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Protecting the Financial Interests of the State and of the European Union

by Kjell Larsson and Johannes Stenbæk Madsen

Image Bank/Antony Edwards

The development of effective financial control in the European Union (EU) candidate countries is an issue high on the agenda in the current Member States, the European Commission, the European Parliament and in the candidate countries themselves. In anticipation of the EU's expansion, all are concerned about the ability of aspiring Member States to protect the Union's financial interests when managing EU funds, and to do this within the framework of adequate financial control systems covering the entire national budget. The Berlin 1999 European Council on Agenda 2000, and reports by the Committee of Independent Experts and the European Court of Auditors, have also emphasised the need for more effective management and control of EU funds.

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Glossary of Terms

- **Financial Control** usually refers to the financial aspects (whether administrative, managerial or budgetary) of management/internal control. Such controls may be either *ex-ante* (controls in advance of expenditure) or *ex-post* (controls after expenditure).
- **Management/Internal Control** refers to all the procedures and means making it possible to meet objectives and to comply with the budget and the rules in force, to safeguard assets, ensure the accuracy and reliability of accounting data and facilitate management decisions, in particular by making financial information available at the appropriate time.*
- **Audit** refers to *ex-post* reviews of a body's activities, operating systems and outputs to ensure that these are in accordance with objectives, budgets, laws and standards. The aim of such reviews is to identify, at regular intervals, deviations in performance that might require corrective action.*
- **Internal Audit** indicates a department within an entity, entrusted by its management with carrying out checks and assessing the entity's systems and procedures in order to minimize the likelihood of fraud, errors and inefficient practices. Internal audit must be independent within the organisation and report directly to management. The term can also indicate an activity.*
- **External Audit** means audit carried out by a body which is external to and independent of the auditee, the purpose being to give an opinion on and report on the accounts and financial statements, the regularity and legality of operations, the financial management and performance.*

*Adapted from the nine language glossary of terms *Glossary: Selection of Terms and Expressions Used in the External Audit of the Public Sector* by Patrick Everard and Diane Wolter. © 1989 Court of Auditors of the European Communities, Luxembourg.

How the European Commission currently uses the term "financial control"

In the context of the screening of EU candidate countries and preparing the European Commission's Regular Reports on progress, the Commission associates slightly different terms with "financial control". In this context, "financial control" covers both what the Commission terms "internal financial control" and "external financial control". The former is synonymous with what is usually referred to as financial control, and the latter being synonymous with what is usually referred to as external audit. As used by the European Commission, the key difference between the terms financial control and audit is that financial control includes both *ex-ante* and *ex-post* controls, whereas audit exclusively covers *ex-post* controls (see also article on page 4 by Robert de Koning, DG-AUDIT).

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Protecting the Financial Interests of the State and of the European Union

For the candidate countries, EU accession depends explicitly on the adoption of and the ability to apply the existing body of EC legislation, the *acquis communautaire*, including the requirements for internal financial control. At a time when the institutional capacities of the Union are the subject of intense discussions, an effective adoption of the *acquis* appears more than ever to be decisive for the candidate countries' accession to the Union. Moreover, improving financial control structures, organisations, procedures and methods within the government administration, and bringing them in line with good European practices, is essential not only to achieve European aspirations but also to promote better value for money for the national taxpayer.

The Key Concepts of Financial Control

The last issue of *PMF* (Vol. V, No. 5, Sept/Oct 1999) focused on the functioning of external audit institutions. This issue focuses on the structures, organisations, procedures and methods of financial control within the government administration, or simply, internal financial control. It is essential to distinguish between these two related control functions. Still, a prerequisite for effective financial control within the administration is the existence of effective external audit, and it may in fact be argued that the opposite is equally true.

Many of the key concepts in articles and books on financial control are not clearly defined. In some cases, they may be well defined and understood by accountants and auditors in one country, but are then used with very different meanings in other countries. In other cases, as in many of the candidate countries, generally recognised concepts to distinguish between, for example, control and audit do not exist. This creates confusion and misunderstandings, and it has made the reform work in many countries more difficult and time-consuming than it would have been had there been a common understanding of the key concepts. We think it would be a good step forward if some "unification" of concepts could be achieved. In this context, the European Commission services involved in the process of EU enlargement have an important role to play in defining the key concepts of financial control. Towards this end, we are pleased to publish in this issue of *PMF* an article by Robert de Koning of the Commission's DG-AUDIT, explaining his service's use of the concept "public internal financial control" in the context of EU enlargement (pages 4 and 5).

The *Acquis Communautaire* on Financial Control

The *acquis communautaire* sets few obligations for external audit but delineates many specific requirements for internal financial control. These requirements address such terms as sound financial management and control, audit trails, internal control, internal audit, paying and implementing agencies, accreditation, certification and internationally accepted auditing standards. Some of the key EU regulations on internal financial control are described on page 8.

In this issue, Kjell Larsson and Johannes Stenbæk Madsen, of SIGMA's Audit and Financial Control unit, explain the concepts underlying the "Baseline on financial control", which was developed by SIGMA when requested by the Commission to assess the situation of internal financial control in the candidate countries. In addition, Suzanne Brom and Hans van der Wielen of the Dutch Ministry of Finance, share their experiences on the audit of EU funds in a Member State on pages 10 and 11.

European Models of Internal Financial Control

The way in which internal financial control is practised varies considerably from one European country to another. Traditionally speaking, two broad approaches can be identified among the EU Member States. One approach, found in countries such as France, Portugal and Spain, is sometimes referred to as the "third party *ex-ante* approach". The other approach, found in countries such as the Netherlands and the United Kingdom, emphasises the responsibility of the official authorising expenditure and that of the head of the line ministry, which could be referred to as a "management responsibility approach". In Member States employing the "third party *ex-ante* approach", the ministry of finance not only plays a key role in budgeting and allocating funds to line ministries, but also in intervening directly with an *ex-ante* control by its own staff placed in the line ministries. In Member States using a "management responsibility approach", each line ministry takes full responsibility for spending its own budget and for ensuring appropriate checks and safeguards.

Specialised Internal Financial Control Organisations

European models for specialised internal financial control organisations correspond to the two approaches referred to above. The Portuguese model is similar to that of other countries traditionally employing a "third party *ex-ante* approach". Portugal has a centrally placed Inspectorate General for Finance (IGF), which reports directly to the Minister of Finance and is responsible for *ex-post* financial control of all public expenditure and revenue of the government administration. In addition to the IGF, line ministries have their own control organisations (Inspectorates General). By contrast, and as an example of the "management responsibility approach", the Internal Audit Service of the United Kingdom's Ministry of Finance is not responsible for financial control of public expenditure and revenue as such, but rather for ensuring that management/internal control systems in the line ministries, including the ministries' own specialised financial control organisations (Internal Audit units), ensure effective financial control. Many central and eastern European countries have until now had no specialised internal financial control organisations as such, but some have a "control office", which inter alia investigates complaints against staff from the public. Many of these control offices also investigate allegations of irregularities and fraud before turning the cases over to the courts. Most central and eastern European candidate countries are transforming such functions into genuine financial control organisations. The following pages feature three articles exemplifying the different approaches to internal financial control and specialised internal financial control organisations. On page 9, Chris Butler of the UK's Treasury describes the evolution of internal audit in the United Kingdom. On page 12, Vitor Caldeira, Deputy Inspector General of the Portuguese Inspectorate General for Finance, explains how the Inspectorate General operates in that country. Finally, on page 13, Paul van Sprundel and his colleagues of the Flemish section of the Belgian Interfederal Corps of the Inspecorate of Finance describe some of their experiences in carrying out a fundamental reform of their organisation. As an example of the recent positive developments in EU candidate countries, Dace Nulle of Latvia's Ministry of Finance reports on the background and context of a newly prepared regulation on internal audit and recent developments in the establishment of a new internal audit system (page 14).

Technical Assistance in Preparing for Accession

An essential part of all SIGMA projects on financial control and audit is the trans-

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Public Internal Financial Control (PIFC) in the Context of European Union Enlargement

by Robert de Koning

In this article, Robert de Koning of the European Commission's Financial Control Directorate General, abbreviated as DG-AUDIT, defines his service's concept of "public internal financial control" in the context of European enlargement. He also presents the various meanings of the term "financial control" as used by different Member States and the European Commission in order to arrive at a general global definition of its components.

The Context of EU Enlargement

Definitions and terminology are a matter of convention. They are the result of an agreement to be as precise as possible about issues of common interest between institutions (and their individuals) trying to define certain concepts of common activities. It is therefore important to define the institutions as well as their activities. But first of all we have to define the framework in which these institutions deal with public internal financial control (PIFC) work.

This framework would seem to be the issue of enlargement of the European Union with the new applicant countries, so prominent now in activities within and outside the European Commission. For our purpose we have to direct our focus to public administration reform and even further to developing new (or improving existing) systems of public financial control in the applicant countries. The aim of this activity is to achieve adequately functioning organisations that guarantee the principles of economy, efficiency and efficacy in dealing with public funds. By doing so, we should take into account the strengths (but not the weaknesses) of existing financial control systems in the Member States and the European Commission, as well as the definitions and recommendations of institutions that externally consider and assess such systems. We also should take into account the background of existing control systems in applicant countries in as far as this supports the principles mentioned above.

