



## SIGMA

### Support for Improvement in Governance and Management

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## CROATIA

### PUBLIC INTERNAL FINANCIAL CONTROL (PIFC)

ASSESSMENT MAY 2008

#### 1. Introduction

The change process in the area of Public Internal Financial Control (PIFC) in Croatia has continued to develop since mid-2007. This process does not only concern the legal framework, but also the policy aspects, with the adoption of a strategy for PIFC at the local level and of course the implementation steps. However, the legal aspect has remained important, in particular with the adoption of secondary legislation to the recent PIFC Law.

The main actor in the area of internal financial control is the Ministry of Finance, in particular the Central Harmonisation Unit (CHU) for Financial Management and Control (FMC) and Internal Audit (IA), set up as a result of the adoption of the new Public Internal Financial Control Law of 15 December 2006.

#### 2. Baseline Questions

##### 2.1 *Is a coherent and comprehensive statutory base in place, defining systems, principles and functioning of financial control?*

Until the adoption of the PIFC Law, the Organic Budget Law of 3 June 2003 (OBL), otherwise known in Croatia as the Budget Act, provided the overall framework for internal financial control, defining the role and responsibilities of the various actors and the concept of “budget-user”. The head of a “budget-user” is responsible for budget planning and execution. The OBL further introduced the tasks of internal audit and budget supervision as well as the function of financial controller.

The OBL remains the foundation for the whole system of budget execution and related control procedures, but it has been further supplemented by the PIFC Law, which provides in detail specific PIFC concepts and procedures and brings up to law level the provisions relating to internal audit, previously contained in secondary legislation (“rulebook”).

As part of the efforts related to the accession process, public internal financial control has been subject to an overall approach, leading to the *Policy and Vision of Internal Audit* of July 2003, followed by a first *Development Strategy of PIFC in the Republic of Croatia*, adopted by the government on 2 September 2004. While constituting a substantial improvement in the area, the latter document was considered too vague and allusive to be really useful as a basis for the development of PIFC. The Croatian authorities (the new Department for Harmonisation of Internal Audit and Financial Control in the lead, but also sample line ministries and the supreme audit institution, i.e. the State Audit Office), in close co-operation with the technical assistance providers in place, drafted a second version of the strategy. This thoroughly revised document was adopted by the Council of Ministers on 15 June 2005, after receiving a positive opinion from the European Commission, and now constitutes the basis for further developments in this area. It can thus be regarded as a policy paper to help in the establishment of a comprehensive PIFC system. The text summarises the achievements so far in the area of PIFC and makes further suggestions for the full development and refinement of the current system. The document refers equally to national funds and EU

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funds. The PIFC principles mentioned in the policy document were to be translated into legal provisions, and the strategy foresaw the drafting and adoption of the PIFC framework law. The strategy has now been complemented by an action plan, aimed at describing the actions needed in the period 2007-2008 for the completion of the strategy and in particular the implementation of the adopted PIFC Law.

The draft of the PIFC Law was initially prepared by a group composed of CHU employees, representatives of line ministries and of the State Audit Office, professors from the faculty of economics, and the head of internal audit of a state-owned company. Due to various circumstances, the drafting of the PIFC Law took more time than initially planned, and the process took more than 18 months to be finalised, with the support of the European Commission (DG-Budget).

The resulting text deals with both financial management and control and internal audit, including central harmonisation functions. It contains the basic ingredients composing the strictly speaking PIFC part of chapter 32 and was accordingly considered favourably by EU authorities. However, the text that was adopted, which does not seem to have raised many discussions in parliament, tends to over-regulate the area, at the expense of flexibility and adaptation capacity. This over-regulation could result in implementation problems, especially as a number of provisions are rather abstract, and their relation to administrative and financial realities in Croatia is not obvious. For the sake of clarity, an important effort of explanation and awareness-raising would be worthwhile, targeting key public officials, starting with the managers in charge of implementing the new framework..

A better co-ordination between this text and the other existing (and applicable) texts is still needed. In particular, an assessment is still to be made of the impact of the adoption of an overall PIFC Law on the current OBL, which already contains a number of provisions related to PIFC. Consequences should be drawn from such a review in terms of amending the OBL, including deleting its superfluous or contradictory provisions. This exercise should have been carried out once the PIFC text was adopted. This was not the case, and it will be useful to consider this now in the process planned to amend the OBL.

