

REPORT

The draft Concept for a Financial Control System in the Russian Federation

**Comments from:
SIGMA and the Swedish Russian Co-operation Programme**

13 December 2001

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1. INTRODUCTION

The Russian First Deputy Minister of Finance, Mr Aleksey Ulyukayev, has asked SIGMA and the Swedish Russian Co-operation Programme (SRCP) to comment to him personally on a draft Concept Paper, including an attached Activity Plan, for the set-up of a new federal financial control system (including the external audit) within the Russian Federation. These comments are intended to help the Minister in his discussions with the various bodies concerned in financial control and audit. SIGMA/SRCP have not received the Activity Plan.

SIGMA and the SRCP have co-operated with a group of senior experts on this project. They have commented on the draft Concept and provided comparative information on their own national systems. The experts co-operating in the project are:

- Alain-Gerard Cohen, Financial Inspector General, France
- Gisela Färber, Professor, Germany
- Harry Havens, former Assistant Auditor General, United States
- Åke Hjalmarsson, Head of Section, Ministry of Finance Sweden
- Kjell Larsson, Director of OLAF, European Commission
- Andy McDonald, former Comptroller General, Canada

The experts participate in this project as individual persons and their comments and views do not represent the institutions they are working for.

Lage Olofsson from SIGMA has been the project manager. Bob Bonwitt (SIGMA), Rolf Eidem, Cecilia Colliander and Gösta Ljungman from the SRCP have made important contributions in the project process, as has Barbara Glynn (SIGMA) who has been the project assistant.

In this paper SIGMA, the SRCP and the experts present their views on the common principles for financial control systems and how these could be used in the process of setting up a new financial control system within the Russian Federation. One should bear in mind when reading the material that the comments are made from a limited knowledge about the specific situation and problems faced within the Federation.

Any national system set-up should always be built upon the specific situation of the individual country. At the same time, it is our opinion that both international experiences and international standards are of tremendous help in such activities. Furthermore, it is our view that divergences from international standards should always be thoroughly motivated and explained.

Executive Summary

The first objective of the draft Concept was to establish why the Russian Federation needs a system of state financial control. We have found that the first objective is met. It is positive that you have already established an approach and a vision in the draft Concept for the set up of the new financial control system. This part may be used as the overall guidance and direction for the authorities that will implement the new financial control system.

Other objectives for the draft Concept were to:

- **establish what direction the state financial control development should take;**
- **the aims and main tasks of state financial control within the Russian Federation.**
- **principles and organisation of the state financial control system in the Russian Federation.**
- **procedures for implementing and enforcing the concept for a unified system of state financial control in the Russian Federation.**

Our comments and concerns deal more with these objectives. In this paper we give a number of recommendations and under each one, you will find a number of key aspects that must be addressed, as a matter of principle in the Concept and in depth during the implementation. The main recommendations are:

- **Make a division between financial control of budget execution and financial control of market activities and use different approaches to each.**
- **Ensure this division takes care of and balances the control needs for the four pillars Government, Market, Parliament and Judiciary**
- **Ensure that key aspects (as listed in the report) are addressed for each of the four pillars**
- **Use the Concept as a framework for the Activity Plans**

To support implementation of these recommendations, we suggest that you analyse the contributions of the experts.

2. RECOMMENDATIONS FROM SIGMA/SRCP

2.1. Introduction

Like the experts we are of the opinion that the draft Concept gives a good overview of the current problems of the misuse of state resources, corruption and illegal financial transactions and shortcomings in the area of financial control in the Russian Federation. The main problems mentioned in the draft Concept are familiar to us from most other countries although the extent and seriousness varies.

At the same time both we and the experts identify the need for stronger linkages between general statements and principles on one hand and proposed measures and responsibilities on the other. We have also identified some areas, which need to be analysed in more depth, and others where we believe the thrust of the Concept could be usefully redirected.

These problems lead us to the conclusion that the framework described in the draft Concept would benefit from being fundamentally re-structured; otherwise its implementation will be put at risk. To do so would probably not be a long process as the key components have already been addressed. The following will hopefully help you in that process.

2.2 The main views of the experts

The main views of the experts can be summarised as follows:

- The Concept defines financial control in a very broad way. For a number of reasons the experts would propose to divide the concept into pillars following either the legal environment (whether entities are regulated by public or private law), or funding origin and/or the objective of the responsible controllers within each pillar. The experts propose slightly different methods for this division.
- An unclear division between financial control of budget execution and other forms of control connected to a well functioning market or the relationship of citizens and private companies to the state (tax payments, adherence to laws, etc.) risks endangering the intentions set out in the draft Concept.
- The experts are concerned both with the purpose and the possibilities of creating a unified system for financial control in the broad sense proposed in the draft Concept. An attempt to create one single system will most likely have the effect of not being able to correct the problems mentioned in the draft Concept. The inefficiency of a centralised system is also addressed, as is the need to find a step-wise approach to how the new financial control system is build up.
- All the experts stress the importance of drawing clear borderlines between the responsibilities of the different control functions, which should be represented in institutional design. The responsibilities and design should be based in law.
- The experts stress the importance of defining a separate system of financial control related to the budget execution, which might be divided into three layers: a) internal control in budget spending units; b) Government control over the execution of the budget in budget spending units; and c) parliamentary control over budget execution by the Government. The fact that in the Concept paper the first layer is not regarded as a part of the financial control system is considered to be a significant weakness. It is the opinion of the experts that this layer should be the fundamental basis for the financial control system.
- The experts stress the need for an independent Supreme Audit Institution (SAI) responsible for the external audit of Government budget execution. The importance of being independent both in its relationship to Parliament and to the Executive is regarded as a strong prerequisite for an SAI to function and to maintain credibility and value.
- The experts also focus on the need to establish special measures for combating fraud, corruption and other forms of severe economic illegality, which effect the income or expenditure side of the budget.

2.3 Recommendations from SIGMA/SRCP

Having carefully studied your draft Concept paper and the expert's comments, SIGMA/SRCP would like to give the following four recommendations. These recommendations are intended to assist you and the Ministry of Finance in creating a stable solution to the problems of state financial control as described in the draft Concept. We would like to divide our recommendations into two parts. The first one concerns the factual content of the draft Concept. The second part concerns the actions needed for a successful implementation of the Concept when it has been finalised. The implementation of such an ambitious undertaking will take some years. It is therefore, in our view, important that the finalised Concept paper provides **a clear framework and direction for the authorities that will be responsible** for making sure the Concept becomes reality.

2.3.1 The draft Concept

The draft Concept sets out its objectives as being to establish:

- why the Russian Federation needs a system of state financial control and what direction its development should take;
- the aims and main tasks of state financial control in the Russian Federation;
- principles and organisation of the state financial control system in the Russian Federation;
- procedures for implementing and enforcing the concept for a unified system of state financial control in the Russian Federation.

We find that the first objective is met and that it is very positive that you have already established an approach and a vision in the draft Concept for the set up of the new financial control system. This part may well be used as the overall guidance and direction for the authorities that will have to be active in implementing the new financial control. You say in the Concept that:

"Fulfilling these tasks would ensure that state funds are used effectively and for their designated purpose, reduce the scope for abuse and theft of state assets and improve the general economic and social climate in the country. At the same time, these tasks are in keeping with the priorities set by building a democratic rule of law. This would make a real contribution towards strengthening the vertical of power -- one of the priorities in building the state in Russia today -- and would help further develop the state financial control system in the Russian Federation.

State control is an obligatory part of public fund management. Control isn't an end in itself; rather, it is an integral part of a regulatory system, the job of which is to reveal deviations from accepted standards and violations of the principles of lawfulness, effectiveness and economy in the use of state funds. The system should catch these problems at the earliest possible stage in order to take corrective measures, make the guilty accountable, ensure compensation for losses and take measures to ensure similar violations don't happen in the future."

Our comments and concerns are more on the remaining objectives. There are several reasons for this. It has for example not always been easy to follow the red thread in the draft. It seems as though additions have sometimes been made without linkages to earlier stated principles or analyses. Moreover, we have noticed a tendency to address organisational solutions as always being part of an already existing organisation's responsibility instead of first to analyse what kind of functions are needed to meet the objectives and only thereafter addressing organisational or institutional solutions.

We find it also difficult to see how, if at all, you distinguish between the objectives, mandate and function of activities like internal control, internal audit, external audit, inspection, and supervision. We conclude that there is a need for an in-depth discussion and clarification about the aspects raised here before you start redesign.

Under each of the main recommendations you will find a number of key aspects that must be addressed, in principle in the Concept and in depth during design and implementation.

Recommendation 1: Make a division between financial control of budget execution and financial control of market activities and use different approaches to each.

In our view, the draft Concept would be strengthened if it were structured differently. It would be better to identify and make a division between:

- problems related to execution of the state budget according to principles of legality and efficiency
- problems that threaten a well functioning market and undermine the income side of the state budget.

