designated anti-fraud responsibilities or a Money Laundering Reporting Officer). This will be a key decision for the Head of Internal Audit based upon the individual circumstances and the locally established policies, procedures and responsibilities.

Audit recommendations are handled as agreed management actions for which implementation responsibility lies with line management. Internal audit must establish a follow-up process to monitor and ensure that management actions have been effectively implemented or that senior management has accepted the risk of not taking action. It is incumbent upon the Head of Internal Audit to develop clear escalation procedures for any management response which they judge is inadequate in relation to the identified risk. The Audit Committee plays a key role in ensuring that management's response and resolution of issues is satisfactory. Audit Committee responsibilities are set out in the Audit Committee Handbook published by the treasury.

3.6.3. Relationship with external audit

In central government, the NAO, under the C & AG, is responsible for external audit. The NAO audits the financial statements of all central government departments, agencies and other public bodies and reports the results to parliament. It also carries out approximately 60 value-for-money studies each year looking at how government projects, programmes and initiatives have been implemented. The external auditor is independent of government and the work is primarily conducted for the benefit of parliament and the public, but is still of significant benefit to the organisation. The results of external audit reviews are published and in the public domain. There are equivalent external audit bodies for each area of devolved government and the Audit Commission is responsible for appointing the auditors for local authorities and health service bodies in England and for promoting value for money in these sectors.

Internal audit and external audit are encouraged to cooperate by sharing strategies, plans and working practices to optimise audit coverage and reduce the audit burden on the organisation. External auditors may seek to place reliance on internal audit work in accordance with ISA 610 if it considers that the work is sufficiently objective and technically competent and has been carried out with due professional care.

3.6.4. The Audit Committee role

The Audit Committee is an independent committee of the board comprising independent non-executive directors. The Committee has particular responsibilities relating to the work of internal



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and external audit and to assurance and financial reporting issues. It provides an independent challenge to the executive and one of its primary duties is to ensure that there is comprehensive and reliable assurance to support the Accounting Officer in discharging his/her responsibilities.

There is consequently a major synergy between the purpose of the Head of Internal Audit and the role of the Audit Committee. The committee will typically be interested in internal audit's charter/terms of reference to ensure that it has sufficient status and independence to operate freely and effectively in its work. It will also take a close interest in the adequacy of audit resources. The committee will advise the board and Accounting Officer on internal audit strategy and plans, forming a view on how well they support the Head of Internal Audit's responsibility to provide an annual opinion on the overall adequacy and effectiveness of the organisation's governance, risk management and control processes. The committee will monitor the results of internal audit work and how well management responds to issues raised by that work.

3.7. Coordination of public internal control

The treasury and cabinet office are the lead departments in government responsible for setting policy and advocating good-practice principles. The rules and principles for governance, financial discipline and control are centrally established. An independent Financial Reporting Advisory Board (FRAB) advises the treasury on technical accounting principles for the preparation of financial statements. The FRAB acts as an independent element in the process of setting accounting standards for government and exists to promote the highest possible standards in financial reporting. The FRAB ensures that any interpretations or adaptations of generally accepted accounting practice in the context of the public sector are justifiable and appropriate.

Coordination of good practice is largely achieved through professional networking arrangements. For example, the treasury has central teams that take the lead in supporting the government finance profession and government internal auditors, setting policy and best practice, arranging events and providing direction for the development of the respective professions. Professionals are encouraged to share areas of common interest and to help promote cross-government improvements. There is also an Interdepartmental Audit Group that shares good practice in auditing EU-funded work.

Departments take personal ownership of their performance and drive their own programmes of continuous improvement. Every department has to disclose how well its system of internal control has operated on an annual basis in its report and accounts, which are audited and published. The Accounting Officer has to make an evidenced assessment and make appropriate disclosures, based upon stewardship reports from the directors and an independent opinion from the Head of Internal Audit. There are a number of tools that have been developed centrally that are made available to departments for them to assess and improve their capability. For example, there are assessment tools for procurement, programme and project control, financial management, internal audit, risk management, information risk management, security, fraud, financial systems risk, value for money, etc. It is for departments to assess their own capability by exercising their day-to-day responsibilities and drawing upon such tools, with the results often independently validated by peer review or internal audit.