The PIFC Law does not specifically amend the OBL, which still contains meaningful provisions related to PIFC, in particular the initial basis for the principle of managerial accountability and the possibility of delegation within a hierarchical structure. The PIFC Law can be understood as a further detailed elaboration of the functions defined in the OBL. It would be preferable to clarify the issue and expertly screen both texts so that risks of either redundancy or discrepancy are prevented and finally eliminated.

According to the provisions of the Organic Budget Law, the secondary legislation relating to internal audit was practically completed with the adoption of the budget-users' internal audit rulebook in August 2004, which the new rulebook of 12 December 2005 revised completely. This more recent text adequately covered most issues now addressed by the PIFC Law, and the rulebook format was in many respects more appropriate than a law format for internal audit-related issues. . The Minister of Finance has passed two specific rulebooks dealing with internal audit and financial management and control, adopted respectively on 3 and 28 March 2008.

**In the context of the chapter 32 accession negotiations, the government has now developed a PIFC Strategy and Action Plan, which has already been revised on various occasions. A PIFC Law has been adopted as a further result of this process. It still needs careful harmonisation with existing legislation, such as the Organic Budget Law, which still contains important PIFC-related provisions. There will be a need for further resources to support the effective implementation of this new framework. The Croatian authorities will need to proceed speedily and in a co-ordinated manner with other public actors, in particular other budget-users, in the implementation of the new provisions, including efforts in training and awareness-raising at all relevant levels of the public administration.**

## **2.2    *Are relevant management control systems and procedures in place?***

The Organic Budget Law establishes that the head of a “budget-user” is responsible for the lawful and proper planning and execution of the budget [art. 5 (3)]. This very general provision needs detailed implementing rules, and some are still missing (e.g. the decrees and rulebooks foreseen in article 8 of the Organic Budget Law). In addition, since each budget-user is responsible for the production of its own specific rulebooks, there is a risk – and there is already some evidence – of discrepancies or even gaps in the areas where the Ministry of Finance rulebooks did not provide any particular guidance.

The main innovation of the PIFC Law is that it defines the concept of financial management and control, its purpose and organisation. It defines more specifically the responsibility of the head of a budget-user and how

his/her function can be delegated. It furthermore introduces two new functions in addition to the head of the budget-user: the head of financial management and control (responsible for setting up and implementing financial management and control), sometimes referred to as the “FMC champion”. and the co-ordinator of financial management and control (responsible for “operationally carrying out and co-ordinating the establishment and development of financial management and control”). From the mere wording of the PIFC Law, the difference between these two functions is not very clear (both are involved in the establishment of the FMC system, but the co-ordinator is more involved with operational tasks).

The PIFC Law devotes detailed provisions to the quotation of the basic components of the “COSO” internal control model. Control activities are mentioned in a non-exhaustive list, but the decision regarding which activities are to be selected and implemented in the specific organisation is left to the head of the budget-user.

These provisions have started to be implemented with the appointment of the heads of financial management and control (“FMC champions”) and the FMC co-ordinators and with the setting up of the FMC working groups that are required by the secondary legislation. Operational activity in this area will only begin once the appointed persons have undergone a training programme organised by the Minister of Finance. However, within six months after the enforcement of the PIFC Law, the appointed heads of financial management and control have to produce and to have adopted the “FMC system establishment and development plans” that are to be introduced in each budget organisation. This plan should in principle be based on a self-assessment exercise that is meant to evaluate the five financial management and control components taken from the COSO framework. This evaluation should be supplemented by a description of the “business processes”, including the audit trail attached to each process. All of this activity is to be carried out in compliance with the FMC manual developed by the CHU.

The PIFC Law contains useful provisions, and on some points it is clearer than other relevant legal texts. Financial management and control in practice are nevertheless still very much understood as a matter for specialist bodies or individuals within an organisation or as a set of specific procedures.