The experts and SCRP/SIGMA concur that **establishing a unified structure of financial control is not feasible**. The experts' opinions vary in respect of the exact division of the concept into pillars, but are unanimous in recommending that the concept be desegregated.

Recommendation 2: Ensure this division takes care of and balances the control needs for the four pillars Government, Market, Parliament and Judiciary

We understand that there may be a strong political need to establish a Common Programme addressing mismanagement, fraud and corruption in the public sector as well as different forms of illegal economic behaviour of market operators. Within this context we suggest that the future Concept address financial control in four pillars. They can be distinguished in different ways -- for example, following the division between public and private law, funding sources, or common simpler objectives for different forms of control. Whatever the division chosen, the fundamental underpinning of financial control in both public and private sectors is a reliable judicial and law enforcement system.

We propose that you test if the following division suits your purposes:

- **Government** -The Executive need to set up a financial control structure which ensures that the authorities under their jurisdiction report and carry out the budget in the intended way. To our understanding the Russian Constitution states that the President as the Head of the State also leads the Government and therefore has the highest responsibility for the execution of the budget;
- **Market** - The need for the State to organise and enforce prerequisites for a well functioning market and defend the income side of the state budget.
- **Judiciary** - The need for a well functioning law enforcement and Judiciary.
- **Parliament** - The Parliaments' need a functioning audit system auditing whether or not the Government have reported and executed the budget in line with the Parliaments decisions, under good internal control and in a lawful way.

Recommendation 3: Ensure that key aspects (as listed in the report) are addressed for each of the four pillars.

Underneath each one of the pillars below there are basic principles worth stating. In addition to this you could give some clear statement on the direction of development and the objectives. Some important standpoints have also to be made in terms of functions and organisational responsibilities. These will then function as guidelines for the authorities who will be responsible for analysing and making proposals for the set up in the form of legislation etc. within the different pillars. Furthermore, the implementation of the activity plans will take several years. Complementary decisions will have to be made and priorities changed during the implementation phase. Clearly stated principles, development directions and objectives are of vital importance in development processes like this. Below is a basis for these fundamentals:

The first pillar; the financial control system within the Government:

As a first step **the system of financial control within the Government needs to be defined.** The definitions made in the Concept are, in our view, too broad and cover activities that in the international arena are regarded as other forms of control activities, with very different objectives and different ways for their operation. These parts, which of course may be of high importance, should therefore not be covered within the financial control concept.

In our view any financial control system, as far as possible, **should follow the lines for financial control systems that have been developed in Europe and the West during the last 30 years.** One important argument for this is that our economies are becoming more and more inter-linked and are using the same standards. Moreover, using the same principles will facilitate discussions and negotiations on multinational initiatives in which Russia may take part in and will facilitate contacts in all areas with Europe where there are requirements to be used on the financial control approach (e.g. agriculture, funding of infrastructure investments).

– The **key elements of an effective system of financial control that should be covered in the Concept** are:

- That it should be based on the Rule of Law.
- Strong central ministry responsible for all financial matters.
- Clearly defined internal control responsibilities of a budget-spending unit for managers.
- Internal audit established in the individual budget spending units.
- Centrally decided standards for accounting, financial reporting, internal audit, and a means to enforce these standards.
- The standards should, as far as possible, be based on international standards. There are several reasons for this. One is that financial activities today are, many times, cross border activities. Such standards will also limit the possibilities for manipulation and is a safe guard for a continuous updating and development of the standards. The use of international standards also facilitates cross-border co-operation of many different kinds.

- Lines of accountability must be clear and transparent (this often includes personal responsibilities) inside individual entities and between different levels of the state administration.
 - Effective, coherent systems and procedures should exist for ex-ante controls (wherever situated).
 - Clear, comprehensive and transparent public annual reporting of all public sector entities.
 - There should exist mechanisms for the fight against fraud and corruption, which is detrimental for the financial interests of the state.
- The very basis of an effective system is to give the budget managers good preconditions and clear responsibilities for the implementation of what the budget is. In the draft Concept the insufficient internal control within the Government agencies is mentioned as one of the bigger problems that has to be addressed. At the same time the draft Concept does not define the budget spender’s internal control as a function within the financial control system.

In the draft Concept some of the main principles for state financial control are stated as being:

- Lawfulness of actions taken by state financial control agencies and their officials;
- Objectivity;
- Independence of state financial control agencies in the exercise of their powers from state agencies, organisations and officials;
- Disclosure of the results of inspections and checks, while at the same time ensuring that state, commercial and banking secrets of the inspected organisation remain confidential;
- Inevitable proceedings against and punishment of those found guilty of financial violations etc

Above we mentioned the internal control of the individual manager in the budget spending units as the basis for a financial control system. **The principles above should, in our view, be redefined** in such away that they also cover the spending of the budget as such. What is also **crucial to reflect upon are the principles important for the budget execution, such as transparency, clear division of mandates and accountability.**

Besides the above we recognise a number of issues which would benefit from further analyses and consideration under the implementation of the activity plan:

- The direction when it comes to the development of the budget process.
- New reporting demands on the management in that process.
- External and internal audit arrangements to make sure the internal systems for control of tax, customs and social benefit administrations are in place and function well. Special control arrangements are normally needed inside such administrations.
- The need for a separate function responsible for under the law setting the specific rules for the budget execution (prerequisites, administrative handbook etc.).
- The need for a separate function giving support to the managers and other persons involved in the administration of the state budget at different levels (defining training needs, information etc.).
- The need for a separate function for Treasury control.
- The need for a function for an independent audit function under the Government and the scope, mandate and role for such a function.

- The need for a function for supervision of and support to the internal audit under the individual budget spenders.
- The need for a separate function responsible for administrative action when breaches in the system occur and the borderlines towards the judicial system when fraud and corruption are at stake.
- The needs to enforce the legal protection for people carrying out internal control and internal audit.

How this should be organised and how to produce a set up reducing the risks for overlaps and inefficiency are questions that have to be addressed in a second step. One important thing is not to mix up different roles and to create a good overview within the Ministry of Finance.

The second pillar: The system giving good prerequisites for a well functioning market and defending the income side of the state budget.

The income side of the budget is negatively affected by badly functioning markets holding back economic growth. Therefore, a number of measures must be taken by the state to counter-balance market imperfections, corruption, and other forms of market distortions. Even when the executive or the Government delegates the responsibility for such policies to authorities under them, they are still accountable before the Parliament.

Tax evasion and other instances of withholding Government income are also detrimental to the income side of the budget.

In comparison to the forms of control discussed under the first pillar, the second pillar will mainly address what can be called **inspections, which principally focus on different market-actors i.e., companies and individuals and legal compliance**. Other forms of state interference in the market are **different forms of supervision**. The objectives of these inspections or supervisory activities are fundamentally different compared with the objectives within the financial control system described under the first pillar.

For example, it is important for the well functioning market that private companies with a certain number of stakeholders are obliged to issue annual financial reports, which are audited by external private auditors with a high degree of professional knowledge and ethics. It is also important that functions are established for the basic education of these auditors, including re-education, examinations and supervision of the auditor's performance. Some basic standards should be put in place for the auditors at the same time as their reporting obligations must be clear when it comes to tax-fraud and other illegal behaviour within companies. Another important thing for the market is the existence of a public register over the individual auditor's appointment in different companies and over the board members. A function responsible for serving the public with the annual reports from the companies is also a good help in building confidence between different actors on the market. One can always discuss the pros and cons of organising these functions as state operations or as a responsibility for different actors in the market. Whatever solution is taken a relationship is always built up between the market and representatives for the state. The set up is always built upon a legal framework.

Another example is the banking sector and the need for an inspection function besides the private external audit of the bank companies. The same goes for insurance companies. The way these functions shall be organised is being discussed today in many European companies.

These kinds of control functions are most often carried out by state authorities, lead by an appointed director accountable to the Government when it comes to how he has carried out his given budget. The demands when it comes to internal control and internal audit in authorities like this are basically the

same as in other budget institutions and the manager has the same need for certainty when it comes to ensuring himself that the task is carried out in line with given intentions. As an institution they are subject to the financial control system described above.

The third pillar: Law enforcement and the Judiciary

Another step could then be, to define how the mechanisms for the fight against economic crime should be strengthened. International experiences show that these mechanisms should be separated from the financial control within the state administration. The reason for this is that the objectives are different, that the environment and the steps needed to be taken differ fundamentally. We are concerned that the need for professional conduct and development will be threatened if a common approach is taken for the four pillars.

The anti fraud structure in place should be based upon the understanding that:

- a growing part of severe economic crime activities involve cross-border operations in goods, services and human beings with counter-flows of money often involving several countries; and
- the economic crime operations happen fast, utilising all the available modern technologies and have operations spread over many countries.

These type of frauds makes it necessary that the anti fraud structure has, from the very beginning **a clear mandate to operate in close co-operation with similar investigation and prosecution bodies in other countries**. Exchanging information on suspected activities, assisting other bodies in their work as well as to be assisted by them when confronted with cases that has links to other countries are important tools to be used.