From the outset, it should be noted that the European Commission could in no way impose a specific model of public financial control on any sovereign state. EU Member States all have different models and no ideal model seems to exist; even the system used in the Commission is not a "model" ; it is presently the subject of much discussion on how to reform it. However, the Commission is called to assess the existing control systems in applicant countries and this is to be done on a regular basis.

From the outset, it should be noted that the European Commission could in no way impose a specific model of public financial control on any sovereign state. EU Member States all have different models and no ideal model seems to exist; even the system used in the Commission is not a "model" ; it is presently the subject of much discussion on how to reform it. However, the Commission is called to assess the existing control systems in applicant countries and this is to be done on a regular basis. These assessments form part of the advice given to the Council on the state of advancement of public administration reform relating to the public internal financial control function in the applicant countries. The need for this task follows not only from the obligation to safeguard the proper use of Community funds, but, in a much wider sense, is a logical result from the desirability to preserve the benefits obtained from transforming centrally planned to market oriented economies.

Before we can start describing the principles that provide the pillars for modern theories of adequate public control functions, it is necessary to first agree on the terminology and scope of financial control as used in the framework mentioned above. With so many actors in the field of advising applicant countries (to mention but a few: the EC, the European and national Courts of Auditors, Member States, Phare consultants, SIGMA, etc.), it is no surprise that there exists some confusion about the proper terminology used when describing the various functions and limitations of "financial control".

What is "Public Internal Financial Control"?

Based on its experience in all of the applicant countries, it has become common practice now in DG- AUDIT to talk about "public internal financial control (PIFC) systems":

Public, covering control activities in the public sector as opposed to controls and audits in the private sector;

Internal, covering controls exercised by central and decentralised government agencies as opposed to external control exercised by a body outside the government, e.g. the National Court of Auditors or the Parliament;

Financial, to stress the financial (whether-administrative, managerial or budgetary) character of the activities to be checked;

Control, meaning all activities to oversee the entire field of financial management, enabling the government to be "in control" of its finances (therefore comprising all control tools like *ex-ante* control and *ex-post* audits); and

Systems, covering institutions, staff, training, methodology, reporting, responsibilities, sanctions and penalties.

Various Understandings of the Term "Financial Control"

Some clarifications need to be elaborated here. Within the European Union, the term "financial control" is used in different ways. In certain Member States, "financial control" refers to a concept of control, as an overall system of organisations, controls, rules, procedures and regulations set up to provide reasonable assurance of economic, efficient and effective use of financial means. This system includes the whole gamut of *ex-ante* controls, internal and external audits, systems audits, performance and information technology (IT) audits, etc., and covers a variety of organisations and functions.

In other Member States, the term "financial control" is more restricted to a specific organisation performing certain aspects of the overall control function, e.g. a centralised *ex-ante* financial control organisation, an inspectorate general, treasury or external audit service, or a specific procedure (*ex-ante* control or internal audits).

It is evident from a point of view of advice, that the Commission will have to assess the entire "financial control" system in an applicant country rather than one specific control organisation or procedure. It is, however, interesting to see how the term of "financial control" is developing; most prominently these days within the Commission. The specific "*ex-ante* financial control function by an independent centralised body" (as was and still is the case in the Commission) is presently under heavy scrutiny. The reasons are relatively straightforward.

The sheer existence of a body called to give so-called "*ex-ante* approvals" to management decisions involving financial consequences seemed to take away financial responsibility from the manager to the "financial controller". At the same time the huge and increasing numbers of financial transactions together with static work forces in the financial control organisation did not seem to improve the awareness of financial responsibility at that end, despite the much necessary introduction of modern sampling and reporting techniques.

It is therefore not amazing that the call for "financial re-responsibilisation" of programme (project) management is becoming louder and that the accent is shifting away from *ex-ante* approvals (having an "antediluvian feel" as quoted by the Second Report on Reform of the Commission, Vol. II, Sept. 1999) by a centralised organisation towards de-centralised *ex-ante* controls built into management systems (albeit functionally independent from the management itself) and audited by a centralised and equally functionally independent internal audit organisation.

In the context of EU enlargement, it is therefore useful to define "financial control" as being the entire system of financial management and control (whether centralised or de-centralised) established by an entity having budgetary responsibilities, involving *ex-ante* approval, through sampling and reporting techniques, as well as *ex-post* internal audit systems, including the need to constantly feedback findings and recommendations by both systems with the aim to provide a management tool for assuring economy, efficiency and efficacy in the use of its financial means.

Public internal financial control refers to the government's internal control systems aimed at protecting the financial interests of the government at large, while external control refers to financial control activities by external bodies (supreme audit institution and the parliament, exercising democratic control functions) whose task it is to scrutinise and assess the financial control systems of the government.

Refining the Components of the Term "Financial Control"

With the above in mind it is therefore possible to make the following refinements in the terminology of the various aspects of "financial control":

Public internal financial control refers to the government's internal control systems aimed at protecting the financial interests of the government at large, while external control refers to financial control activities by external bodies (supreme audit institution and the parliament, exercising democratic control functions) whose task it is to scrutinise and assess the financial control systems of the government.

Third party *ex-ante* approval is the procedure whereby a functionally independent financial control organisation (whether centralised or decentralised) checks and approves management decisions with financial repercussions before such decisions can be taken. This procedure provides for the possibility of refusal by the controller, which can, however, be overruled under certain strict conditions ("passer-outre" procedure). It is important to check with the Treasury function of the Ministry of Finance whether certain functions of the *ex-ante* approval system are not already automatically taken into account (e.g. checking the availability of funds before approving a contract or of committed funds before making disbursements).

Internal audit is the total sphere of activities of *ex-post* verification by an organisation (located within the organisation to be audited but independent of the management functions of that organisation) of whether management and control systems comply with budget specifications, objectives, rules and standards and more generally to the principles of sound financial management. These internal audits include compliance and substantive tests, systems audits, performance audits, information technology audits and any other kind of *ex-post* verification that the independent internal organisation deems fit to ensure the compliance of management with financial rules and regulations. An important aspect is the establishment of an adequate feedback mechanism of the internal audit findings and recommendations into these rules and regulations. ■

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Baseline for Financial Control in EU Candidate

by Kjell Larsson and Johannes Stenbæk Madsen

In the spring of 1999, the European Commission asked SIGMA to produce "baselines" or minimum institutional requirements for key areas of public management, including (internal) financial control.
Prepared in co-operation with Commission services, these baselines were then used as yardsticks for assessing the institutional situation in the ten central and eastern European candidate countries. SIGMA delivered assessments in June 1999, and updates in September 1999. This article addresses formal EU requirements and good European practices that are contained in the baseline on financial control.

The EU Jurisprudence on Financial Control

The Treaty of the European Communities does not specify any predetermined model of financial control to be applied by Member States, but it establishes general obligations. It sets out the responsibilities of the European Commission and establishes provisions for budget and financial management and for the European Court of Auditors (ECA). In particular, Article 280 of the Treaty provides for the fight against fraud. Many other detailed requirements are set out in other regulations and directives on how the processes of management and control of EU funds and resources should be designed and function. Some of the regulations considered in the baseline are listed on page 8.

The Four Baseline Criteria

SIGMA's baseline identifies four basic criteria for (internal) financial control:

- A coherent and comprehensive statutory base defining the systems, principles and functioning of financial control (management/internal control) systems, including mechanisms for internal audit/inspectorates.
- Relevant management/internal control systems and procedures.
- A functionally independent internal audit/inspectorate mechanism with relevant remit and scope.
- Systems to prevent and take action against irregularities and to recover any amounts lost as a result of irregularity or negligence.

Below, the criteria of the baselines are elaborated:

1. *A coherent and comprehensive statutory base defining the systems, principles and functioning of financial control (management/internal control) systems, including mechanisms for internal audit/inspectorates, must be in place.*
A coherent and comprehensive set of laws and regulations defining the systems, principles and functioning of financial control is a prerequisite for an appropriate financial control system. This includes the constitution, laws or regulations on ministerial competencies, civil service, budgeting, accounting, external audit, internal control/ audit. The EU specifically requires that countries receiving funds provide the Commission with relevant legal references and a list of the authorities and bodies designated to manage and control EU funds. In regards to the control itself, it is important that there is a legal base for an internal audit/control mechanism with the mandate to audit all relevant funds, whether this is in the form of an Inspectorate General of Finance (IGF) with overall responsibilities for financial control, or an Internal Audit (IA) body responsible for the audit of a ministry.
As a point of departure, provisions regulating financial control should be passed and approved at an appropriate constitutional level, preferably as laws or regulations passed by parliament. This will of course depend on the character of the provisions in questions. Generally speaking a law carries more weight than a government decree.