However, the impression is that this entire process is far too broad, because it covers all budget-users, without any differentiation amongst them, and all types of processes – financial and non-financial – in a relatively short period of time. This gives the impression of an overly and still exceedingly legalistic exercise, and for the time being means that the process will take more time to be completed than initially planned. This process draws on already scarce resources.

The Central Harmonisation Unit (CHU) for PIFC in the Ministry of Finance is headed by an assistant minister and has two clearly established components, one for internal audit – IA (seven staff out of eight planned) and one for financial management and control – FMC (five staff out of seven planned).. The PIFC Law provides for a high-level PIFC Council, which is supposed to act in an advisory capacity to the Minister of Finance and as such should support the activity of the CHU. This council has now been established but its role appears to be rather limited at the moment and with very little scope for development.

The future tasks of the CHU are clearly set out in the PIFC Strategy and in the PIFC Law. However, carrying out those tasks in the area of FMC and addressing new issues, such as establishing and maintaining networking functions or assessing the quality of internal audit work, will constitute serious challenges. This is all the more so as the competencies of the FMC community outside the CHU are growing, while the practical experience of the CHU in its area of work remains limited.

The annual report on the establishment of financial management and control systems is now produced by each budget-user. These reports, compiled by the CHU, constitute the basic material for the “Consolidated Annual Report on Public Internal Financial Control in the Republic of Croatia”, of which three issues have been published so far since 2006.

In the area of management of EU funds, a Central Financing and Contracting Unit was established in 2001 and transformed into an agency (CFCA) in 2007. It is currently headed by a director and has 69 staff. A National Fund has been set up, and one of the state secretaries in the Ministry of Finance has been appointed as the National Authorising Officer. Procedures have started for the development of management capacities of agencies responsible for EU pre-accession funds – at the moment Phare, ISPA and ongoing CARDS support – in the framework of the Decentralised Implementation System. The process has been completed for Phare, ISPA and CARDS and now for the SAPARD programme. The process is now underway for the IPA programme, which replaces all former EU financial support schemes. The systems and procedures required for the management and control of EU pre-accession funds, as well as the process for setting them up, could serve as useful references for the domestic budget, and adequate linkage and co-operation have

been organised in that respect, with regular – in principle weekly – meetings of key actors in the management of pre-accession funds, attended by the CHU.

The Treasury Reform Strategy adopted by the government in October 2007 will have an impact on many aspects of the budget execution (cf. Sigma's May 2008 assessment on Public Expenditure Management in Turkey). This new policy is likely to have consequences for the control activities of budget-users, and proper co-ordination with PIFC development activities is still of the essence.

**Systems and procedures for management and control are only partially in place at the moment in Croatia. The FMC set-up prescribed by the PIFC Law and its secondary legislation is progressively being put in place and implemented. In its current conception, however, it largely remains a specialist's domain, as it has an overly bureaucratic and theoretical appearance and could prove to be quite costly in view of its too broad area of application.. More linkage and better co-ordination with other key related activities, which have a more operational character - i.e. with the budget execution procedures , including the planned Treasury reform, and activities pertaining to setting up the system for EU funds management – are necessary for the PIFC policy to become really effective and rooted in the routine practices of the Croatian public administration.**

### ***2.3 Is there a functionally independent internal audit mechanism in place, with relevant remit and scope?***

Internal audit in the public sector is now based on articles 16 to 33 of the PIFC Law, which to a large extent reflect the contents of the rulebook of 12 December 2005. This rulebook remained applicable until the new secondary legislation on internal audit was issued with the rulebook “on user of internal audit” of 3 March 2008.

As it is unrealistic, and inappropriate in quality terms, for each budget-user to set up an operational internal audit unit, considering the number of these bodies, the rulebook of 2005 had tried to introduce innovative and practical arrangements so that the function could be carried out even in the absence of a permanent unit. These procedures are maintained by the PIFC Law and detailed by the new rulebook, with some additional flexibilities, since the mere application of the objective criteria could lead to very cost-ineffective solutions.