When analysing different forms of illegal behaviour and clearly defining them in the Penal Code, one has to reflect on how **different measures can be taken to prevent, detect, investigate, prosecute, sentence, convict and regain losses**. Basic prevention should be safeguarded by a well functioning financial control system within the state administration (see Pillar 1) on one side and a regulatory framework for the private sector on the other and the quality in the different measures established for the control of legal compliance (see Pillar 2).

Questions that have to be raised, are what is the relationship between, for example, the police and the prosecutor on the one hand and the financial control system described under the first pillar and the different forms of inspectorates mentioned under the second pillar, on the other hand? In all countries described by the experts a clear boarder line exists based on a legal obligation for the authorities under the above mentioned pillars to report cases of suspected frauds to the authorities within this pillar at the same time as they are not involved in any form of investigations.

It is also important to analyse the different actors within this third pillar when it comes to powers for combating forms of economic crimes and the need for professional development, new tools, intelligence resources and ways of building up and using information bases in a co-ordinated way. In such analyses the integrity for the individual must always be considered.

Specific needs under certain periods for specialised functions where different professionals can co-operate together i.e., financial police or prosecutor functions incorporating economic, police and/or customs investigators/inspectors with special competence can always be considered as other forms of special task forces.

Given the description in the draft Concept it seems rather obvious that measures have to be taken also within this pillar. The need for a special investigational body with considerable investigative powers and independence could be set up and focused on economic crime in the public sector and economic crime affecting the financial interests of Russia. The body should have access to and work together with prosecutors fully dedicated to this type of crime. Such an agency may be modelled upon the experiences of the European Anti Fraud Office (OLAF).

The importance of a free press and different measures for establishing a culture of honesty should not be underestimated.

The fourth pillar: Parliamentary Control over the budget execution

The division of powers in the Russian Constitution is based on the **division of responsibilities and a balance of powers between legislative, executive and judicial authorities**. The reason for this is to defend democracy and the individual rights of citizens.

It should be clear that **the legislative power needs several different functions** to help them follow up on whether or not the executive carries out the decisions taken by the legislative in line with its intentions and ways to make the executive accountable for shortcomings, breaches etc. One of these functions is the Supreme Audit Institution (SAI). The worldwide community of SAIs has developed a common base for the role, mandate and task of such an institution. In the preamble to the Lima Declaration of 1977 it is stated:

"Whereas the specific objectives of auditing, namely, the proper and effective use of public funds; the development of sound financial management; the proper execution of administrative activities; and the communication of information to public authorities and the general public through the publication of objective reports, are necessary for the stability and the development of states in keeping with the goals of the United Nations."

Furthermore, the Lima Declaration states that the **independence** from both the Executive and the legislative powers is an indefensible feature for the confidence in the reports from a SAI. To use the Lima declaration as a principle for the set up of a financial control structure within the Russian Federation will mean that **the Audit Chamber shall not be involved in the executive responsibilities** within any of the three other pillars. Instead, the role of the SAI is to audit whether or not the executive and authorities under it fulfils its obligations within, amongst others, the aforementioned three pillars. To be able to draw conclusions regarding this fulfilment **the SAI needs to have the powers to conduct**:

- audit within the different forms of control authorities mentioned under pillars 1-3;
- audit on the spot in authorities under the executive and on how subsidies have been used by beneficiaries of state funds.

Giving such powers the objective with the audit is still an activity establishing a base for judging the executive's accountability.

Looking at these four pillars together the different objectives and the special features within each one of them and the complexity of the different measures leads us to the solution that **different concepts should be elaborated for each one of them**. In our view the different political areas combined with different roles and responsibilities amongst the central authorities in the state demands this.

2.3.2 Give good conditions for the Implementation

Recommendation 4: Use the Concept as a framework for the Activity Plans

In our view it is important that the Concept in general defines the point of departure for the set up of activity plans for the respective pillar. It is also important that the organisation of the development project (s) be indicated already in the Concept. Tentative resources should be committed and a clear division of responsibilities stated. In our view it might be a good idea to divide the responsibilities between at least the following actors in each and every area of the Activity plans:

- A Steering committee could be made responsible for the oversight and promotion of the development activities. The Steering committee must have an overview of the different activity plans under the pillars and be responsible for co-ordination of the priorities, milestones, follow-up etc. Analytical resources should be given to the Committee.
- Separate task forces should be established within the different pillars responsible for drafting activity plans, analyses, drafting the legal foundation and other proposals.
- The responsibility for enforcement should be placed on the authorities responsible within the different pillars. The task forces mentioned above could have the responsibility for the follow up.

2.3.3 Other

Analyse the contributions of the experts

The comments of the experts and the country descriptions are, to our mind, a source of great value for everyone in the position of analysing problems regarding the misuse of state resources, corruption and illegal financial transactions and shortcomings in the area of financial control. For the design of national systems **internationally recognised principles and experiences from other countries are of good value**, even if it should clearly be stated that national organisational solutions must be founded in local culture.

Co-operation

It may also be a good idea to seek support as soon as possible for co-ordinated assistance from international donors. At the same time it is important to not start implementing technical assistance projects within the area before the Concept, the Strategies and the Activity plans have been decided.

ANNEX 1: VIEWS FROM THE EXPERTS ON THE CONCEPT

1.1 Comments by Mr. Cohen

1. Introduction

The Concept Paper presents a good description of the problems and issues in the Russian Federation today related to the relative lack of efficiency of the “State Financial Control” (SFC)

One problem when reading the Concept is that many aspects regarding the SFC are described whether or not they already exist or are planned for implementation. Also the analysis is too confused and solutions offered by the SFC are not sufficiently well connected to the different issues mentioned. Fundamental distinctions are missing probably due to the (wrong) concept of a unique 'unified state control system' which, in our opinion, it is not possible to implement for it tries to covers too many various aims and fields which are at stake at the same time.

Therefore the present comments wish to:

- Clarify the analysis by making distinctions and connecting each form of control to each specific issue it is shaped for
- Complete the concept of the SFC according not only to the French experience but also to the European Community regulations and demands in the field of control (“Public Internal Finance Control”)¹

In order to demonstrate this, the present paper will deal with:

- Objectives and aims of the State Financial Control.
- Structures of the SFC according to the different types of control.
- Contents and methods of different types of control.

2. Objectives and Aims of State Financial Control

From the concept paper we can not only distinguish but also summarise the three main categories of aims:

- i. Obtain and guarantee a sound financial management system in the public administration;
- ii. Fight against fraud, corruption and so on (“Country's economic security”);
- iii. Strengthen the Central Federal power with regard to other powers.

1. For the Member States Regulation No. 438.01 and for Candidate Countries ‘Chapter 28’ concerning PIFC.

Obtain and maintain a sound financial management

This goal has to be divided into two levels of aims:

- i. Public funds should be legally spent and used only for their designated purposes. This means that the execution of budgetary and extra-budgetary funds is done properly without any illegality, deviation or over-spending.
- ii. Public funds should be spent effectively, efficiently and economically without any waste, in order to obtain the best value for money.

Guarantee the country's economic security by fighting against fraud, corruption, money laundering etc.

To achieve this, a distinction has to be made between the following:

- Administration Ministries: Strong action taken against corruption, 'favours' in attributing public procurement, tenders, permits grants etc.
- Private Sectors: Strong action against: tax frauds, custom frauds, money laundering, exports/imports, money and financial markets etc.

Strengthen the central financial power towards:

- Region, districts, municipalities
- State extra-budgetary funds, decentralised state administration
- Private sector. The wish is that, “the SFC will have a broad role regard to the private sector” in order to enforce the (financial) law also with regard to the various actors in the market economy

To fulfil these quite different aims, various types of control should be used.

2. Structures of the controls

Following the model of a western country like France, numerous control ‘bodies’ are used, according to the different fields which have to be covered by the control activity. As well as the great number of specialists used, a major distinction has to be made between three different fields of control:

- i. Internal controls;
- ii. controls of private bodies;
- iii. control by Central powers of other centres of power.

Internal financial controls

Each ministry has its own type of control, which includes ‘inspections’ of financial aspects: agriculture (3 different ‘bodies’ of inspections), interior (4 bodies), finance (3 bodies - treasury, insurance and general inspectorate of finance) etc.

Each ministry has a 'general' inspectorate connected directly to the Minister's office. Other ministers can call the General Inspectorate of Finance for special enquiries only provided public money is at stake. These controls cover three different aspects: legality, sound financial management and internal audit.

The legal control is distinct from fraud and corruption and it has distinct controls separated from other controls. In France, there is one body that specialises in anti-corruption issues linked to public tenders and another one against corruption among Civil Servants for other causes.

Due to EC influence a few internal activities have been developed inside the administration. For example, there is the Treasury and, for European Funds (CICC), the linking of the four general inspectorates of the four Ministries concerned.