2. *Relevant management/internal control systems and procedures must be in place.*

The following systems and procedures are seen as the most basic:

- Accounting and reporting standards/regulations.
- Accounting systems.
- A defined audit trail (showing the flow of funds from the national budget/the EU and the roles and responsibilities of the different national entities involved; this should include National Funds and Paying Agencies).
- *Ex-ante* controls of commitments and payments.
- Procurement control (following Baseline on Public Procurement Management Systems).
- Control of state revenues (including future own resources - customs, levies, Value Added Tax - VAT, Gross National Product - GNP).

The existing system should be defined and have well-established and functioning accounting and reporting standards, e.g. in a government Policy Paper on financial control describing weaknesses and recommendations for improvements. An accounting system, preferably computerised, should be in place. It should also be considered here whether EU funds will be channelled through a central treasury function, classified under the budget classification system and accounted for in the budget accounting system, or, if not, how the treasury function will be operated. In addition, a sufficient audit trail, by which the movement of data can be traced forwards and backwards in the accounting system, should be defined and described. This will enable auditors and managers to cross-refer each bookkeeping entry to its source and thus facilitate checking accuracy or validity of claims and payments. This is of particular importance when it comes to the handling of EU funds. Specific guidelines for the development of audit trails for EU funds management, are described in Regulation 2064/97.

To meet requirements for financial control of EU funds, an *ex-ante* control mechanism for the approval of commitments and payments needs to be in place. *Ex-ante* controls are an explicit requirement when it comes to the control of funds under the Common Agricultural Policy (CAP), where paying agencies must offer guarantees that the admissibility of claims and compliance with Community rules are checked before payment is authorised. For Structural and Pre-accession funds, the *ex-ante* control requirement follows implicitly from the requirement for prevention and correction of irregularities, as mentioned in several Council regulations. In addition, a system for ensuring that public procurement transactions are

Countries

carried out according to the national law – which should be based on EC Directives – and are also subject to financial control arrangements that apply in other areas of public expenditure needs to be put in place. Finally, for the proper handling of EU own resources, competent national authorities must perform checks in accordance with specific provisions in the relevant parts of the EU jurisprudence (see page 8).

3. *A functionally independent internal audit/inspectorate mechanism with relevant remit and scope has to be in place.*

This could have the form of one or several organisational entities, but should meet the following criteria:
- Be functionally independent.
- Have an adequate audit mandate (in terms of scope and types of audit).
- Use internationally recognised auditing standards.

Systems for the appropriate co-ordination and supervision of the applied audit standards and methodologies should also be established.

To provide for an independent professional control of public spending, an IGF/IA that functions independently of the authorising and implementing functions should be in place. The independence of the IA body is an explicit requirement for the control of EU funds, when it comes to internal audit bodies of paying and implementing agencies. It is also a formal requirement for the body eventually designated to prepare a final certification of expenditure of EU programmes (the certifying body) (for further details see page 8). For the internal audit function of paying and implementing agencies as well as for the certifying body, the independence and the mandate to audit all relevant funds must be ensured, both legally and in practical terms.

In the case that the internal audit function is not performed by an IGF independent of the organisation being audited, one way of ensuring appropriate (functional) independence is to position the IA unit on a superior level in the organisational hierarchy, reporting to e.g. the highest ranking civil servant of a ministry or the minister.

With regard to audit mandate, the IGF/IA must have the possibility to assess the soundness of the financial management and control system as such. This is a specific requirement for the control of EU funds. This normally implies that the IGF/IA has the legal right and practical ability to assess the economy, efficiency and effectiveness of the financial management system as such. Doing this, the IGF/IA must apply internationally accepted or recognised auditing standards, including performance audit standards. The requirement to apply internationally accepted auditing standards is specifically mentioned in the EU jurisprudence. Furthermore, specific EU requirements for the applied audit methodology, imply that the IGF/IA must have the technology and compentence to perform and document appropriate audit sampling and risk analysis.

Finally, a central body should be responsible for the co-ordination and the supervision of the applied standards and methodologies in the government administration. This could for example be the Ministry of Finance.

4. *Systems must be in place to prevent and take action against irregularities and to recover any amounts lost as a result of irregularity or negligence.*

The criteria for assessment in this area are:
- The extent to which existing systems are preventive.
- Actions must be taken.
- Existing laws/regulations should make it possible to recover amounts lost following irregularities or negligence (as defined by regulation No. 2988/95).

It should also be considered whether appropriate structures for fighting fraud and corruption exist or whether this is handled via the normal institutions of financial control or by a separate entity(ies).

In order for the financial control system to have a preventive effect, mechanisms need to be in place to take action against irregularities and to recover amounts lost as a result of irregularities or negligence. This is a specific EU requirement. Also, a system to report on irregularities detected as well as ongoing follow-up actions has to be in place. Finally, an authority responsible for the co-ordination and co-operation of the fight against fraud and corruption should be designated. This could be a separate fraud fighting body or a financial control body in the government administration. The national authority should co-operate with the European Anti-Fraud Office (OLAF).

Using the Baseline

Assessing the institutional situation in the central and eastern European candidate countries against the baseline criteria provided SIGMA and the European Commission with valuable comparative information. This has now been made available to the countries, e.g. via the Commission's Regular Reports of October 1999 on progress made by the candidate countries in applying the *acquis communautaire*. The information and the conclusions drawn in the SIGMA reports also serve as a strategic starting point for SIGMA's own planning and programming of projects with the candidate countries. ■

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Basic EC Legislation on Financial Control

Management and Control of EU Expenditure

- Commission Regulation No. 1663/95: Contains detailed guidelines for accrediting Paying Agencies (regarding accounts of the Guarantee Section of the European Agricultural Guidance and Guarantee Fund - EAGGF (under the CAP)) (Annex). The regulation refers to the implementation of Council Regulation 729/70, which is repealed by 1258/1999. New implementing regulation can be expected.

- Commission Regulation No. 2064/97: Specifies the criteria for management and control systems and establishment of audit trail for the handling of Structural Funds (Annex). The regulation refers to the implementation of Council Regulation 4253/88, which is repealed by 1260/1999. New implementing regulation can be expected.

- Council Regulation No. 1258/1999: Specifies basic requirements for the establishment of Paying Agencies for Common Agricultural Policy (CAP) funds and general provisions for management of the CAP, including the requirement for Member States to provide a certification of EU accounts.

- Council Regulation No. 1260/1999: Contains general provisions on the management of Structural Funds, including general requirements for financial control (Art. 38).

- Council Regulation No. 1266/1999: Specifies basic requirements for the management and control of all Pre-accession instruments (Instruments for Structural Policies for Pre-Accession, SAPARD - Special Accession Programme for Agriculture and Rural Development, and Phare funds)(Annex).

- Council Regulation No. 1267/1999: Specifies the basic requirements for managing and controlling ISPA funds and outlines the key aspects of Sound Financial Management and Control (Annex III).

Management and Control of EU Own Resources

- Council Decision No. 88/376: Describes the system of the Communities' own resources (implemented by 1552/89).

- Council Regulation No. 1552/89: Implements Decision 88/376 on the system of the Communities' own resources.

- Commission Regulation No. 386/90: Describes rules for unannounced physical checks, substitution checks, scrutiny of payments applications and co-ordination of controls of agricultural products (customs).

- Commission Regulation No. 3122/94: Describes risk analysis criteria for selecting export declarations (customs).

- Commission Regulation No. 2221/95: Describes requirements for sampling for laboratory analysis, sound and fair marketable product quality (customs).

Regulations Concerning Institutions for Prevention and Recovering Lost Amounts

- Council Regulation No. 595/91: Sets out reporting and recovery procedures to be followed in case of irregularities and wrongly paid amounts in connection with the financing of the CAP. The regulation refers to the implementation of Council Regulation 729/70, repealed by 1258/1999.

- Council Regulation No. 1681/94: Sets out reporting and recovery procedures to be followed in case of irregularities and wrongly paid amounts in connection with the financing of the structural policies. The regulation refers to Council Regulation 4253/88, repealed by 1260/1999.

- Council Regulation No. 2988/95: General provisions on the protection of the European Communities financial interests.

- Council Regulation No. 2185/96: Regarding on-the-spot checks and inspections carried out by the Commission in order to protect against fraud and other irregularities.

- Regulation (EC) No 1073/1999 of the European Parliament and the Council: Concerns investigations conducted by the European Anti-Fraud Office (OLAF) with standard co-operation agreement (Annex).

- Council regulation No 1074/1999: Concerning investigations conducted by the European Anti-Fraud Office (OLAF).

Ensuring Good Financial Management in the United Kingdom

by Chris Butler

Under the British system, department accounting officers in the central administration are responsible for obtaining prior approval from the Treasury for all expenditure. The National Audit Office helps to account for spending by auditing the accounts of departments, and conducting value-for-money audits (VFM or performance audits) or examinations of economy, efficiency and effectiveness in the use of resources. The following article addresses these and other aspects of the UK approach to ensuring sound financial management.