Internal auditors' jobs are now incorporated into the civil service scheme and salary scale. They are consequently included in the decree of 30 May 2005 amending the decree on titles of positions and job complexity coefficients in state administration, which defines the respective salary levels of civil servants in a way that makes the job competitive. No problems of recruitment or staff evaporation have so far been reported, which seems to be a better situation than in other parts of the Croatian public administration. This has been achieved primarily by increasing the complexity of job coefficients, resulting in an increase in the salaries of internal auditors.

To protect internal auditors or heads of internal audit units against arbitrary decisions of the management, the PIFC Law provides for the CHU to be informed prior to disciplinary measures, transfers or dismissals of internal audit personnel by the head of a budget-user. The PIFC Council, among other functions, may be called upon to evaluate the justification of reasons for the dismissal and/or transfer of the head of an internal audit division. The law specifies that internal auditors cannot be dismissed or transferred to other positions on account of their reports and recommendations (art.23 § 1). This should go without saying, but unfortunately the law does not enunciate further the procedures on these points and the extent to which the Minister of Finance, once the CHU has been informed and can provide an opinion on individual measures (art.35 § 1, e), can oppose unjustified decisions. Such a key issue deserves more procedural details than the provisions currently contained in the law.

According to current legal criteria, 35 budget-users are obliged to set up internal audit units. In practical terms, internal audit units have been formally established in 13 central ministries and 18 state administration bodies, which have amended their respective systematisation decrees to that effect. The training scheme encompasses seven mandatory modules and a set of seven optional courses for more in-depth study of certain aspects.

This training has been provided by the technical assistance project in place up until the end of 2005 and by the follow-up assistance project that started in April 2006. In this respect, the Ministry of Finance adopted in March 2007 a new programme for professional training and examination for the qualification of public certified internal auditor. This programme will serve as a basis for further training and examination. It remains the case that there are still no permanent training resources for the future that provide both initial

and continuous training. Some auditors have nevertheless been trained as trainers and have started to deliver lectures and provide training to the newly appointed groups of internal auditors. A possible path to explore would be through co-operation with the external audit body in the area of training, considering the opportunity and interest of designing a common syllabus, as has been the case in neighbouring countries. The possible future contributions of the training resources of the Central Office for State Administration should also be taken into consideration.

It has been noted that the average internal auditor in the Croatian public administration already has considerable experience in other or related areas of administrative activity, such as the precursor of the financial police or other “control bodies”. This fact speaks for the seniority and experience of most newly recruited internal auditors, but on the other hand may introduce the risk of a biased approach to daily internal audit work. A problem relates to the fact that not all internal auditors who have been trained and sometimes certified in the framework of the assistance project are necessarily employed as internal auditors, as all “systematisations” have not been revised to include these positions.

In the framework of the PIFC technical assistance project, internal auditors are provided with substantial documentary support. The department for internal audit and control (precursor of the CHU) has issued an internal audit manual, which can be regarded as a basic handbook for the performance of systems and regularity audits. The guide refers to generally accepted standards in the area and covers the basic technical needs of a public internal auditor. In 2005-2006 chapters on risk management and the auditing of EU pre-accession funds were added. The CHU, with the support of the technical assistance, has continued to provide internal audit units with methodological support in terms of documents, such as a code of ethics, or internal audit charter template, and a programme and instruction on professional training; some of these documents having already been produced in a second version to take into account the adoption of the PIFC Law. This methodological support is certainly useful, but it tends to be presented to internal auditors less as examples than as mandatory documents, from which it is impossible to deviate, even if justified by local circumstances. This approach is not appropriate, for instance, with regard to the internal audit charter.

The amount of audit work completed to date is still small and it is not yet possible to judge the usefulness and effectiveness of the guidance that has been provided. The impact of audit work seems however limited at the moment, and in that respect the interpretation of the PIFC Law has been too restrictive in the distribution of audit reports. The independent nature of the internal audit activity tends to be overstressed, with the result that internal auditors have only one speaking partner (and addressee of reports), the head of the “budget-user”, and internal audit work is still not embedded in the current activities of the audited organisation. This is detrimental to an enhanced efficiency of this new task.