Control on the private sectors

Specialised bodies, shaped and designed for a designated target make all different forms of controls of the private sectors. Most of them come under the umbrella of the Ministry of Finance: e.g., tax inspection; customs inspection etc. Many of them are also attached to a specific Ministry such as the employment inspectorate, social security inspection, agriculture etc. Banks, the security market (COB), and money laundering (Tracfin) are more or less independent from the Ministry of Finance but are attached to several ministries.

Control of the central powers upon decentralised bodies

By decentralised 'bodies' we mean:

- extra-budgetary funds for autonomous agencies;
- regions, districts, municipalities;
- decentralised state administration giving services at local level (agriculture, industry, education etc.).

The financial control of these entities depends on the degree of independence from the central body.

- A preliminary ex ante control meaning that no decision of programming or any operation using public funds can be done without the 'visa' of the (at the local level) Ministry of Finance (Treasury).
- A control before payment meaning that all public expenditure can be paid only by a public accountant and must be verified before payment by the checking of all documents needed.

In France the local representative of the Government -- the 'prefect', makes the non-financial control on the same bodies. In other terms one can say that the control of central power on any entity using public funds is done both by the prefect (for technical aspects) and by the Ministry of Finance by its local accountants for financial aspects.

3. Methodology: contents of the controls

The EC financial regulations clarify some major distinctions in the field of financial control. Three different types or levels of control can be distinguished:

- checks
- 'audit trail'
- audits

The checks

“Checks”, are on-the-spot controls made by specialised bodies or inspections. But this rather traditional concept has been entirely renewed by what European regulations call 'sample checks'. Instead, of being ruled by random or vague criteria, checks are scientifically determined to make sure that with not less than 5% of checks the entire field of operation of a determined kind is covered. Two notions are used for that purpose:

- Sample or representation. As in the “Gallup-pole” the sample must be carefully determined to be representative of the whole.
- Inclusion of the 'risk factors'. The sample should be corrected by taking into account the risk factors made known themselves by careful analysis of the 'audit trail'.

The 'Audit Trail'

The audit trail means that the different phases of any administrative process of an operation are 'in control'. This means that at every phase the following has been determined:

- The official responsible
- The official(s) in charge
- The documents (templates) to be used
- The process (guidelines) to be followed
- The standards to be obtained.

The audit trail will thus guarantee:

- The financial tractability
- The final certification (being done by a designated authority who has the 'control' of the whole trail but who can rely upon the responsibility determined at every stage.)

The Audits

Audit is not an inspection leading to a sanction. The purpose of it is not to enforce legality but to suggest to the management corrective measures in order to improve the financial control systems. Various levels of audit can be laid out, such as:

- Internal self audit by the management body itself or 'self assessment'
- On the managing trail by the paying authority before payment (see above)
- External: independent audit at a higher level (National). In this case, the audit is expected to deliver periodic statements after having examined the audit trail on one side and the sample checks on the other. The periodic statement is both an appreciation of the running system and a recommendation to improve it.

4. Conclusion:

Coming back to the concept of a 'unified state financial control system':

We have seen how numerous the control systems are according to the purposes chosen: regularity is not controlled in the same way that fraud is fought, and the administration has to be controlled differently from the private sector. Moreover, it is wise to distinguish methods of control, for instance 'inspection' from 'audit'.

But if we try now to unify what has been split and try to imagine, in an ideal scheme of things, a unified database and monitoring computer system of control, we can, at best come to not less than two systems (whereas in France, for instance, there are around twenty).

- A unified system for financial control inside the administration, following public money wherever it goes (even in private operations). The methodology to be used is
 - Audit trail or internal control
 - Sample checks (5%)
 - Audit levels
- A unified system against fraud (such as OLAF) for money operations, banking, money laundering of currencies, capital flight and public tenders, public grants, permits etc.²

The latter system could rely upon the following: databases of the above operations; intelligence and information; policing and judiciary methods. This concept has nothing to do with the financial control system described earlier. In my opinion, only the first one should be designated as 'Financial Control' or SFC.

2. These two aspects should probably also be separated i.e. money aspects (International) from the frauds inside administration due to its powers on the private sector.

1.2 Comments by Professor Färber

The paper aims at establishing a unique system of financial control in the Russian Federation. The subject of financial control is broader than usual because it contains not only the pure public sector in the sense of using the tax payers' money legally and efficiently to produce public services and transfers but also the illegal use of "private" money in the sense of corruption, money laundering and illegal foreign capital export (p.2). But the main focus is to be laid on the financial control within the Government sector.

I agree that the described problems show a severe problem for the whole Russian economy. Public fraud and tax avoidance are dependent from each other and undermine economic development as well as democracy. So, the establishment of an effectively working system of ex ante and ex post financial control in the public sector is one of the most important pre-conditions for the further stable development of the Russian state.

I would like to give special comments on three main points, which are particularly important from the German point of view.

1. Clear responsibilities and a corresponding institutional design

The paper emphasises the importance of one single system of financial control in the Russian Federation under the responsibility of the Ministry of Finance. Although the Audit Chamber is indicated to be independent I cannot avoid the impression that it is nearer to the Ministry of Finance than to any other institution and therefore de facto part of the ministerial institutional field. Furthermore, it is noticeable that many different functions of financial control is intended to be intermixed in a single system, which easily leads to a severe strain of the institutions and their failure programmed by that.

I see the following fundamental functions focused in the paper:

- the legal and effective collection of taxes;
- the legal and efficient use of public resources by a working expenditure management;
- the effective control of the use of public transfers;
- the effective control of the public treasury;
- a working documentation/accounting/controlling system to ensure the financial management during the fiscal year (execution of the budget) as well as the ex post control;
- the internal control of taking in and expanding resources in the Government sector;
- the "external" control of the all financial transactions of "public sector money" by a Court or Chamber of Audit; and
- the effective control of legal transactions in the financial (banking) system which is interconnected with the illegal and corruptive use of public money.

It is clear that all these functions need a clear legal regulation concerning goals, institutions and competences and – if necessary – rules and procedures. It is rational to submit all functions – except the external financial control – under the Ministry of Finance. But all these functions need a different institutional base for execution because they are different and not homogeneous with concern to bureaucratic activities and specialisation.

- Most obvious is the separation of the control of banking transactions. This can be organised in a special agency under the control of responsibility directed by the Ministry of Finance. This agency can require information from the financial sector about corruption, tax avoidance and money laundering and transfer it to the special public institution responsible for the investigation of tax evasion or the general judicial system.
- Taxes are collected by Tax Offices, which are directed and controlled by the Ministry of Finance. Here special entities for the investigations of tax evasion are to be implemented. They should have special judicial competences.
- The expenditure management, including the management of transfers in favour of public enterprises and private persons and enterprises is to be decentralized as far as the principle of efficiency requires the equivalence of the “line” responsibility and the financial responsibility in one hand. The intended use of the resources is to be controlled by internal and external audits.
- For the management of transfers, a special regulation of granting must secure the base of the provision of all data necessary for internal and external control and the sanctions in the cases of misuse of the resources (remit, exclusion from further transfers, sanctions by criminal law).
- The direction of the public treasury by the Ministry of Finance is a necessary counterpart of the decentralisation of expenditure management to the line Ministries and the agencies under their responsibility. Whereby it is to be regarded how many cash points are necessary for covering all revenue and expenditure transaction across the country under the goals of efficiency on the one hand and the aspects of control on the other hand.
- Line Ministries and agencies and the cash points of the Treasury should be combined to an intelligent system of accounting/controlling data which enables the Ministry of Finance as well as the Court of Audits to intensify their control against fraud, corruption etc. The general accounting function remains untouched by this additional task. The function of general financial management during the fiscal year by the Ministry of Finance has to be supported by the accounting system too.
- The Ministry of Finance should establish a proper agency for internal financial control of the expenditure and revenue transactions of the line Ministries and their agencies. It should not be interconnected with the other above mentioned executing institutions. This agency should get far reaching judicial competences by law - similar to the units investigating tax evasion in the Financial Offices.
- Finally, the independence of the Court or Chamber of Audits should be guaranteed with concern to all dimensions, which are mentioned in my country report. It has to be independent from the Ministry of Finance too because it is the only institution controlling the budgetary management of the latter.

The paper gives to the Chamber of Audits many tasks of control (ex ante, current, ex post). Here a clear priority setting to the ex post control and a current control only in cases of projects which are undertaken across several fiscal years or of general importance should help to prevent the institution from strain.

2. Legal regulation of the public financial transactions and accountability

The paper counts among the important principles of state financial control “the lawfulness of actions taken by state financial control agencies and their officials” (p. 6). This perspective emphasizes the “moral legitimacy” according to which all transactions must be based on legal rules. There is, however, another important perspective of legal regulation of administrative procedures under the aspect of the outcome of the process of control. If administrative transactions like spending of budgetary appropriations are regulated by law or decree, in certain details the material content of the expenditure management can largely be controlled by looking at the procedures undertaken themselves. For example, certain types of theft or misuse of public money can easily be identified by other persons involved in the procedures if the necessary signatures are not on the forms of the expenditure ordering institution, if the forms are not complete. In this case the treasury is not allowed to spend. To get many people from different institutions involved in illegal use of public money risks to be revealed more probably than being able to undertake the spending without involvement of any other person. Therefore the separation between spending administration and the cash point which physically undertakes the expenditures.