The United Kingdom maintains a decentralised system of controlling government expenditure. The Treasury, as Finance Ministry, plays several key roles within this system and has recently established a new regime for public expenditure. Spending plans by departments (ministries) are divided into 1) "departmental expenditure limits," which are fixed for three years, and 2) "annually managed expenditure," which cannot reasonably be subject to firm multi-year limits. The Treasury approves these spending plans before presenting them to Parliament for approval. The UK's public expenditure costs of European Community membership are all fully accounted for in Government plans. The Government thus ensures that taxpayers and Parliament are informed of the use of Community funds, and controls and audits these funds with the same care as it controls its own expenditure.

The UK's public expenditure costs of European Community membership are all fully accounted for in Government plans. The Government thus ensures that taxpayers and Parliament are informed of the use of Community funds, and controls and audits these funds with the same care as it controls its own expenditure.

The Treasury appoints an accounting officer for each parliamentary vote, to manage the expenditure, ensure that money is used for the specific purpose intended by Parliament, and account for it at the end of the financial year. Normally the accounting officer is the most senior full-time official (e.g. the Permanent Secretary) of the department (the ministry). As part of their financial management duties, accounting officers are responsible for obtaining prior approval from the Treasury for all expenditure. Regular spending does not need specific authorisation, but new spending, not covered by the approved spending plans, requires Treasury approval.

Parliament and the Auditors

Auditors have a key role to play in accounting for spending. The Comptroller and Auditor General, the head of the National Audit Office (NAO), is an officer of Parliament and by virtue of his statutory position enjoys a high degree of independence. NAO staff audit the accounts of departments (certification or attestation audit), and may also conduct value-for-money (VFM) examinations of economy, efficiency and effectiveness in the use of resources. These latter examinations may lead to a report to the Public Accounts Committee of the Parliament. The Committee, when alerted by the Audit Office of a critical VFM report or a qualified audit report, cross-examines the relevant accounting officer. The hearings are published, and sometimes televised, adding to the discomfort of the accounting officer. In order to achieve good financial management, and hopefully reduce the likelihood of an adverse hearing in the Public Accounts Committee, the accounting officer is required by Treasury's manual *Government Accounting* to have an internal audit service. The Treasury sets the standards and practices in the *Government Internal Audit Manual* which internal auditors must follow.

Internal Audit Gives Assurance

All aspects of control, which concern the accounting officer, the Treasury and Parliament are covered by internal audit which appraises the current controls over the:

- Effectiveness of operations.
- Economical and efficient use of resources.
- Compliance with applicable policies, procedures, laws and regulations.
- Safeguarding of assets and interests from losses of all kinds, including those arising from fraud, irregularity or corruption.
- Integrity and reliability of information, accounts and data.

Internal audit assures the accounting officer on all these aspects. The results of individual audits are reported, and each year a summary report is issued with an audit opinion on the adequacy and effectiveness of the internal control system.

A new requirement obliges accounting officers to state each year that internal financial control has been reviewed within their organisation. This signed statement further emphasises the accountability of accounting officers and underlines the role internal audit plays in supporting them. In some cases, the accounting officer may be called before the Public Accounts Committee of Parliament to account for the way in which the department's resources have been employed in discharging its functions.

After many years of development, internal auditors in central government are ready to respond to these growing demands. British experience shows that the keys to making internal audit effective are to establish internal audit standards and to encourage professional training in internal audit. The Treasury's Audit Policy and Advice team maintains the standards and continues to encourage innovation and development of best practice. ■

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Governement offices viewed from Great George Street; Big Ben in background, London.

Financial Control and Audit of EU Funds in the Netherlands

by Suzanne Brom and Hans van der Wielen

Image Bank/Pete Turner

EU Member States are obliged to implement the Union budget and to assure its sound financial management. In the Netherlands, audit departments in ministries of the central government help to fulfil tasks related to this responsibility by carrying out evaluative, *ex-post* audits.

An important feature of the EU system of management and control is that the European Commission (EC) is ultimately responsible for the proper use of EU funds. However, the principle of subsidiarity is increasingly being applied to the actual implementation of EU policy. Subsidiarity implies that both the European Commission and the Member States have an "own responsibility" for legal and regular implementation of the EU budget and for sound financial management. The involvement of national authorities and bodies should be as wide as possible.

In many European countries and within the European Commission, the system of control is largely determined by the segregation between the duties of authorising officer, financial controller and accounting officer. In that system, the financial controller issues *ex-ante* approvals for all revenue and expenditure. Such approval allows the authorising officer to establish a commitment or entitlement. The system is different in the Netherlands and Anglo-Saxon-oriented countries, where *ex-ante* controls (operational in character) are incorporated into the budget implementation process, and *ex-post* audits (evaluative in character) are carried out by the ministry audit departments. This article addresses the audit activities of these ministry audit departments.

Agricultural Guarantee Expenditure

Agricultural Guarantee expenditure encompasses subsidies for farmers, especially contributions per hectare and per animal. In the Netherlands, the Member State responsibility for Agricultural Guarantee expenditure lies with the Minister of Agriculture. Advance payments are paid by the European Commission to the Ministry of Agriculture. The daily management lies with the paying agencies. In the period 1998-1999, the Ministry of Agriculture decided to reduce the number of paying agencies, in conformity with the wish of the EC to keep the number of paying agencies as low as possible. Now, six paying agencies remain. Most of them are so-called Commodity Boards (e.g. the Commodity

Board for Arable Products and the Commodity Board for Dairy Products). These Commodity Boards are public bodies, and their legal status is laid down in the Law on Public Business Organisation.

Physical on-the-spot checks and scrutiny of the commercial documents are mainly carried out by the General Inspection Service of the Ministry of Agriculture and by the Customs Service of the Ministry of Finance. These two services consult with each other on a regular basis to guarantee good co-ordination of their verification work.

The paying agencies are designated by the Budget Directorate of the Ministry of Agriculture. The EU criteria for accreditation require that the paying agencies provide sufficient assurance concerning the proper functioning of their administrative organisation and systems of internal control.

EU regulations also stipulate that within the Member State a department or body that is operationally independent of the paying agencies must issue a certificate regarding the annual accounts of the paying agencies (attestation procedure). In the Netherlands, the Audit Department of the Ministry of Agriculture has been designated as this certifying body. It must perform a financial audit, resulting in a report stating whether there is reasonable assurance that the accounts to be transmitted to the European Commission are true, complete and accurate, and that the internal control procedures have operated satisfactorily. The certifying body has to conduct its examination according to internationally accepted auditing standards.

Structural Funds Expenditure

Structural Funds are deployed for activities and measures aimed at, for example, regions whose development is lagging behind or are seriously affected by industrial decline, for combating unemployment, and for promoting rural development. EU operations must contribute to corresponding national operations; this therefore implies Member State co-financing.

Responsibility for Structural Funds at the supranational level in the Netherlands lies with the Minister for Economic Affairs (Regional Development Fund), the Minister for Social Affairs (Social Fund) and the Minister of Agriculture (Agricultural Guidance Fund). However, implementation of operations funded by the Structural Funds is largely decentralised in the Netherlands. For the most part, money goes directly from the EC to regional, local or other authorities (often provinces). Accounting for Structural Funds expenditure to the EC normally takes place at the level of individual projects or at the level of the responsible provinces.

The final beneficiaries under a Structural Funds project are obliged to present the provincial authorities with an audit certificate regarding the final expenditure statement. Relying on these certificates, the external auditor of the province will subsequently perform his audit. In turn, the audit department of the relevant ministry carries out a regular assessment of the design and operating effectiveness of the management and control systems in order to assure that the requirements set have been met. In this manner, the audit department reviews the work of the external auditors of the provinces or the other designated authorities.

Such a review should assess whether the checks and balances within the national management and control systems on all levels provide sufficient conditions for legal and regular expenditure and in which areas the main risks appear. In this respect, the audit department takes a system-oriented approach to assessing task formulation, working standards and planning, implementation and results of the audits performed.

If the ministry audit department, as a result of its review, concludes that there are essential shortcomings in the management and control systems, it may be necessary to perform on-the-spot checks. In most cases, however, the ministry audit department will demand that more substantive and compliance tests (including on-the-spot checks) are performed by the regional auditor at the level of the designated authority. The ministry audit department itself only performs on-the-spot checks on an exceptional basis.

In 1996, regarding the financial control of Structural Funds, each of the three audit departments involved signed a protocol of co-operation with the European Commission. These protocols state that the European Commission and the ministry audit departments conduct their audits in line with a common audit methodology statement. National inspections carried out on this basis have the same evidential value and enjoy the same status as inspections conducted by the Commission's Financial Controller. To ensure optimum coverage and to avoid duplication and overlap, the ministry audit departments and the Commission's Financial Controller consult each other twice a year on their working programmes.

Co-operation Among Audit Bodies

The Dutch Court of Audit *(Algemene Rekenkamer)* makes extensive use of the financial audits carried out by the ministry audit departments. The audits of both the Dutch Court and the ministry audit departments are system-based and analytical. In contrast, audits carried out by the European Court of Auditors are more data-oriented and substantive.