The development of internal audit should lead to redefining or clarifying the role of at least two “control” bodies. The creation of the Budget Control or Supervision (*nadzora*) Service in the Ministry of Finance is based on section XI (articles 133-136) of the Organic Budget Law, but can be traced back to former provisions. The service is in essence responsible for verifying the “lawfulness, purposefulness and timeliness of the use of budgetary funds” and for proposing measures or sanctions to remove and/or punish misdemeanours and other breaches of financial/budgetary law, on the basis of the Law on Administrative Procedure and the Organic Budget Law (section XII contains a long and very detailed list of penalty clauses). Building on that function, the service is about to reform its operating mode so as to act as a fully-fledged inspection body, according to views expressed by the EC. This service has in addition been tasked with the functions of the anti-fraud co-ordination structure (for EU funds, in the sense of chapter 32) and as such serves as the contact point for the European Anti-Fraud Office (OLAF) in Croatia. However, this is a very early step in the process.

A Government Supervision (*nadzora*) Office was created in January 2001 as a part of the Prime Minister’s Office, with the functions of co-ordinating internal control bodies set up in accordance with the provisions of the then applicable budget law, and of carrying out such control tasks throughout government offices. According to the Organic Budget Law of 2003, the role of the Government Supervision Office should evolve so that this body becomes the Government Office of Internal Audit. It was supposed to act as an internal audit body for budget-users that were too small to justify the existence of a permanent internal audit unit. As stated in Sigma’s previous assessment, this solution was not realistic, and the role of the Government Office of Internal Audit is rightly limited to the various small budget-users reporting to the Prime Minister’s Office (*Vlada*). The Government Office of Internal Audit has started to operate in this direction.

**Significant progress has been made in the design of the internal audit set-up in the Croatian public administration, which is now supported by the relevant parts of the new PIFC Law. Future internal auditors have received basic training from technical assistance providers, and a respectable number of**

**them have even been given advanced training. The amount of audit work seems to have also increased and developed, but the concern moves now to the efficiency of the activity, its impact and some misconception in reporting and methodologies.**

**2.4. *Are systems in place to prevent and take action against irregularities and to recover any amounts lost as a result of irregularity or negligence?***

In addition to the basic PIFC systems, the new PIFC Law introduces in article 36 a special provision related to the prevention of irregularities. Heads of budget-users are requested to appoint irregularities officers. These officials are to receive notifications on irregularities and suspected cases of fraud, and they can also act on their own initiative in this area. Informed about an irregularity or suspicion of fraud, the irregularities officer (but also the head of the budget-user) is to take “adequate measures (including informing the State Prosecutor and the Budget Supervision Service, which is the body in charge of irregularities in the Ministry of Finance). A whistle-blower protection system has been established.

Most irregularity officers had been appointed at the central state level at the time of this assessment, and some had been appointed at the local level. These innovative solutions demonstrate a degree of commitment on the part of the Croatian authorities in relation to the issue of irregularities. Few candidate countries, if any, have opted for such arrangements, and this may explain why there seems to be some difficulty in exactly defining the role and functions of these public officials. The CHU has not produced any particular guidance on this aspect so far, and this may lead to a reconsideration of this set-up at some future point.

Article 56 of the Organic Budget Law provides the current base for the recovery of amounts lost as a result of irregularities or negligence. A specific case of application, as far as EU funds are concerned, is provided in the recent guidelines on the prevention, detection, reporting and treatment of irregularities concerning EU funds. These guidelines define the procedure to be followed by implementing agencies, and finally by the National Authorising Officer, in the event of unjustified expenditures.

The recovery procedure for taxes and other receivables, as implemented by the Tax Administration, is applicable to the collection of EU resources, and can extend to forced recovery for certain levies.

The unit for combating irregularities and fraud has been established within the Budget Supervision Service of the State Treasury in the Ministry of Finance (in accordance with amendments to the systematisation of the Ministry of Finance adopted on 14 December 2006). The functions of the Organisational Unit for Combating Irregularities and Fraud (OUCIF) are further defined in the rulebook and are in line with the suggestions made previously for the setting-up of AFCOS. A specific action plan for the implementation of the provisions related to the establishment of OUCIF was adopted as early as January 2007 and suggests that every step, including staffing and training, will have been carried out by the end of 2007. This time frame is rather ambitious and somewhat early as it is doubtful that there will be full-time work for the two staff now composing the OUCIF. Beyond the formal measures to be taken in order to establish the OUCIF (such as signing co-operation agreements with other authorities, such as the State Prosecutor), it would be worthwhile for this body to start reflecting on its missions and remit, which could possibly be covered by a specific anti-fraud strategy.