The detailed regulation of procedures of expenditure management and tax collection therefore may be a barrier to efficiency, but it aims on the function of administrative control against misuse and fraud and corruption. A high proportion of budgetary legislation is indeed focused on that type of accountability or can be explained by this function. It supports the efficient use of public resources if the costs for detailed and complicated procedures of spending and taking revenues are smaller than the potential losses of fraud, theft and corruption.

The aspects of direct regulation and control of procedures can partly be replaced by incentives within the budgetary process, which secure the efficient use of public money because of the fact that the responsible people within the institutions act on their own interests. This case is given when the interests of the institution, here, the Ministry of Finance or the legislator, the Parliament are congruent with the interests of the civil servants providing expenditures and revenues or if the system pays these people for following the goals of their respective institutions. This principal-agent-perspective can however, only be realized if the goals and the goal attainment are measurable, which is more difficult to be identified in the public than in the private sector.

Therefore, the instruments of financial control will always rely, for an important part, on the legal detailed regulation of procedures and interconnection of institutions aiming at mutual control. The optimal mix of legal regulation and the implementation of incentives focusing the outputs of spending and revenue collecting. Both instruments anyway can not work without additional external controls, which detect e.g. coalitions of people or institutions established to control each other but acting at the expense of the public.

3. Federative aspects of the financial control system

The paper emphasizes several times the necessity of a system, which covers the whole regional and federative system of the Government sector. It has to be regarded that in the Russian Federation the central Government is dominating, and the independence of the lower tiers (provinces and local Governments) is not so far reaching as in other federal countries. Also the financial autonomy of the

decentralized jurisdictions is a limited one with regard to their dependence on financial resources/transfers from the federal budget as well as to the general competences/tasks. At least in the recent years there were problems that e.g. the Province Governments had much more financial resources at their disposal than they had proper responsibilities, which had to be managed by the use of the resources. So, an important source of fraud, corruption and general inefficiency could be caused by the imbalanced financial relations within the Russian Government sector.

These aspects have to be regarded by the construction of the federative network of financial control, particularly the internal and the external audit institutions. Provinces and “their” local Governments need “own” institutions as far as their proper competencies are concerned. They should be controlled themselves by the Chamber of Audit of the Federation in all cases in which the jurisdictions use of resources of the Federation.

Additionally, all auditing institutions should use comparable methods of control. This can be reached by a common frame of education of the civil servants working in the Chamber of Audits on the one hand and by a network of collaboration among the institutions on the other hand.

Finally, it is to be emphasized that all inefficiency in the use of public money responsibility, its misuse in all variations which is caused by the construction of the federal systems, the interGovernmental relations or the “financial constitution” itself can not be compensated by any system of financial control. Therefore the efficiency and effectiveness of financial control also depends on necessary reforms in the field of interGovernmental relations.

1.3 Comments by Mr. Havens

The concept paper is correct in stating that widespread misuse of state resources, corruption and illegal financial transactions in the private sector are very serious problems that must be overcome if Russia is to develop as a stable democratic state with a growing market economy. The paper also makes a number of other valid, important points, including:

- The weakness of internal control systems in Russian Government entities and the vital need to strengthen those systems.
- The non-systematic approach to inspections, in which some entities are inspected repeatedly while others completely escape inspection.
- The need to clearly define the powers and responsibilities of control agencies and the relationships among them and to eliminate ambiguities in the relevant laws.
- The need to improve budget procedures to minimise loss and misuse of state funds.
- The need for consistent guidelines, applicable to all state financial control agencies, for carrying out and reporting control activities.
- The need for better co-operation with financial control agencies in other countries and with relevant international organisations.
- The need to strengthen personnel, information, technical and financial support for those involved in the control function.

The last two paragraphs of Section II of the Concept Paper provide a good explanation of the importance of effective controls on the use of state assets and of integrity in this area as a basis for democratic development.

Despite these very positive elements, I have some significant reservations about the approach implied in the paper. My first concern is with the attempt to apply a single, unified system to the very different problems of effectively managing state assets and stopping criminal behaviour in the private sector. These are both serious, important problems deserving of effective measures. However, trying to develop a single control system to deal with both of them creates several risks, such as:

- There may be a temptation to give undue emphasis to one set of objectives, catching and punishing criminals, with inadequate attention being paid to the other, installing effective financial control systems in Government ministries, agencies and enterprises to prevent misuse of state assets.
- The techniques needed to assure proper use of state resources, if applied by the state control agencies to the private sector, are likely to prove excessively intrusive into private transactions, creating undesirable rigidities and inefficiencies and thereby hampering the growth of the market economy.
- There will be a temptation to make state financial control of the private sector excessively broad, creating further rigidities and inefficiencies. This is exemplified by the extraordinarily extensive list (in the second paragraph on page 3) of the types of firms to be covered by the control system.

- There is some risk that the introduction of a pervasive state financial control system in the private sector, while intended to reduce illegal activity, will, instead, create an environment conducive to bribery and corruption of the staff of the control agencies.

My second concern is that, while the Concept Paper does a good job of identifying some of the most important problems, it is less clear regarding how these problems will be overcome, especially with respect to the weak internal control systems of ministries and agencies. This may simply reflect the present stage of development of the ideas in the Concept Paper.

My third concern involves the degree of centralised direction of the financial control system that seems to be implied in the Concept Paper. Centralised direction is probably necessary to assure progress during the early stages of development of internal control systems in ministries, agencies and enterprises. In the longer run, however, centralised direction can inhibit the flexibility and adaptability that are needed to assure the development, installation and maintenance of internal control systems that meet the needs of separate entities that operate in very different circumstances. Thus, in my view, the goal should be to hold managers of state entities accountable for the proper use of state resources entrusted to them and, consequently, to hold them – rather than a central body -- accountable for the effectiveness of the internal control systems in their entities.

I am also concerned about the extent to which this centralised direction of the financial control function may be intended to encompass the Audit Chamber. Co-operation is certainly desirable between the Audit Chamber and other financial control agencies, such as the sharing of audit plans and results, and consultation to avoid unnecessary overlap and duplication of audit work. But the credibility and value of the Audit Chamber, as the external auditor of the Russian Federation Government, depends in great part on its being independent of other centres of power and not subject to outside direction regarding the matters to which it will apply its audit resources or the conclusions it will draw from that audit work.

* * *

Overall, the Concept Paper appears to be a useful starting point, but much work remains to be done to further develop the ideas and to clarify the intended lines of action, and more thought should be given to the wisdom of trying to build a unified system that seeks to control both Government financial activity and financial transactions

1.4 Comments by Mr. Hjalmarsson

1. Introduction

The purpose of the *Concept* regarding reform of the state financial control is to provide a foundation for a comprehensive reform covering a very broad area. Several state bodies are actors in this wide area and several important laws regulate the activities these organisations perform. In order that the reform becomes complete, consistent, logical and without gaps it seems reasonable to start the discussion with a broad approach.

The organisational structure which presently exists in Russia in this area, deviates significantly from what is usually found in well-developed western economies. This does not unconditionally imply that the organisational and legal development in Russia should mean that western systems are copied. Russia is at another state of development, has another historical past and is in a difficult transitional situation, all conditions to which due attention has to be paid.

Therefore, there are good reasons to welcome the chosen approach, which means that a broad outline including the main features for co-ordinated development in a highly prioritised area is presented. When this has been said, it is also necessary to stress that the very broad approach means that control functions for which there are quite separate motives and which include different tasks are brought together.

In my firm opinion, the state financial control structure should be divided into at least two categories in order to promote clarity in the discussion and the analysis. One category should consist of financial control connected with the execution of the approved state budget and the Government's responsibility to Parliament. The other category should include state financial control measures with the purpose of ensuring that citizens and companies observe the laws in the economic field. The latter category could possibly be further subdivided. Obviously, national, historical and constitutional circumstances should be allowed to influence the designing of the organisation for state financial control. But there are also very good reasons to benefit from the experiences made in western market economies. It is therefore satisfactory that some paragraphs in the *Concept* rather closely resemble what can be found in international standards for external audit and internal control.

2. Motives for state financial control related to the execution of the state budget

Briefly summarised the fundamental purpose of the control related to the execution of the state budget is to ensure that the budget approved by Parliament is also the budget which the executive branch actually executes. This implies that what should be verified is that (1) the appropriations are not exceeded, (2) the appropriations allocated to specific purposes really have been used for these purposes, (3) the state has collected the estimated revenues, and (4) the executive branch during the implementation has observed general and specific laws and regulations which govern the execution.