On behalf of the country's Parliament, the Dutch Court assesses the central government's financial management of both national and EU funds. Over the past few years, EU activities have acquired a prominent place in the Court's audit programme. The Dutch Court consults regularly with the ECA, as well as with other national courts of audit. When the European Court of Auditors conducts audits in the Netherlands, the Dutch Court assists and accompanies the ECA representatives. In addition, the two audit bodies occasionally carry out joint audits. ■

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Portugal's Financial Control System

by Vitor Caldeira

In this article, the Deputy Inspector General of the Portuguese Inspectorate General of Finance briefly describes the system of financial control. The Portuguese system is a modernised version of an Inspectorate General of Finance model, with emphasis on *ex-post* controls and co-ordination of controls by a centrally placed government body.

External Versus Internal Control

Portugal's system of financial control is based on a model that distinguishes between different types and levels of control, including a clear separation between external and internal control functions. The Parliament exercises external control at the political level, while the Court of Audit, in its capacity as an independent, sovereign court, does so at the judicial level. In its capacity as the country's supreme audit institution, the Court of Audit is at the same time responsible for performing the external audit function.

Internal control is carried out by bodies which determine their own working methods, including the inspectorates general in each ministry and by other audit bodies which are assigned internal control tasks. These tasks include the verification, follow-up, evaluation and provision of information concerning legality, regularity and good management of activities, programmes, projects, and operations carried out by public or private entities. Private entities which receive national, EU or other public funds are subject to internal control.

Taking into account the portuguese control experience of the EU structural funds, a co-ordinated system for the internal control of the state financial administration was put in place in 1998. This system covers budgetary, economic and financial domains as well as other assets, and aims to ensure clear, coherent control.

The system must guarantee that:

- all areas are controlled;
- none are subject to double examination;
- each level of control respects its area of competence; and
- that common and accepted audit methodology is used.

The Internal Control System

The organisation of internal control in Portugal is divided into three levels:

1) micro level management
2) sectoral control
3) high level or horizontal control.

At the horizontal or high level of internal control, there are three bodies: the Inspectorate General of Finance, which is the control institution responsible for the overall financial control of all public revenue and expenditure, the General Budget Directorate, responsible for the horizontal control of the implementation of the state budget and the Financial Management Institute of Social Security, responsible for the social security budget horizontal control.

At the sectoral level of internal control, there is a network of audit bodies. These include those entities charged with organic, functional, or even regional internal control tasks, such as Inspectorates (for example, the General Health Inspectorate or Regional Finance Inspectorates of Madeira or Açores). Sectoral control concentrates on assessing the soundness of the organisation, reliability, and activity of internal control at the micro level.

At this first (micro) level of the system, control occurs in operational units implementing management activities of public funds. The audit sections of these units perform the controls. The verification and follow up of the management activities and decisions is the main task of these internal audit functions, which are fundamental inputs to the work of the higher levels of control.

The Inspectorate General of Finance

The Inspectorate General of Finance enjoys a key position in the system. It reports directly to the Minister of Finance and it functions, among other things, as the national liaison body with the European Commission in the field of financial control.

It carries out three types of *ex-post* controls:

1) Financial control or audit. The objective is to give an opinion on the financial and accounting systems and the procedures of internal control of entities under public law, such as public enterprises, and paying agencies for EU Agricultural Funds.

2) Control of legal conformity and financial regularity. The goal is to provide an assessment of legal and administrative conformity, regularity of administration and systems of financing and financial management.

3) Financial management control or "performance audit". This is an examination of the extent to which public organisations or agencies have used financial, human and other resources in an economic, effective and efficient manner in the implementation of their objectives.

The second and third forms of control are carried out in a co-ordinated fashion across the state financial administration.

With this system, Portugal has succeeded in meeting the basic EU requirements on financial control and in introducing a more efficient audit and financial control system that has improved the value-added of controls of state budget funds. ■

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New Public Management Techniques Challenge the Flemish Model of Budgetary and Financial Control

by Paul van Sprundel, Georges Stienlet and Albert Vanhoof

Until recently, the Flemish financial and budgetary control model, like that of Belgium, rested exclusively on the traditional concept of accountability, that is primarily based on ensuring regularity and propriety in the use of the public finances. Initiatives to adopt methods of public management inspired by Anglo-Saxon and Scandinavian practices have met with mixed results.

The Government and the Minister of the Budget, assisted by the Inspectorate of Finance, exert a central control function with the aim of checking:

- Legality (interpretation and application of regulations for individual cases).
- Regularity (compliance with a prescribed procedural checklist, correctness).
- Budgetary compliance (respecting the expenditure limits per item as voted by Parliament in the annual budget law).
- Economy of any policy proposal with a financial consequence.

This budgetary control model is highly centralised within a hierarchical organisation. The model exerts *a priori (ex-ante)* or preventive line-item control based on compliance with regulations, procedures and formal budget laws. It consists of financial evaluation in the strictest sense, and has no systematic links between the evaluation of policy execution and budget allocation decisions.

Developments in Policy Making

Since the early 1990s, the Government of Flanders has begun to adopt methods of public management inspired by Anglo-Saxon and Scandinavian practices in which effectiveness and efficiency, alongside economy, play a prominent role. Initiatives have been taken to introduce performance analysis; move towards performance budgeting; introduce an economic or cost accounting system; enlarge the autonomy of agencies; promote public and private partnerships; and outsource certain aspects of policy execution.

A central trait of these developments is a change in systems of accountability towards greater emphasis on performance measurement rather than line-item controls. These developments greatly affect the position of the central controller in the budget process during the stages of budget preparation and budget execution. While it has become less important for organisations to respect a strictly fixed line-item budget, they now are expected to achieve, to the best of their ability, an agreed level of performance.

New Initiatives to Strengthen Control

Steps have been taken to introduce performance analysis within the Flanders administration on a global basis. Yet there has been reluctance in some parts of the organisation to adopt this new management technique. The same problems arose with regard to output-budgeting. Although there have been experiments with output-budgeting, the annual budget is still made up on the basis of incrementalism and input-budgeting, causing discouragement among those services that have tried hard to create an output-budget.

Another initiative is the introduction of the budgetary implementation plan. Based on the budget voted by Parliament, this plan is prepared by individual departments (ministries) and contains a detailed budget execution programme. The budgetary implementation plan is intended to facilitate expenditure management by assigning greater responsibility to the administrators concerned. However, due to reservations at the political level this practice has not been widely adopted.

Another initiative is the release of a circular prescribing that proposals presented to the Inspectorate of Finance within the scope of an *a priori* evaluation must comply with the techniques and methodology of performance analysis. Also, beginning with the 1999 Budget, departments are obliged to draw up the explanatory note accompanying the budget according to performance analysis principles. This obligation influences the way public officials look at performance analysis, and helps them to identify ways to introduce this methodology into their daily work.

- Input budgeting: budgeting based on the costs of the input (staff, operational means) available without any link to performances that have to be delivered, effects or targets that have to be obtained.
- Output budgeting: budgeting based on the costs of the output or performances that have to be delivered to achieve effects and targets government has defined.
- Principle of incrementalism: the quasi-automatic and mechanical calculation of the increase of the budget whereby only the input side is taken into account.

Recent experience has revealed that the following problems are hindering the adoption of new practices in public management:

- New public policy-making ideas are not rooted deeply enough in the administration.
- Interests at the political level and the administrative level conflict. The political level is mostly interested in efficiency, since responsibility for this lies with the administrative management. The administrative level, on the other hand, is especially interested in the effectiveness of the policy for which the responsibility lies at the political level.
- There still is no adequate instrument to measure effectiveness and efficiency.

These problems put the financial control model in an ambiguous situation. In the meantime, those responsible for carrying out financial control are working to build the necessary bridges between today's reliance on line-item control and the adoption of modern management and policy-making techniques giving more autonomy to administrators. ■

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Latvia Establishes a New Internal Audit System

by Dace Nulle

Kjell Larsson

Dace Nulle

The European Commission's 1998 *Regular Report on Progress Towards Accession* identified a number of shortcomings in Latvia's system of internal audit and financial control. Indeed, the internal "revision" departments in place at that time were weak – lacking personnel, sound methodologies and capacities for co-ordination. Recognising the need to strengthen financial control, in February 1999 the Government charged the Ministry of Finance with the task of co-ordinating the establishment and implementation of an internal audit system in Latvia. This article summarises progress to date.

The establishment of a new system of financial control in Latvia called for a series of policy discussions on the scope of internal audit. This culminated in the presentation of a policy paper to the Cabinet of Ministers on 23 March 1999 setting out the conceptual framework for the development of a new, comprehensive internal audit system.

Following the adoption of the internal audit concept in April 1999, the Ministry of Finance began to prepare a new regulation on internal audit. This proved to be a very time consuming process. Support for the new regulation was slow in coming. Some ministries interpreted the move as an infringement on their independence.
Others raised concerns about the Ministry of Finance's co-ordinating role, voicing fears that, as a result, its scope might be restricted to audits of accounts alone. The Ministry of Finance worked with each ministry, at the State Secretary and expert levels, to promote a common view of internal audit as a management tool benefiting each institution. The Ministry of Finance endeavoured to limit its co-ordination role to the facilitation of knowledge and skill-sharing and to improving the capacity for audit.