**Systems seem to be in place to deal with irregularities and to recover amounts lost. The first steps in the establishment of the Croatian AFCOS are now being taken.**

### **3. Capacity to Further Develop the System**

The Croatian Ministry of Finance has constantly shown willingness for the development of PIFC, with the recent establishment and strengthening of the CHU, the redrafting of the PIFC Strategy to illustrate the commitment of the whole government to support this new policy, and recently the adoption of the PIFC Law and of its secondary legislation. The adoption of the PIFC Strategy and plan by the government bears witness to this and has provided a solid political basis for further development. There also seems to be a serious involvement of line ministries and other central agencies, at least the most important among them, which can only have a snowball effect. The many initiatives and achievements, above all in legal terms, in 2006-2007 have made up for some previous lost time in the change process related to accession.

In addition to this proven commitment, the request of the Ministry of Finance for a PIFC peer review in 2008 illustrates its acceptance of external scrutiny and its willingness to improve.

It seems that the ability to co-ordinate foreign inputs to the development of public finance has become greater and more efficient, which is also due to reduced donor activity in recent months. The expected adoption of a Treasury reform strategy solely designed by professionals in the Ministry of Finance is another sign of the strengthened ownership of reforms in the ministry. Ongoing improvements with respect to public expenditure management, budget processes and development of the treasury system are relevant for the development of PIFC as such, as well as for the introduction of procedures and methods applicable to the management and control of EU funds. There will be a need for co-ordination of internal initiatives as well.

#### **4. Summary and Next Steps**

The PIFC system in Croatia has experienced some development and made good progress in the past year, starting with the adoption of a specific and comprehensive strategy and plan for PIFC. The adoption of the PIFC Law and the related implementing actions and rules have given a new impetus to the development of the PIFC policy and to the activity of the CHU within the Ministry of Finance.

The current set-up can satisfy the demands put forward by the EC in the course of the accession process. Moreover, it represents an important investment in human as well as financial resources, and it is important to secure the proper long-term return of this investment. The system nevertheless remains fragile because it is still in a very early phase. However, it has also been largely a top-down process, prompted by external factors, which still seems to many actors to be a very specialised process that is difficult to incorporate into the day-to-day management of organisations.

In addition, PIFC conception and implementation have been made a rather complicated and legalistic process. The PIFC Law enters into a great deal of detail, and several of these provisions would have found a better place in secondary or tertiary legislation, if a legal text was even needed at all. In addition, there is a tendency to implement legal provisions with a high degree of compliance with the letter of the law, as opposed to understanding the objectives.

The CHU should continue to build its capacity and develop its activity, which by no means should be restricted to the production of legal texts or the delivery of training but address the practical implementation of FMC and Internal Audit, in particular the functions of networking and support.

The Public Internal Financial Control Strategy will contribute to progressively bringing Croatian financial control arrangements in line with good practices of other candidate countries and EU Member States. However, some clarification is still needed with regard to the various key functions. A better balance should still be sought between institutional and legal procedural aspects on the one hand and practical working aspects on the other, so as to keep PIFC from becoming a matter reserved for some specialist functions only. This could now start more strongly as some budget users have now begun to work operationally in these areas.. These policies and measures should take into particular account their efficiency and operational character beyond the period of technical assistance. The adopted PIFC Law covers all major requirements, in particular those of the European Commission. However, there are some risks attached to its still highly formalistic contents as well as to the prospects for its smooth implementation, including issues of co-ordination/overlapping with other texts.