Parliament

Parliament, i.e. the legislative branch, needs financial control in order to be sure that its constitutional fiscal power is respected by the executive branch when it implements the approved state budget. This is of fundamental democratic importance since it is Parliament that puts resources at the Government's disposal for specific purposes. It also follows on from the basic fact that the Government is responsible to Parliament.

The Government

The Government (and the president) executes the approved state budget. But of course, it is not the Government and its ministers themselves who execute the state budget. The practical implementation is performed by departments in ministries, Government agencies and other state institutions. We can also be quite sure that it is not exactly the budget that Parliament approved that shall be executed, but a budget, which is considerably more specific. In addition a number of regulations decided by the Government/president should be observed at the implementation stage.

From this it follows that the Government/president needs a well developed and well functioning control structure which can contribute to ensuring that Parliament's and the Government's decisions are fully respected when a range of executive units implement and account for their respective parts of the overall state budget.

Executive units

The head of an executive unit has the irrefutable and imperative duty to take responsibility for operations being executed according to the budget and to relevant laws and regulations etc. Further, the head shall also ensure that the operations are carried out in an effective manner. Consequently, the head of an executive unit – irrespective of whether it is a department in a ministry, a Government agency or another state institution – must have at its disposal a control structure within the organisation in order to be in a position to assume responsibility for the financial and non-financial execution of the budget.

Conclusion

The simplified description presented above leads to the conclusion that three links and points of control can be identified in the chain of execution. The introduction of a regional dimension would add further links. This picture reflects what is often referred to as “the principal – agent model” which usually serves as a guideline when control structures in public and private organisations in western economies are designed. The Concept would be improved if a fundamental picture of this kind for the budget related state financial control could appear more clearly.

3. Functional elements of the control structure related to the state budget

Parliamentary audit

The natural starting point for the discussion is the parliamentary audit – not because it is the “highest” or “finest” in any respect – but because its role and tasks are rather obvious and well defined in a democratic society and it can to a large extent be designed in accordance with international experiences and practices. The role can be derived from the fact that it is Parliament that approves the budget and that it is the Government that executes the budget. The principal, i.e. Parliament, must receive a reliable statement verifying that the agent, i.e. the Government, has observed Parliament's budgetary decision and other decisions, e.g. the Budget Code, when implementing the state budget. For these reasons there should be a parliamentary audit function reporting to Parliament.

How the parliamentary audit performs its task and what it will actually do will to some extent depend on what kind of organisation for financial control exists in the executive branch and on what kind of reports the Government presents to Parliament. Under favourable conditions the financial control within the executive branch is well developed and the Government submits annually a report on the execution of the state budget. In this case the task is to verify whether the information on state revenue

and expenditure in the statement and the actual use of state financial resources is in compliance with the approved budget and the rules governing the execution decided by Parliament. The control activities can include examination of reports from executive units and of how these reports have been consolidated. Furthermore, the structure of internal control in the executive branch can be investigated and a small sample of transaction controls can be carried in order to evaluate how well the control structure works.

Under unfavourable conditions, i.e. when the internal control structure in the executive branch is unreliable, more detailed controls will have to be made.

This audit is independent both of the principal, i.e. Parliament, and of the object for the examination, i.e. the agent or the executive branch. Purpose, task, position, reporting etc. for this kind of audit is relatively clearly stated in INTOSAI's The Lima Declaration of Guidelines on Auditing Precepts. This means that the auditing body shall possess the necessary independence, tasks and the competence in order to qualify as the Supreme Audit Institution (SAI) of Russia.

In this connection it should be emphasised that the Russian President has wide-ranging powers and a considerable influence on how the approved state budget is executed. As a consequence the President and his administration are obvious objects for close scrutiny by the parliamentary audit function. From this it follows that the President and his administration should not be able to influence how the parliamentary audit plans and carries out its duties.

When designing the structure for the financial control within the executive branch, it would be practical to consider the parliamentary audit and its activities as more or less given elements in the overall structure for state financial control.

Internal control and internal audit in executive units

It would now seem natural to continue, when discussing the financial control, what the Government/president must have to its/his disposal in order to be able to ensure control over the multitude of units who have immediate responsibility for the execution of the budget. For practical reasons, however, the discussion will continue with the controls that must be in place in every executive unit entrusted with the task of implementing measures financed from the state budget.

It is very encouraging that in several passages in the Concept, the importance of internal control functions in the units executing the budget, is emphasised. There is good reason to declare that unless the internal control functions work in a satisfactory manner, the remainder of the structure for financial control will be built on sand. No reasonable size of the externally initiated and managed control functions can compensate for a non-existent, weak or inefficient financial control within the executive units. The fundamental starting-point for building the state financial control therefore must be to clarify that the head of an executive unit is responsible for the internal control in his organisation.

Thus, it should be laid down that the head of a state executive unit – be it a department, an agency, institution etc. – is responsible for the budget being executed in a correct and lawful way. In order to achieve this every head must make sure there is a satisfactory internal control structure including a feasible organisation, feasible rules, methods and attitudes of the staff etc. How the internal control systems (or the system for management control) can be designed is illustrated in INTOSAI's Guidelines for Internal Control Standards.

In every executive unit there should be a function for internal audit working on behalf of the head of the executive unit. Ultimately its task is to make sure that the decisions of the head of the organisation regarding the budget and decisions regarding accounting, closing of accounts, reporting, payments, commitments and working methods to be used in carrying out the operations, are obeyed. The main mission of the internal audit is to review and evaluate how the systems for internal control work. The internal audit is independent in relation to the objects of its investigations and it reports to the head of the executive unit. In this way the principal – agent model becomes applicable also within an executive unit.

Purpose, task, position and reporting for the internal audit are stated in the Professional Practices Framework (The Definition of Internal Auditing; The Code of Ethics; The Standards for the Professional Practice of Internal Auditing; The Practice Advisories) issued by the Institute of Internal Auditors.

Control functions of the Government/president

In the two preceding sections we have described functions for financial control, which exist in most western economies and for which there are rather well established standards with regard to the content, organisation and form for the operations. Thus, the two functions are parliamentary audit (external audit) that examines the executive branch, and financial control in the form of internal audit and internal/management control in the executive units. In this way the two cornerstones in the control structure are able to be rather well defined. It is not equally easy to define the function in between; i.e. how the executive powers own financial control structure should be designed. Obvious and established norms, standards or models are missing.

The purpose of the financial control function of the executive branch is to ensure that the Government with a clear conscience can state that it does what can reasonably be required in order that the financial control within the executive branch is satisfactory. The financial control shall be so well developed that the parliamentary audit shall lack reasonable cause for serious criticism. To a large extent tasks, organisation and methods of working for this control function should be defined in a residual manner, starting from what the parliamentary audit does and accomplishes and what the internal audit and internal control in the executive units accomplish.

In a large country like Russia where the size of the operations financed from the state budget is considerable it seems reasonable to assume that the executive power must oversee a control or audit function whose duty it is to verify annual financial reports and the accounting of the executive units (ministries, departments, Government agencies, institutions etc.) and also verify if the management's have observed the relevant rules when implementing the budget and the operations. It is also important that an evaluation be made of how well the internal controls work within each executive unit. The described control function works on behalf of the Government and carries out an external and independent audit of the executive units. It reports to the Government. This function for financial control is not explicitly touched upon in the Concept. However, to some extent this control function has duties, which are presently performed by the DGFKA/KRU.

The function for financial control, which has now been described, can be organised as one centralised unit or it can be decentralised and attached to the different ministries. Advantages of a centralised body are that it facilitates the development of a unified professional competence and ethics, the development of standards and methods, allocation of resources between audit objects, and the training of internal auditors working in the executive units. A decentralised organisation would probably require some kind of central co-ordinating and supporting body.

A centralised control function can have different organisational affiliations and report to the president, to the Prime Minister or to the Minister for Finance. Obviously, the choice made in this respect will to some extent influence the organisation's position and efficiency.

The financial control is a part of the budget procedure

The financial control functions, which have now been discussed, have the ultimate purpose of ensuring that the state budget approved by Parliament is executed and reported in the correct way. This means that the aim is to protect and preserve Parliament's fiscal power. It is a matter of protecting the distribution of power between Parliament and the Government enshrined in the Constitution, the Budget Code and other laws.

From this it follows that the control functions also are aimed at ensuring that state property is not removed from state ownership in inappropriate ways or used for unintended purposes. Still, the control functions should not be regarded as entities belonging to the judicial sector. The different control functions report to its principal, i.e. Parliament, the Government and the head of an executive unit. Subsequently, it is up to the principal to decide whether an observation is of the character that it should be handed over to a public prosecutor for further investigation or if some administrative sanction should be imposed.

The state budget is decided on an annual basis and every new budget builds on the previous year's budget. The annual character of the budget makes it necessary to have an annual report of the detailed financial outcome of the budget. From this it follows that the financial control that is part of the budget process must also have this periodicity. This means that the state financial control related to the execution of the budget shall examine how the approved budget has been executed every fiscal year and also presents a report from this examination. Other cycles for reporting will make the control lose much of its importance. The same is true if reports are presented with considerable delay.