Latvia has embarked upon the process of establishing a decentralised internal audit system that will fulfil internal audit functions for all government and EU funded activities and significantly improve overall financial control. The system builds on the strengths of existing internal revision units while introducing new methodologies and key structures to ensure that national and EU resources are managed in a sound way.

In June and July 1999, the Ministry of Finance undertook a series of bilateral meetings with each ministry in order to assess their needs for extra resources in establishing strong internal audit units. This task was rendered even more difficult due to the fact that audit systems have not yet been identified in ministries and by the absence of risk assessments.

The agreement reached between the line ministries and the Ministry of Finance provides additional resources to five ministries in setting up their internal audit system.
It also provides for the evaluation in all ministers of additional needs for resources in mid-2000, once risk assessments, as well as strategic and annual plans are in place.

Regulation on Internal Audit

The Cabinet approved the Regulation on Internal Audit on 5 October 1999. It requires the introduction of internal audit in all ministries, defines the scope of internal audit work and sets out the principles for internal audit (such as independence). The regulation also covers such issues as the audit of Community funds, annual statements of assurance and reporting of internal audit work, as well as the co-ordination of internal audit within the public administration.

Under the new regulation, each ministry will set up internal audit units that are functionally independent of the ministry. The head of each internal audit unit will report to the state secretary of the ministry. All subordinate and supervised institutions, as well as EU funded projects, will be subject to internal audit. Determining whether such institutions or projects are to carry out internal audit directly or be subject to their respective ministry's internal audit unit, will be the responsibility of the state secretary.

Strengthening the Decentralised System

Latvia has embarked upon the process of establishing a decentralised internal audit system that will fulfil internal audit functions for all government and EU funded activities and significantly improve overall financial control. The system builds on the strengths of existing internal "revision" units while introducing new methodologies and key

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Fiscal Transparency in Hungary Since the Beginning of Transition

by Csaba László

Before Hungary's transition period, everything surrounding the state budget process was opaque. At the beginning of the 1990s, however, Hungary began to develop a fiscal system appropriate to an emerging democracy. This included the introduction of a new public finance law and an independent audit organisation. In this article, former State Secretary of the Ministry of Finance, Csaba László, reviews measures taken and outlines what remains to be done to institute fuller fiscal transparency.

In the early 1990s, Hungary's new government introduced several measures to comply with minimum legal standards for a democratic political system. In 1992, the Parliament approved the public finance law. It regulated the entire budgeting procedure, including the allocation of responsibilities among the different players, and timetables. In comparison to the pre-transition period, the budget became very detailed, and parliamentary discussions became much longer and more serious. The independent state audit office started work in 1990.

Measures introduced to establish the legal framework of a market economy also led to increased fiscal transparency. New laws on bankruptcy, accounting, banks and securities forced restructuring of the banking system. Although these reforms were very costly, they eliminated most of the financial sector's hidden losses. By 1994, the institutional situation had improved dramatically, but it still did not comply with the minimum requirements of a transparent fiscal system from an economic point of view. Basic information was simply unavailable in a form that could permit analysis by decision-makers and the public.

Increasing Fiscal Transparency

Between 1995 and 1999, the Government introduced numerous measures to enhance the transparency of the fiscal system. Over the same period, the growing maturity and importance of the Hungarian capital market demanded the availability of reliable and accurate information about the public sector. The market's main players developed new research capacities with special focus on the public sector. As a consequence of this external pressure, transparency in economic policy making became a question of government credibility. A list of achievements during this period follows:

Chain Bridge and Danube, Budapest.

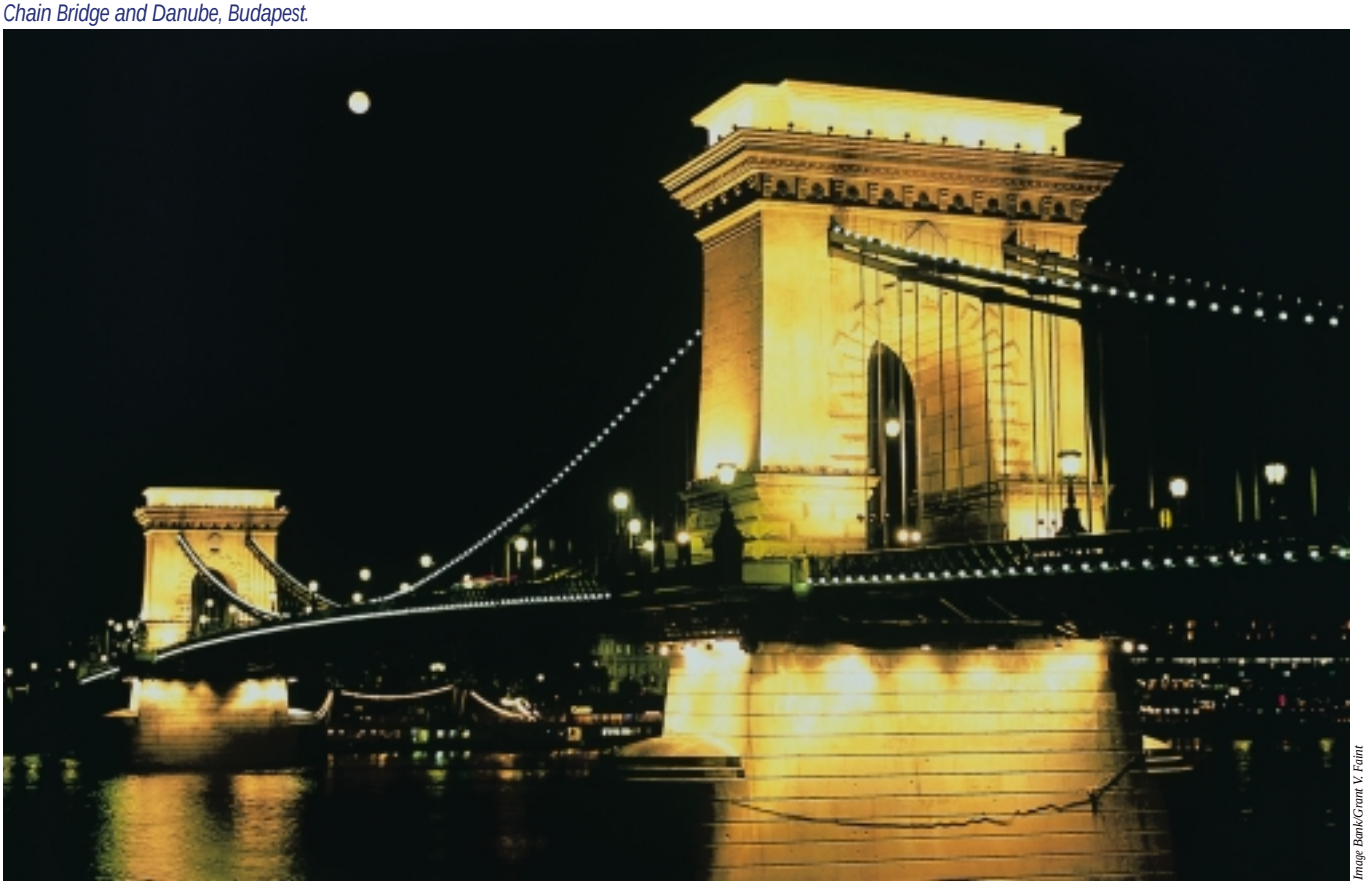

Image Bank/Grant V. Faint

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Latvia Establishes a New Internal Audit System

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structures to ensure that national and EU resources are managed in a sound way.

To date, the objective of strengthening internal audit in Latvia has received support from a number of sources, both bilateral (for example, from the British Council's PADBAS project) and multilateral. The EU has provided significant assistance, most notably under the Phare National Programme (Budget and Treasury Project, Public Administration Reform Project) and through SIGMA.

Work on the preparation of specific guidelines and manuals for internal auditors, as well as on the introduction of risk assessment in internal audit work, is currently underway. Plans for the immediate future include: the preparation of strategic audit plans for all ministries, the drafting of basic guidelines for an internal auditor training programme, the elaboration of a peer review methodology as well as the establishment and strengthening of the Internal Audit Council foreseen under the new regulation.