The NAO, in selecting value-for-money audits, will often give a cross-government perspective on particular subjects such as risk management or financial control. This can make evident situations in which particular departments are not performing as well as others and need to make improvements. Reports are publicly available and the value-for-money reports provide evidence for the Committee of Public Accounts hearings on behalf of parliament.

The cabinet office is responsible for supporting the prime minister and the cabinet of the UK government. It works closely with the treasury on governance and takes the lead on capability and in relation to security. The cabinet secretary, who is the head of the civil service, has a capability review team that commissions capability reviews of departmental performance using senior leaders from across the public, private and voluntary sectors. They assess whether departments have the right strategic and leadership capabilities, how well they are performing and consider whether they have right staffing skills, tools and appropriate engagement with key stakeholders, partners and the public.

From time to time, the treasury will review the current state of the profession and work collaboratively with departments to plan and implement any necessary improvements. Occasionally, the reviews or proposals are of such a nature or profile that they will be discussed by a parliamentary committee. For example, the Public Administration Select Committee reviews the proposed changes to board-level governance arrangements. Other reviews and proposals tend to be published on the treasury website, often as part of a departmental consultation process before being finalised and implemented.

For some high-risk programmes/projects there is greater central visibility and intervention. For example, there is a Major Projects Review Group (MPRG) that scrutinises and approves government's largest and most complex major projects. Other significantly important projects also go through a treasury approval process to ensure that there is a strong business case for the work and that it is affordable and viable. For such projects there needs to be a comprehensive assurance plan and the project will be subject to treasury approval points throughout the project lifecycle.

Internal auditors review their own department's internal control arrangements in order to inform the Accounting Officer, enabling him/her to meet the accountability obligations. Internal audit reports are purely for internal consumption. They could be released as part of a request for information under the Freedom of Information Act, but would be subject to the public interest test before being disclosed.

Internal auditors are required by the Government Internal Audit Standards to carry out periodic internal reviews of their own effectiveness and, at least once in a five-year period, commission an independent external review. The treasury has put in place peer review mechanisms to ensure that professionally qualified reviewers with sufficient status and experience are made available to independently review those requiring assessments. For government, the treasury requires the reviews to be commissioned by the Accounting Officer as the main recipient of the assurances. There is a Head of Government Internal Audit Profession within the treasury who is responsible for the standard of internal audit across government and driving forward a programme of improvement. In terms of coordination, the treasury supports networking and continuous professional development.

4. Fight against fraud

The NAO works with a range of government and non-government bodies to tackle fraud and reduce the cost of fraud to the UK economy. Stakeholders include the National Fraud Authority (NFA), the CIPFA Better Governance Forum, the Audit Commission and the Counter Fraud Champions. The NFA is an executive agency within central government that brings together the efforts of a large number of counter-fraud bodies across the private, public and voluntary sectors that are involved in gathering intelligence and taking action against fraudsters. In central government a network of Counter Fraud Champions has been established, representing all main departments, with a view to tackling fraud and error. The Counter Fraud Champions will lead the fight against fraud and error in their own central government department and in the agencies and other public bodies for which the department has responsibility. Their priorities will include instilling an anti-fraud culture in their organisation, measuring fraud in their departments and publishing the figures for the first time, making sure new policies and programmes are fraud proofed by undertaking fraud risk assessments.

5. Ongoing and/or future reforms

Resource accounting — International Financial Reporting Standards (IFRS)

For some time, UK government accounts and budgets have been prepared on a resource-accounting basis. This entails the application of accruals accounting for reporting on the expenditure of central government and a framework for analysing expenditure by departmental aims and objectives, relating these to outputs where possible. This has provided incentives to departments to improve the management of what it owns and what it owes (its assets and liabilities). It provides information on how resources have been used to meet objectives and enables users of the accounts to assess more easily whether taxpayers are receiving value for money. A recent



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development has been the adoption of IFRS, providing greater read-across between the preparation of private and public sector accounts.

Clear Line of Sight

This development has simplified financial reporting to parliament by ensuring that it reports in a more consistent fashion, in line with the fiscal rules, at three stages in the process — on plans, estimates and expenditure outturns. The work has aligned budgets, estimates and accounts in a way that allows the treasury to control what is needed to deliver the fiscal rules, incentivises value for money and reduces burdens on government departments. It has combined and/or aligned the timing of the publication of government financial reporting documents in order to avoid duplication and make them more coherent.