This view of the financial control related to the state budget is to some extent reflected in the Concept. However, the Concept would be improved if the functional control structures described in the preceding sections could appear more clearly and if the applicability of international standards was clearly stated.

4. Different kinds of financial control in Russia

In the Concept different kinds of financial controls in Russia are described. For instance there are descriptions of what is called preliminary control, current control and follow-up control. These kinds of control are also mentioned in the Budget Code. Following are some comments to these different controls.

The preliminary control described occurs when the information etc. for the preparation of the budget is scrutinised. This is something quite different from the pre-control or ex ante control, which can be found in western public organisations. From the description it appears that this is a task, which in western economies is included in the normal preparation of next year's budget and is performed by the line ministries and the Ministry of Finance. To the extent this task is not already part of the line ministries budget preparation in Russia it should become so. It gives a misleading impression to call this financial control and it can make a correct functional analysis more difficult. In the Concept it is said that steps need to be taken in order to improve the budget procedure. It could be an advantage if attention were paid to the so-called preliminary control in this connection.

It is obvious that the current control described in the Concept occurs in all western economies. In most cases the current control is performed in the unit that is responsible for executing its respective part of the budget. The internal audit ensures that control systems are in place and that controls really work. In some cases control staff from the Ministry of Finance are stationed in the executive unit with the task of checking especially larger commitments and payments before they are made. This means that there can exist pre-control in direct connection with the current controls, but this is something quite different from the preliminary control described in the Concept.

The follow-up control described occurs in all western countries and is always called audit and normally it consists of auditing that is external and independent of the object for the investigation.

Then internal financial control in budget executing units is also described. But this is an element in the overall control structure, which has been commented upon in the preceding sections. This control element cannot be compared with the temporal classification of controls made in the preceding paragraphs. It is obvious that internal financial control can be carried out ex ante, currently and ex post.

It is difficult to avoid the impression that the classifications in the Concept in reality reflect an organisational structure where preliminary and current controls correspond to tasks carried by GUFKA while the follow-up control is a task carried out by DGFKA/KRU. It is important that concepts and definitions of this kind, where the meaning differs from what is usual in an international perspective and which also have a strong organisational connotation, are not allowed to bias a rational analysis based on control functions.

In the Concept the internal financial control is described correctly on several occasions. This kind of control, as has been emphasised above, is of fundamental importance. From the Concept it appears that this kind of control is presently inadequate and also to a considerable extent is missing in the executive units.

5. State financial control not related to the state budget

A few comments need also be made regarding state financial controls not primarily related to the execution of the state budget. In Russia as well as in other countries there are a number of state bodies, which to some extent are involved in financial control on their respective field of activities. This holds true, for example, for the Ministry of Taxation and Collection, the Federal Customs Committee, the Federal Office on Currency and Export Control and the Bank of Russia. The control exercised by bodies such as these is an integral part of their duty to ensure that the citizens observe the obligations laid down in different laws. The purpose of the financial control is directed towards the citizens and the companies and the objective is to make sure that they pay the taxes etc. which they, according to laws and administrative decisions, are obliged to pay.

The objects, the methods, the place for control, the reporting, the participation from the judicial authorities and the measures taken when errors are revealed do not have much in common with financial controls focused on how the units within the executive branch implement the budget, carry out the accounting and report budgetary revenue and expenditure. Consequently the analysis is facilitated if these kinds of fundamentally different financial controls are kept apart in the Concept. The risk seems obvious that mistakes will be made if an effort is made not to include related issues in an all-embracing legal framework and administrative structure.

Quite another matter is that, for example, the Ministry of Taxation and Collection and its regional and local units are investigated by internal and external budget controlling bodies in order to guarantee that the assessment of taxes is performed correctly and that the assessed taxes are collected and immediately and fully handed over to the state treasury. In this case the financial control is directed towards the executive unit and not towards the taxpayers.

In the Concept it is stated that an authorised agency (for financial intelligence) must be organised within the executive branch with the mission of collecting and distributing information on financial transactions and co-ordinating the exchange of information between different state financial control bodies. The activities shall not be restricted to transactions in which the state is one part but also includes transactions between private parties, which look “suspicious”. This organisation has such a wide area of operations that it seems feasible not to include it in the functional structure the purpose of which is to ensure that the state budget approved by Parliament is executed in a correct, lawful and effective way.

6. The comments in brief

The Concept starts from a definition of state financial control that is so wide that it includes several different kinds of financial controls performed by state bodies. This very broad scope does not facilitate the analysis and the discussion.

In the continued discussion and implementation of a new and comprehensive system for state financial control in Russia a basic division should be made in 1) financial control related to the execution of the state budget, and 2) other kinds of financial control. In the first case there is a focus on how units within the executive branch carry out their budget related duties, while in the second case the focus is on how citizens and companies fulfil their fiscal obligations towards the state. The state financial control related to the state budget should be regarded as a functional structure with three links and three points of control based on the principal – agent relation. The three links are 1) Parliament – Government/president, 2) Government – executive units, and 3) head of executive unit – the executive unit.

From this can be derived three functional control elements, namely the parliamentary audit, control functions of the Government/president, and internal control and internal audit. The purpose, position, tasks and reporting etc. for the first and the third of these control functions are well illustrated in established international standards. These standards should be allowed to guide the continued analytical process.

Internal control in the form of well designed and well working control systems in the executive units is a fundamental requirement without which the work of the other two elements of financial control will become much more difficult – if not impossible. The internal audit and the systems for internal control seem to be weak in the executive units. Therefore, a decisive effort from the Government to improve these fundamental elements of control is indispensable.

The different kinds of financial control described in the Concept lack, in important respects, correspondence to concepts and definitions used in western economies. The present Russian concepts, which obviously also have clear organisational connotations, make a rational functional analysis more difficult and should therefore be avoided.

State financial control functions, which are not directly related to the executive's implementation of the approved state budget should be analysed, discussed and organised separately.

It is difficult to imagine that it actually would be possible to effectively co-ordinate all the financial control activities which state bodies of very different kinds carry out. In this connection it should be remembered that audit bodies by definition independently chose what to audit and how to carry out the examinations. This leaves limited scope for co-ordination.

Rather than creating a unified structure of state financial control, the ambition could be to form a comprehensive control structure where every part has its clearly defined responsibilities. Co-ordination of operations could to a large extent be replaced by provisions and routines for exchange of information.

1.5 Comments by Mr. MacDonald

Definition of Financial Control

The root definition of State Financial Control provided in the paper focuses on compliance, objectivity, independence, transparency and accountability for actions. It covers both internal controls and internal audit under the rubric of internal controls. I believe that it requires more explanation. First, a definition of management controls, and then followed by financial controls and the roles of management, the internal and external auditors. While the role of the auditor is important, I believe that the role of management to ensure effective management controls must be inserted into the framework, with accountability and sanctions, including criminal prosecutions for serious breaches of the law, clearly identified. The definitions of management controls, financial controls and the roles of management and auditors are well covered in the OECD publication *Managing Public Expenditure*, a Reference Book for Transition Countries.

Scope

The scope of the paper is extremely broad. In order for it to be effectively implemented, the notion of financial controls needs to be desegregated into a number of specific entities that can be individually addressed. While they can be considered in a number of ways, I have divided them into four categories. Each could be administered by a separate agency or agencies, reporting to the Minister of Finance in his role as the responsible minister for the fiscal health of the nation.

1. Internal Government Financial Controls

Content: Budget formulation, resource allocation, investment and spending processes, debt management, borrowings, loan guarantees and responsibilities and accountabilities of public officials to prevent resource misuse, fraud or corruption and ensure compliance with the laws and the efficient and effective use of public monies.

Applies to: Public servants, elected public officials and employees of state owned and controlled enterprises in the national Government entity.

Enforced by: Internal management control processes in the Ministry of Finance and in ministries and SOEs, management culture that supports the objectives of these controls, assisted by well-functioning internal audit and the external auditor. In cases of fraud or corruption, law enforcement agencies would be called in to investigate and, where appropriate, lay criminal charges. Administrative sanctions could be levied internally according to an appropriate policy to be developed for the less serious transgressions.

2. External Controls on Government Transactions in the Course of Regular Business

Content: tax collections, customs and excise revenues, social transfer payments of any kind and privatisation initiatives

Applies to: Public officials involved in the processes, private sector businesses and the taxpaying public.

Enforced by: effective internal controls in the revenue collection agencies, skilled and dedicated management and staff, effective tax and revenue auditors, transparent reporting of operations and results, and audit involvement in future privatisation initiatives to ensure compliance with procedures and rules governing such transactions.

3. Financial Market Controls

Content: An effective control environment over the range of transactions occurring in the financial marketplace within Russia, to ensure that the laws governing these businesses are respected, that violators are detected and punished.

Applies to: Financial institutions, securities exchanges, currency regulations, foreign exchange operations, etc.

Enforced by: Individual regulatory bodies with a specific legislative mandate to ensure that sound controls exist in each area and that appropriate penalties can be imposed for instances of non-compliance.