These are just the first of many steps towards building a strong internal audit system in Latvia. However, as the latest European Commission *Regular Report*, recognised, "some progress has been made in 1999." Given government commitment, the willingness of state institutions to adopt internal audit, and continued support from Phare, the implementation and development of internal audit is expected to proceed at pace. ■

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Fiscal Transparency in Hungary Since the Beginning of Transition

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- Budget figures are consolidated; statistics cover all subsectors of government; and privatisation revenues are clearly separated from the other revenues.
- According to a pre-announced calendar, budget figures and the outstanding cash balance of the treasury single account are published monthly.
- The structure of public sector has been simplified through the elimination of almost thirty extrabudgetary funds and the social security self-governments.
- Figures on the sustainability of the pension system based on a fifty year forecast are published in budget documents.
- In 1999 the State became the sovereign borrower, taking over this role from the central bank. The central bank balance sheet was cleared in 1997 by transferring the net foreign debt to the budget.
- Starting in 1999, the budget procedure became a two-step process. At the beginning of summer, Parliament must approve the broad lines of the budget, including the deficit and some of the main characteristics of the coming year's fiscal policy. The second step is the traditional parliamentary approval of the detailed budget.
- A new initiative requires the administration to produce pre-election reports for the public on the local, ministry and national levels.

As a result of these changes, the Hungarian fiscal system has become one of the most transparent in Central and Eastern Europe. Nonetheless, more remains to be done to enhance transparency and to being the system fully into line with the norms of European Union Member States.

The Unfinished Agenda

At the beginning of the 1990s, Hungarian politicians and public servants were keen to apply standards for fiscal transparency of modern democracies. There was a clear consensus that fiscal transparency is crucial to political transition, and this lead to the creation of a working group to address this subject. Building up credibility soon became so important that a very strong political will emerged to improve transparency of economic policy making.

International organisations, such as the IMF, the OECD, and the World Bank, gave support to this process.

Now, the top priority of the government is EU accession. Fiscal policy must fulfil the Maastricht criteria using an accurate information base in line with EUROSTAT requirements. Transformation of the entire accounting and information system must take place to be in alignment with EU standards.

Improving the effectiveness and efficiency of the public sector makes it necessary for performance indicators to be used in budget debates. Although this is a difficult process methodologically, experience from other OECD countries shows that this could greatly contribute to controlling expenditure. The gradual introduction of accrual accounting in several areas of the public sector is among the actions under consideration.

Over the past ten years, Hungary has made significant strides in enhancing fiscal transparency. Nevertheless, the system still does not provide sufficient information to taxpayers and politicians about expenditure allocation and about the effectiveness and efficiency with which public money is spent. Addressing these shortcomings will enhance the credibility of public officials in the realm of economic policy - not only in "the markets", but also among the taxpaying voters as well. It is therefore in the interest of the current government to take further steps to increase fiscal transparency. ■

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New Training Package for Procurement Officials

SIGMA and the ILO's International Training Centre (Turin) have released the course material on "Training of Trainers in Public Procurement" to support dissemination of information on best practice procurement techniques across Central and Eastern Europe. The package puts at the disposal of procurement officials a modular collection of teaching materials based on the EC Directives and the *Public Procurement Manual for Central and Eastern Europe*, jointly published by SIGMA and ILO/ITC in 1996. The materials support the development of national procurement training courses in EU candidate countries.

The "Training of Trainers Package" comprises eight modules, including general principles of public procurement and institutional framework, management of the tendering process, contract administration, accelerated procedures for small value purchases, and electronic tendering. Each module is divided into self-contained instruction units (sessions). Guides explaining the trainer's role in the management of the learning process will be prepared for the sessions. Most of the material in the package appears in written form, allowing trainers to operate as course facilitators rather than lecturers.

Copies of the printed modules have been sent to procurement directors in central and eastern European countries with which SIGMA works, as well as to concerned directorates of the European Commission. Additional printed copies are being made available upon request from SIGMA at the address on page 2 or e-mail: sigma.contact@oecd.org.

SIGMA and ILO/ITC has prepared a CD-ROM version of those parts of the modules relating to the EC services directives. Enquiries about obtaining copies of the CD-ROM should be addressed to ILO/ITC at e-mail: proc@itcilo.it.

Protecting the Financial Interests of the State and of the European Union

Continued from page 3

Jacques Brinon/OECD

Kjell Larsson

fer of knowledge and experiences of EU Member State practitioners to counterparts in Central and Eastern Europe or between counterparts of the candidate countries. The idea of using practitioners from Member States is also the conceptual backbone of the European Commission's twinning initiative whereby practitioners of Member State administrations are engaged

Susannah Mevel

Johannes Stenbæk Madsen

with sister organisations in candidate countries, to assist in the development of legislation, rules and procedures for financial control.

SIGMA facilitates and supplements twinning projects where appropriate, and, in several cases, SIGMA has been asked by the countries and European Commission delegations to set up "bridging arrangements"to prepare and link current development projects to upcoming twinning projects. The box below offers a glimpse of the types of projects in which SIGMA and beneficiary countries are engaged, including support to twinning.

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For further information on the issues involved in preparing audit and financial control systems for EU membership – and SIGMA support to such preparations – see SIGMA's Audit and Financial Control Web at: http://www.oecd.org/puma/sigmaweb/acts/audit/index_ea.htm

SIGMA Activities on Internal Financial Control

Like in other areas of its work, SIGMA activities in the area of internal financial control aim to prepare candidate countries in Central and Eastern Europe for the institutional consequences of EU accession. In the domain of internal financial control, SIGMA puts emphasis on the establishment of structures and the implementation of standards and practices to enable countries to take on the responsibility for the decentralised management of EU funds and resources provided through, e.g., Phare, Instruments for Structural Policies for Pre-Accession, Special Accession Programme for Agriculture and Rural Development (SAPARD), and "own resources."

Recent SIGMA activities include:

- Assessments of the status of financial control in ten candidate countries, measured against the Baseline for Financial Control (see page 6);
- In-depth review of existing financial control solutions in Slovenia and analysis of eventual gaps vis-à-vis requirements for EU funds and resources management;
- Development of structures and standards for public internal audit and financial control in Lithuania;
- Co-operation with European Commission services, delegations, "twinning" experts and candidate countries in defining ways forward to establish, accredite and certify SAPARD agencies and providing counselling in that area (Bulgaria, Estonia, Romania, Slovakia, Slovenia);
- Assistance to European Commission services and delegations in drafting terms of references, evaluation of tenders and defining and implementing different "bridging" activities to prepare for forthcoming donor-Phare projects (in Albania, Bulgaria, Estonia, Latvia, Romania); and
- Comparative analyses and dissemination of information on experiences and lessons learned in Member States when joining the EU. (See SIGMA Papers No. 19 and 20 -- *Effects of European Union Accession: Part I Budgeting and Financial Control, and Part II. External Audit.* These publications are available on the SIGMA web site at: http://www.oecd.org/puma/sigmaweb.)

For the three non-candidate countries participating in SIGMA's work -- Albania, Bosnia-Herzegovina, and the former Yugoslav Republic of Macedonia -- support is aimed at how to establish the necessary institutional foundations for financial control.

Latvia Consults with Interest Groups on European Accession

by Edvards Kušners

Aigars Jansons/ Aktuala Foto Informacija (AFI)

Edvards Kušners

In preparing for European Union membership, Latvia has developed a number of structures for consultation with interest groups outside the central government. A recent initiative seeks to encourage wider public participation in the definition of national interests with regard to EU accession.

In spring 1999, the Latvian Government approved an initial outline of national interests as part of EU accession preparations. Recognition that such an exercise goes far beyond the remit of individual ministries, and even of the Government as a whole, led to the decision to open up the process to consultation with outside interest groups. The Government decided that clear, well-established consultative mechanisms with organisations outside central administration would be essential for conducting effective negotiations on EU membership.

Consultations on Sectors

With this objective in mind, the Latvian European Integration Council launched in May 1999 a series of meetings with organisations and groups outside government on specific sectors of the *acquis communautaire* and gave the task of co-ordination to the European Integration Bureau (Bureau). These meetings have two objectives: first, to gather the opinions of the those working in a particular part of the private sector on key national interests and on what issues should be negotiated; and second, to identify potential members of working groups who could eventually be involved in the EU negotiation process.

Consultations are conducted with representatives of the relevant industrial or citizens' associations, as well as the managers of large companies. The first meeting, focused on Fisheries, took place in May 1999, the second on Culture and Audiovisuals in September 1999. The meetings are divided into two parts. During the first part, Bureau officials provide information on EU policies and on the current state of affairs. Close attention is accorded to those pieces of EU legislation which should be in place after accession, but which are difficult and expensive to implement. In the latter part of the meeting, the floor is opened to the representatives of participating businesses and associations to give their perspectives on the issues under review.

Although the inaugural two meetings attracted only a few participants, those involved agreed that they were useful. In particular, the meetings allowed government officials to look at issues from other perspectives and to prepare the ground for consultation with the private sector during future accession negotiations. They also brought wider recognition that simple and efficient mechanisms of consultation can be found and that such meetings, if well prepared, bring positive benefits to all concerned.

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Raising Awareness of EU Matters

A key finding emerging from these meetings was that business people had limited knowledge about the priority issues facing Latvia in its preparations for EU membership. For many of them, EU accession is not an urgent matter. A related challenge is the varying degrees of knowledge among the participants on issues discussed. A lack of information obviously affects participants' ability to speak about EU policies and the impact of those policies on Latvia. Only a few people can present their views clearly, while many simply listen. But for those with limited previous knowledge, the consultation exercise achieves a third objective – encouraging participants to think more about the impact of EU policies on their businesses and lives.