Whole of Government Accounts

This work is the consolidation of accounts from some 300 central government bodies, including devolved administrations, 600 local authority bodies, 300 NHS and Foundation Trusts and 60 public corporations. The aim was to improve accountability to parliament, allowing comparisons across the public sector and improving the quality of data, including those used in the national accounts.

Sustainability

The government encourages both companies and public bodies to disclose their sustainability and environmental performance via their annual reports and accounts and some aspects are likely to be made mandatory across central government in 2011–12.

Transparency

The government is encouraging greater transparency across its operations to enable the public to hold public bodies and politicians to account. This includes commitments relating to public expenditure, intended to help reduce the deficit and achieve better value for money. As part of this transparency agenda, the government has made a number of initial commitments with regard to central government expenditure, including increased publication. Business plans and progress against key commitments will also be routinely published.

Governance — Lead Non-Executive Board Members

Since May 2010, the Ministerial Code has been changed whereby the Secretary of State will chair the departmental board (the Lead Non-Executive Board Member, or another ministerial board member, may occasionally deputise if necessary). Previously, the Accounting Officer usually chaired the board for departments. This change has been incorporated into a revised Corporate Governance Code for central government. To coincide with this change, each board now has a Lead Non-Executive Board Member who meets regularly with other non-executive board members to ensure their views are understood and that the Secretary of State is made aware of any concerns (including through ensuring that the non-execs meet alone with the Secretary of State from time to time). The Lead Non-Executive Board Members support the Secretary of State in his or her role as Chair of the Board and liaise with the government-wide Lead Non-Executive Board Member.

Governance statements

From 2011/12, it is proposed to incorporate and replace the current SIC with a governance statement. This would pull together into one place what is required for the existing SIC and draw in wider governance reporting, much of which is already required on a comply-or-explain basis as part of governance reporting. This is seen as a good opportunity to position the SIC more firmly into the governance context of which it is clearly a part. The NAO has also identified a number of ways that governance reporting could be strengthened and supporting guidance will address these points. This will help to ensure that governance statements incorporate appropriate disclosures and support better-evidenced assurance reporting.

Internal audit

Changes are proposed to the way that the internal audit service is provided, based around group or shared service structures, to ensure that it is clearly linked to the strategic objectives of the department, with a more flexible people and resourcing model designed to stimulate innovation and renewal and provide development and career opportunities. This will be carried out through effective engagement with key stakeholders on risk management and assurance so that internal audit can help to make a positive and tangible contribution to an organisation's success and delivery imperatives.



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Appendices



APPENDIX 1

STRUCTURE FOR NATIONAL CONTRIBUTIONS TO THE QUESTIONNAIRE SENT TO MEMBER STATES BY DG BUDG B.4

APPENDIX 1

Public internal control systems in the EU Member States

A. Introduction

The 27 Member States have produced their contributions on the basis of a structure/template developed by the Budget DG specifically for this Compendium. This template helps the reader to benchmark each of the Member States' contributions against the suggested structure. The headings and subheadings of one contribution correspond to similar headings in other contributions, as much as possible, facilitating the comparison of items.

A.1. The objective of the Compendium

The objective of this exercise is to make Member States' contributions comparable for future analysis and discussions. In turn, such an analysis will provide a description of the different structures and roles of public internal control systems in the environment in which they operate. In other words, this exercise tries to describe the current state of affairs rather than looking for an ideal system.

A.2. The scope of the description of the public internal control systems

We limit the information sought to first-level spending units (e.g. ministries, agencies, etc.). We do not refer to regional bodies and municipalities. In the case of public federal structures we suggest descriptions of the public internal control systems be restricted to performance at federal level. If you think that it would be appropriate to describe a specific public internal control system at sub-federal level, then please do so.

A.3. Structure of the template

We suggest that your contribution could be structured to cover the following points:

- brief history of your present public internal control systems;
- the public internal control environment;
- the concept of public internal control in your administration;
- managerial accountability and responsibility;
- internal audit;
- coordination of internal control;
- financial inspection;
- ongoing and future reforms.

For each of the above categories, a short description is provided below of what we believe could, if appropriate, be usefully included. Nevertheless, participants may of course introduce further elements if deemed necessary.

In order to appreciate the different components in the internal control concept (point three), it is necessary to take a broad view that will allow for a contextual understanding. The brief history of the public internal control system; the public internal control environment and the ongoing and future reforms (points one, two and five) are intended to serve the purpose of promoting such a contextual approach.