Local government is concerned by the recent developments of PIFC, as it is subject to most legal provisions and their recent amendments, not only for internal audit but also for financial management and control. Internal audit units have been established at a steady pace in municipalities. It remains nevertheless difficult to measure, except in large centres, the impact that these new policies have had so far. The CHU and its current assistance, as previously recommended, drafted a specific PIFC strategy for the local level, which was adopted in October 2007.. This is a significant initiative, but its outcome is essentially a replica at local level of the arrangements decided for central state institutions. The document is a useful reference and some local government bodies have started to implement it, but it does not take sufficiently into consideration the basic differences between the local and state sectors, nor the variety of situations across the local sector. The heavy procedural and organisational apparatus defined by the PIFC Law may be implemented by large administrative bodies, not by middle-sized or smaller communities.

Finally, the ambitions of the Croatian authorities to rapidly develop their PIFC system are quite legitimate. Experience in Croatia – as elsewhere – has shown that these developments need time and will not happen overnight without huge risks for the practical implementation. Less tight deadlines should be set to ensure a real understanding of the new policies, allocation of adequate resources, and – in the end – solid implementation.

It is above all important to bear in mind that the financial control activity is not only a question of procedures or management techniques, let alone a matter for selected specialists, but rather a concern of every employee in the public service, no matter what the hierarchical level or type of activity may be. It implies that each public servant feels individually committed to the legal and financially sound management of his/her service, and this commitment is reflected in his/her daily behaviour. This attitude should permeate the whole organisational culture and be embedded in institutional memory.

Priority should be given to the following actions:

**A) Should be applied (or started) in the short term (next 12 months):**

- The consistency amongst FMC-related texts, such as the PIFC Law and the Organic Budget Law, has to be ensured by appropriate scrutiny in order to avoid ambiguities, redundancies or discrepancies.
- Connections should be established between the implementation of the concept of managerial accountability in the PIFC framework and the development of strategic planning in relation to budget preparation and budget execution as well as related reporting obligations.
- The impact of the Treasury Reform strategy, when implemented, should be duly taken into account, and this could lead to some legal and institutional changes aimed at strengthening and developing the overall capacity, impact and efficiency of the PIFC system, while embedding PIFC concern into the daily activities.
- Efforts to establish and staff viable internal audit units wherever relevant should continue. This may imply that some budget-users – and even a majority them as they are quite numerous in Croatia – do not have a permanent internal audit unit but have recourse to internal audit functions.
- The CHU should endeavour to simplify and streamline certain processes resulting from the too detailed wording of the PIFC Law and its secondary legislation. The FMC arrangements in particular could be reviewed or fine-tuned so that only the most important and relevant budget-users are obliged to implement the entire set of measures and organisational arrangements.
- The strategy for PIFC at local government level should also be implemented with a view to concentrating on issues and bodies that really matter in terms of significance or risk. There is no need to aim at uniform and overall PIFC coverage, as it leads to dispersion and cost-ineffective arrangements.
- The CHU should continue to strengthen its internal structure, using staff who are increasingly professional (who already have internal audit and/or FMC experience).. The focus of the CHU's activity should be more and more directed towards support and networking, while training activities should diminish.
- The development of PIFC could benefit from the further elaboration of policies and measures in the area of management and control of EU funds; the finalised process of accreditation for EU pre-accession funds management would provide an example of good practice that could be shared in the area of PIFC.
- The testing of existing internal audit standards, methodologies and manuals should be included in the upcoming audit work to be carried out under the guidance of the CHU.
- The system for preventing and taking action against irregularities will need to be further developed, defined and eventually tested. The role of irregularity officers could be re-examined.
- In addition to secondary law development, the anti-fraud co-ordination structure should explore its remit of activities, set up appropriate linkages with likely partners within and outside the Ministry of Finance, such as the National Fund, implementing agencies and law enforcement bodies. The action plan would need to be further developed in that respect so as to address the institution-building activities to be carried out by OUCIF before the unit gets involved in operational tasks. Advice and support could be usefully sought from existing counterpart organisations in former candidate countries.

**B) Should be applied (or started) in the medium term (next two years):**

- Beyond the definition of the status of internal auditors as part of the Croatian civil service, an appropriate human resources policy for internal auditors will have to be developed by the CHU, in co-operation with other bodies responsible for human resources management.
- In that context, the development of training schemes and the organisation of future training of internal auditors should continue, in particular in view of the sustainability of results once technical assistance has terminated, and based on an analysis of needs and of the relevance of the current syllabus, as was recently done.