Improving the Consultation Process

The Bureau intends to improve its consultation exercise with the help of the European Movement in Latvia. In August 1999, that organisation received a grant from the Soros Foundation Programme of the Baltic-USA Partnership to organise preparatory meetings with business representatives prior to each consultation meeting. Experts from outside government will be invited to these preparatory meetings. Questions emanating from these preparatory meetings will be submitted to the Bureau to help it better prepare the subsequent consultation meetings. *Acquis*-related topics to be addressed in further consultations include Transport, Free Movement of Goods, Consumer Protection and Health. ■

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Ethics Training Programme for Public Service Managers

by Howard Whitton

An educational tool developed in Australia seeks to address two major problems in public sector integrity management. The first is that no "code of ethics" can help a manager who does not recognise an ethics or corruption problem when it occurs. The second is that there is a serious shortage of experienced trainers who can teach Public Sector Ethics to public officials within a framework that reflects today's professional values.

The *Public Sector Ethics Resource Series* is a multimedia education and training resource on "hybrid CD-ROM", developed for the ten central and state public services of Australia and New Zealand. The series provides a flexible, cost-effective package of resources designed to assist adult learners in developing competence in "professional ethics for public officials."

The CD-ROM technology allows the user instant access to:

- Comprehensive legislation, references, and training materials.
- Guidelines and codes of conduct.
- A unique decision-support model for "ethical reasoning."
- Extensive training materials and case studies.
- Links to useful Internet websites on public sector ethics.

Developing enhanced ethical reasoning skills is the major objective of the *Ethics Resource Series*. The adult learning strategy adopted by the series is supported by two animated tutors, *Parentheses* (said to be a distant Australian descendant of Socrates), and the *Voice of Reason*, a thought-provoking Owl. The characters prompt the users with Socratic questions, so they can adopt a self-paced learning approach to the video case study materials.

Key Professional Skills

The five short case study movies in the *Ethics Resource Series* are intended to provide skill development, professional socialisation and education for middle and senior Australian public sector managers. The case studies emphasise integrity and ethical reasoning rather than compliance. Each 10-minute movie raises about 20 ethics issues for discussion, in the context of a realistic story set in a typical public sector workplace. The major themes covered by the videos include:

- Power, delegation, and public office
- Government, the Minister, and the rule of law
- Respect for persons and Human Resource Management
- Ethics management and conflicts of interest
- Professional conduct and responsibility
- "The public interest" and due process
- Corruption prevention and whistleblower protection
- Integrity, accountability, and ethical public management.

The case studies emphasise integrity and ethical reasoning rather than compliance. Each 10-minute movie raises about 20 ethics issues for discussion, in the context of a realistic story set in a typical public sector workplace.

The *Ethics Resource Series* provides invaluable exposure to the language and concepts of professional ethics that are relevant in the public sector workplaces of today. Among other things, the Series aids users to identify professional ethics issues in the workplace accurately and quickly, use a rational and defensible decision-making framework for dealing with those issues, implement values-based leadership and management, and resolve ethics issues with reference to relevant legislation.

Flexible Technology

The *Ethics Resource Series* draws upon proven software and technology to provide practical tools, and comprises five CD-ROMs. This economical application has already been adopted successfully by the Australian Department of Foreign Affairs and Trade. Ethics training or decision-making support can now be selected as needed by individuals at their desks, or delivered to a specific group of employees at one time by a trainer, or called up over a period of time by participants contributing to, for example, a group discussion of a case-study or a "real time" problem for on-the-job training.

The training videos featured in the *Series* have already attracted very positive responses from international audiences, suggesting that ethics problems in the Australian public services are familiar almost anywhere.

Because of the flexibility of the design and the technology used, it is a relatively simple process and inexpensive to change the voice used in the videos into other languages, or to provide subtitles, thereby saving a great deal of time and movie production costs.

It is even simpler to replace the current Australian document and legislation database with equivalent reference materials relevant to any other jurisdiction in the world.

As a consequence of this flexibility, the *Public Sector Ethics Resource Series* is currently being considered for development for public service applications in Canada, the United Kingdom and other countries. ■

Howard Whitton is Principal Project Officer in the Australian Office of the Public Service Commissioner. He may be contacted in Brisbane at e-mail: Howard.Whitton@premiers.qld.gov.au. *Further information is available from the* Series *website at http://www.ethicslearn.com.*

SIGMA

SIGMA – Support for Improvement in Governance and Management in Central and Eastern European Countries – is a joint initiative of the OECD and the European Union. The initiative supports public administration reform efforts in thirteen countries in transition, and is principally financed by the EU Phare Programme. The Organisation for Economic Co-operation and Development is an intergovernmental organisation of 29 democracies with advanced market economies. Phare provides grant financing to support its partner countries in Central and Eastern Europe to the stage where they are ready to assume the obligations of membership of the European Union.

Phare and SIGMA serve the same countries: Albania, Bosnia-Herzegovina, Bulgaria, the Czech Republic, Estonia, the former Yugoslav Republic of Macedonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia and Slovenia.

Established in 1992, SIGMA works within the OECD's Public Management Service, which provides information and expert analysis on public management to policy-makers and facilitates contact and exchange of experience amongst public sector managers. SIGMA offers beneficiary countries access to a network of experienced public administrators, comparative information, and technical knowledge connected with the Public Management Service.

SIGMA aims to:

- assist beneficiary countries in their search for good governance to improve administrative efficiency and promote adherence of public sector staff to democratic values, ethics and respect of the rule of law;
- help build up indigenous capacities at the central governmental level to face the challenges of internationalisation and of European Union integration plans; and
- support initiatives of the European Union and other donors to assist beneficiary countries in public administration reform and contribute to co-ordination of donor activities.

Throughout its work, the initiative places a high priority on facilitating co-operation among governments. This practice includes providing logistical support to the formation of networks of public administration practitioners in Central and Eastern Europe, and between these practitioners and their counterparts in other democracies.

SIGMA works in five technical areas: Public Administration Development Strategies; Policy-Making, Co-ordination and Regulation; Budgeting and Resource Allocation; Public Service Management; Financial Control and Audit. In addition, an Information Services Unit disseminates published and on-line materials on public management topics.

ON THE AGENDA

Upcoming Programmes

6-7 April 2000, Paris, France. 21st Session of the OECD's Public Management Committee (PUMA).
Contact: Edwin Lau, PUMA, OECD, Paris, France.
Fax: (33.1) 45.24.87.96; e-mail: edwin.lau@oecd.org.
In English and French.

10-17 April 2000. Vienna, Austria. Tenth United Nations Congress on the Prevention of Crime and the Treatment of Offenders. "Crime and Justice: Meeting the Challenges of the Twenty-first Century".
Contact: Jonathan Lucas, Congress Secretary, Vienna
Tel: (43.1) 26060.4280; fax: (43.1) 26060-5917;
e-mail: maureen.mcgregor@cicp.un.or.at;
website: http://www.uncjin.org.
In English.

13-14 April 2000, Paris, France. "Justice and Home Affairs - How to Implement the Amsterdam Treaty?"
International Seminar for Experts in the series Great Debates.
Contact: Cicero Foundation, Paris, France.
Tel: (33.1) 43.80.18.21; fax: (33.1) 42.67.92.04;
e-mail: cifo@compuserve.com;
website: http://ourworld.compuserve.com/homepages/cifo.
In English.

13-15 April 2000, Budapest, Hungary. Eighth NISPACee Conference. "Ten Years of Transition: Prospects and Challenges of the Future for Public Administration".
Contact: NISPAcee, Bratislava, Slovakia. Tel/fax: (42.7) 64.28.55.57;
e-mail: viera@nispa.sk;
website: http://www.nispa.sk/news/events.html. In English.

4-6 May 2000, Wigry, Poland. "Ethics in the Public Administration. Prospects and Challenges for the Future for Local Governments".
Contact: Patrycja Suwaj, Project Manager, School of Public Administration in Bialystok (WSAP), Bialystok, Poland.
Tel: (48.604) 96.67.48; fax: (48.85) 732.34.02;
e-mail: patsuvaj@friko7.onet.pl or wsap@falco.man.bialystok.pl.
In English and Polish.

19-23 June, 2-6 October, 20-24 November 2000, Maastricht, The Netherlands.
Seminar on European Negotiations. Contact: Ms. Noëlle Debie, Programme Organization Division, European Institute of Public Administration (EIPA). Tel. (31.43) 3296.226;
fax: (31.43) 3296.296; e-mail: n.debie@eipa-nl.com.
Or submit the online registration form on the EIPA website: http://www.eipa.nl. In English and French.

Please note that not all of the programmes included in this calendar are open to every public administration practitioner or the general public. Details are provided directly by the organiser, who may be contacted for further information. If your organisation is planning an event, please send details to SIGMA (address on page 2). A more complete calendar of events may be found at: http://www.oecd.org/puma/sigmaweb.