Since the strength and appropriateness of the legal framework is fundamental to effective internal control it is essential that a list of the legal bases of public internal control is provided (e.g. organic budget laws, framework or implementation laws). It is also useful to indicate at what level laws have been adopted (e.g. government, Ministry of Finance or individual line ministries). However, it is not intended to list the articles of the different laws.

Finally, a legal framework in itself does not make for an efficient and effective internal control system. Therefore, please also try to reflect the practical operation and implications of the legal framework in the public internal control system.

B. Suggested structure of the contribution

Please find hereafter the INTOSAI ⁽¹⁾ definition of public internal control:

Public internal control is ‘an integral process that is effected by an entity’s management and personnel and is designed to address risks and provide reasonable assurance that in pursuit of the entity’s mission, the following general objectives are being achieved: executing orderly, ethical, economical, efficient and effective operations; fulfilling accountability obligations; complying with applicable laws and regulations; and safeguarding resources against loss, misuse and damage.’

B.1. Brief history of your present public internal control systems

Please provide a brief overview of the origins and history of your present PIC systems. To set the history in context, it could be worthwhile, where appropriate, to describe what kind of parallel strategies are or were supporting the PIC reforms. These could be strategies or policies related to public administration reforms (PAR) or public expenditure management (PEM).

Public administration reform refers to the overall efforts to improve management, administrative capacity and the way in which the public sector is organised. Public expenditure management focuses on budgeting, accounting and central inspection functions as well as internal control.

Again, where appropriate, please outline who were the drivers of the reform or which institutions played a leading role in the steps towards a modernised government (e.g. parliament, supreme audit institution, Ministry of Finance, Ministry of Interior, etc.) and how the reform was managed.

B.2. Public internal control environment

Please describe the main characteristics of the current systems that provide for the PIC environment, such as the national budget and accounting systems (cash-based or accrual accounting, central accounting system), input or programme budgeting, external audit and the fight against fraud and/or irregularities.

B.3. The concept of public internal control in your administration

Please find herewith the INTOSAI guidelines for internal control in the public sector standards. The components mentioned below constitute the accountability and responsibility of the manager.

⁽¹⁾ International Organisation of Supreme Audit Institutions.

The guidelines cover the following five interrelated components:

- implementation of the control environment;
- risk management;
- implementation of control activities;
- processes to manage information and communication;
- monitoring of control activities and their ongoing improvement.

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Please describe the characteristics and/or elements on which your PIC system is built. We would like you to focus on three elements which we think are relevant, if appropriate, for the situation in your country (if not, a statement to the effect that it does not is sufficient).

1. Managerial accountability/responsibility
2. Internal audit
3. Coordination of public internal control development

B.3.1. Managerial accountability/responsibility

Managerial accountability refers to a process whereby managers at all levels are responsible for, and may be required to explain, the decisions and actions taken to meet the objectives of the organisation they manage.

Managerial accountability implies responsibility for sound financial management at all levels, i.e. the adequate organisation, procedures and reporting of the results of the organisation. This is a democratic principle and relates to the transparency of the government.

Managerial accountability in relation to the INTOSAI guidelines mentioned above refers to the manager's responsibility for all five components mentioned above.

Please describe how the principle of managerial accountability/responsibility is understood in your administration and whether you recognise that it is or is not interlinked to your PIC system.

If you recognise a link between the principle of managerial accountability and your PIC system, please then describe this by taking into account the aspects below.

- How do top managers assume their responsibility for establishing an adequate internal control system? Please cover, where applicable, the five interrelated components referred to above.
- Is managerial accountability exercised by a politically appointed manager or by the top administrative manager?
- To what extent is delegation of responsibility and of authority used as a tool to delegate decision-making powers?
- To what extent are the responsibilities for policy development and for the implementation of these policies split?

The support that top managers (the term 'top manager' is here used for senior officials that are responsible for either policy development or carrying out these policies) receive from financial officers^(?) (for example budget preparation, preparation of the authorising officer's financial decisions, *ex ante* control processes, tendering and contracting, management advice, accounting and elaboration of financial procedures and guidelines).

^(?) A financial officer is an officer who is responsible for implementing the rules related to the financial management, accounting and preparation of the financial statements in the unit and reports to the top management of the unit.

How do top managers assume their responsibility for determining objectives at all levels and budget planning accordingly?

The objectives of the internal control system (focus on regularity/legality of transactions and/or on value for money (performance) and fulfilment of policy objectives) and its scope (does it cover all financial decisions, i.e. appropriations/commitments, tendering and contracting procedures, income, disbursements, management of assets and liabilities and recovery of unduly paid amounts?)

How is the reporting system organised in general and, especially, any kind of signing off and reporting about the overall performance? (If applicable, please, include information about, for example, a system of annual declaration of assurance or other means of 'signing off'.)

B.3.2. Internal audit

We define internal audit using the following IIA ⁽³⁾ definition:

'Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance process' (the Institute of Internal Auditors)

Internal audit is an integral part of public internal control. However, unlike the other aspects of internal control, that fall under the manager's responsibility, internal audit is functionally independent from the top management.

If your administration has developed internal audit of this kind in the framework of PIC, please describe how it is functionally organised, with reference to:

- the legal basis for internal audit;
- the nature of functional independence of the internal auditor vis-à-vis the top manager to which the internal auditor is attached, in particular regarding:
 - freedom of audit reporting and to make recommendations to the top management or lower levels;
 - the use of audit charters (to be agreed upon between management and the internal audit function);
 - the acceptance of duties that are outside the scope of internal audit and fall under managerial responsibility, including rules to solve conflicts of interest;
 - the function of internal audit to be subject to continuous professional training and public certification procedures — please describe briefly the training scheme;
 - to whom internal audit reports;
 - types of audits that can be performed, e.g. assurance assignments (financial audit, compliance audit, performance audit) and consultancy assignments.

Please explain the formal follow-up procedure for managers related to internal audit reports. Also explain the procedures to be followed when, during the course of an audit, indications of fraud and/or irregularities are identified.

Please describe whether and how the duties between internal audit and financial inspection are separated.

⁽³⁾ Institute of Internal Auditors.

B3.3. Internal audit relations with external audit

The external audit is defined as the activity carried out by the supreme audit institution (SAI), which is external to and independent of the auditee, the purpose being to give an opinion on and report on the accounts and the financial statements, the regularity and legality of operations and/or the financial management to the parliament.

Please describe existing processes for coordination between internal audit and the supreme audit institution (from the point of view of the internal audit).

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B3.4. Audit boards or audit committees

Audit boards are defined here as organisations that provide the government with policy advice on the quality and functioning of internal audit in the entire public sector. Audit committees are defined as organisations in, for example, ministries/agencies that defend the functionally independent role of internal audit vis-à-vis management and support management in understanding and following up on internal audit recommendations.

Please indicate whether any such organisations exist and, if so, provide a short description of the functioning of such audit boards or audit committees. Please also explain the reasons why, in your country, audit boards or audit committees have or have not been developed.

B3.5. Coordination of public internal control

Please indicate whether, in your country, there is coordination of internal control policy/methods throughout the administration, with particular reference, where appropriate, to any central coordination or harmonisation unit(s), their location and to whom they report.

Do these units regularly assess the functioning of internal control systems or internal audit across the public sector and do they produce regular reports/periodic reviews on the state of these systems? If so, to whom are these reports addressed and how are they followed up?

B4. Financial inspection

Financial inspection refers to the activities of a (centralised) governmental body (acting either on its own initiative or on receipt of complaints), that aim to assess the legality, purposefulness and timeliness of use of budgetary funds with a view to establishing violations, fraud and/or irregularities that have, or may have, a negative impact on the budget.

This section seeks information on any possible role that a financial inspection service may have in relation to your internal control system, with particular reference to the positioning and role of any kind of central institution within the public administration that is responsible for fighting fraud and/or irregularities through financial inspections.

Please describe who may initiate inspections by any such 'financial inspection body' (for example requests from Cabinet of Ministers, Ministry of Finance, line ministries, Ombudsman, third parties, any other party, annual investigation programmes, etc.); to what extent this body can undertake inspections on an *ex ante* basis, *ex post* basis or both; and what systems or rules exist for coordination of activities between the 'financial inspection body', internal auditors (as defined above) and other internal control staff.



B5. Ongoing and/or future reforms

Please provide information on ongoing or planned reforms in the public administration reforms, public finance management or public internal control areas and, if appropriate, the reasoning behind these reforms.

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This **Compendium** provides a structured overview of the various Public Internal Control systems used in each of the 27 EU Member States to manage and control their national funds, revenues and expenditures.

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