4. International Financial Controls

Content: import/export controls enforcement, international convention enforcement and money laundering detection and correction.

Applies to: all entities involved in international trade, financial institutions and any business whose operations are amenable to money laundering activities.

Enforced by: specific regulatory entities with a legislative mandate to regulate and investigate instances of non-compliance, with penalties imposed through criminal law.

Enabling Legislation

Effective implementation can only occur if the appropriate legislative base is in place for all aspects of the internal control regime. Individual legislation would have to be prepared to provide the authority for each sub-component of the four control categories mentioned above, stating the objectives, specific responsibilities and the reporting relationships of the head of each of the sub-components. I would recommend that they be at the highest possible level within the bureaucracy, reporting to a Minister whose remit covers the area (many would report to the Minister of Finance) and for maximum transparency and minimal opportunity to avoid remedial action, that regular public reporting to the Dumas be prescribed in law. Some instances could involve investigative forces within the agency, such as tax inspectors, whereas others would utilise existing law enforcement agencies. Penalties prescribed in the legislation should be of a criminal nature for those offences normally considered as criminal acts, and others could be administrative in nature, again supported by legislation.

In Canada, the legal base for internal control is embodied in the Financial Administration Act. It contains all of the principles of internal controls, public money, public disbursements, public property, public debt and public accounts, civil liabilities and offences, and the management framework and accountability of State-owned enterprises. A similar legislative base for the Russian Federation could be appropriate, depending on the comprehensiveness of the current legislative base. The single

primary legal basis for internal management and control could also reinforce the major change initiative required to establish effective internal controls within the Russian Federation.

Implementation

Clearly there would have to be multiple tracks to implement all aspects of the controls identified in the paper. I would like to focus solely on the internal control regimes, and recommend the creation of a separate agency reporting to the Minister of Finance, with full responsibility and accountability for financial management and control within the Russian Federation. This was done in Canada in 1979 after the external auditor revealed that Parliament was close to closing its control over the spending of the Government, and financial control became a political priority for the Government of the day. The position was defined in the Financial Administration Act as the Comptroller General of Canada. It had the rank of a Deputy Minister, and the office reported to the President of the Treasury Board, the chair of the Cabinet Committee of Ministers that oversaw the management of the Government.

When the Office was created, the Comptroller General was given responsibility for the following:

- Financial accounting and reporting policies
- Internal financial management and control policies
- Financial management systems
- Internal Audit policies
- Program Evaluation policies

Recruitment and development of financial officers, auditors and program evaluators within each ministry, a Senior Financial Officer was established to ensure that the financial policies were effectively implemented, that internal controls were respected, that the ministerial accounts were accurate and that reporting was timely and accurate. This SFO reported directly to the department head, the Deputy Minister, and was functionally accountable to the Comptroller General.

As well, an internal audit group was established to undertake the audits within the ministry. This followed the IIA model of an internal audit group, and its head reported to the Deputy Minister and functionally to the Comptroller General. A similar structure was applied to the Program evaluation group.

Finally an aggressive recruitment program for the three communities was launched in order to ensure a regular flow of young, highly trained and representative young professionals into the Government to rejuvenate the communities and allow them to evolve in the desired direction.

The Comptroller General was involved in the staffing of all key posts in ministries in the three communities, and was the functional leader for them. Regular meetings of all ministerial financial, audit and evaluation heads with the corresponding functional heads within the Comptroller General's Office ensured that the policies and practices required were implemented in the ministries, and that best departmental practices were shared among peers.

The heightened profile of financial management and control within the Treasury Board and in all ministries, coupled with the energy of a high level organisation devoted to improving financial management and control across Government and supplemented by the watchful eye of the external auditor led to significant progress over the ensuing decade. Ultimately, the Office was re-integrated into the Treasury Board Secretariat and the Comptroller General responsibilities were transferred back to the Secretary of the Treasury Board, from whom they had been removed some 15 years previously.

I believe that such a model could be considered for the Federation. It offers the opportunity to clarify accountabilities, focuses attention on the key aspects of internal financial control, and utilises the energy and authority of a high level, senior public servant to ensure that the implementation proceeds according to plan. The senior level of the Comptroller General is critical to the success of such an initiative, as only he can deal at a peer level with the top levels of the public service, and participate as an equal in their various meetings. He can also be the senior champion for this major change initiative, an important factor in any major change initiative such as this. The Comptroller General's Office could ensure that a pool of well-trained financial officers, auditors and evaluators could be recruited to provide an infusion of modern internal control skills into the Russian bureaucracy and to support the major changes to internal controls that are required.

Transition

While implementation would occur over several years, I would not rush to disband the ex-ante controls currently in place until there was adequate evidence that effective internal controls were in place in all ministries, that the concept of good financial control was firmly embedded in the values of the public service, and that the Government as a whole was clearly committed to sound management of public resources.

This transition could be gradual in nature, with a relatively greater emphasis being put on ex-post controls and a corresponding lessening of ex-ante approvals as the situation dictated.

1.6 Comments by Mr. Larsson

The Concept paper gives a good overview of the current status of and explains why today's financial control in Russia is weak and ineffective. The main causes mentioned (poor financial, budget and tax discipline, fraud and corruption, weak legal and methodological framework, insufficient and not well-organised internal control within Government agencies, in-effective controls of financial operations between the public and private sector, lack of resources, poor co-ordination between different agencies, lack of good information systems) are known from most other countries although the extent and seriousness of course varies.

I would like to comment, having read the proposal put forward in the Concept paper and reflecting on experiences from a few other countries in setting up financial control systems, on five aspects of the proposal that are of some concern to me.

1. Single unified financial control system

The Concept paper covers all areas of financial control concerning the private and public parts of the Russian society. The proposal is to build up a single unified financial control system. The proposal covers how financial control should operate in the Government administration on both the expenditure and the revenue side, in relation to other public or private sector entities which are receiving some public funds, of the citizens and companies or other private legal subjects, when meeting their obligations to pay taxes or customs or other fees to the state, or to declare the legality of money transfers, and it covers the control of financial transactions between private entities.

It is of course important that financial control activities concerning the same type of phenomena or entities are based on the same standards (not the least if there is a possibility that the outcome will end up in courts) and follows clearly defined procedures. It is equally important that there is a certain degree of co-ordination between control entities making sure there are as few overlaps as possible and that relevant information is exchanged.

But there are several risks with the approach taken in the Concept paper. One is that the single and unified scope will face so many objections from the administration and from the political level that it risks too never be fully implemented. Another is that tackling fundamentally different problems demanding very different approaches in a single and uniform way risks being very ineffective. It is also a risk that the demand for a unified and (centrally) planned approach will in real life prohibit some of the control institutions to act with the necessary speed and flexibility. Something that would be a severe drawback, not the least for the success of actions against organised financial crime.

Proposal: The solution to the questions addressed in the Concept paper should be sought in a division into several smaller parts that are not totally interlinked. These parts should be handled individually both when it comes to the proposal and its implementation. It is possible to divide the Concept in several ways. One division could be 1) Financial control in the public sector 2) Control of the fulfilment of financial obligations by citizens and private legal subjects in relation to the Government/public sector 3) Audit, financial control and public reporting requirements on entities in the private sector 4) Activities to fight against fraud and corruption detrimental to the financial interest of Russia (needs most probably to be divided in a public respectively a private sector oriented part).

2. Who is responsible for financial control and to make sure violations are prevented?

The Concept paper seems to suggest that the state financial control system will have the prim responsibility for the setting up and functioning of the financial control. It is also said that the state financial control system should be more effective in preventing financial law violations.

Many examples exist (and the ongoing reform of the European Commission is one) where a far going separation of financial responsibility from the operational responsibility in the administration has proven to be severely ineffective. This happens either because a culture is created where budget money is spent irrespective of the usefulness of the spending or because this demands an extensive and costly financial control system, which also tends to slow down implementation of decided programmes/policies.

It is of course true that an efficient state financial control system also prevents financial law violations. It is equally true that a successful prevention of such violations demands a more elaborated or sophisticated approach including systematic analyses and closure of loopholes, omissions etc. in the financial legal framework. Prevention is also about making it less interesting from an economic point of view to break some laws or to lower the social acceptance of such activities.

Proposal: It should be clearly laid down in law that the individual managers in the Government/the ministries as a part of their operational responsibility also are responsible for the financial control of all activities within their respective area. No central financial control body should have this responsibility. This responsibility includes putting in place the relevant financial control procedures and practices within the respective area. It also includes a responsibility to regularly follow up how the controls function. The specific internal financial control bodies set up within the ministries should, as the Concept paper proposes, function as a support to the highest management helping to ensure that the relevant controls are in place. It should be free to report directly to the highest official of the organisation it belongs to. These bodies should not be involved in the daily operations and must be able to act independently from line management. The Ministry of Finance is usually the most appropriate organisation for setting the standards and defining the methods that should be used by the organisations and the specific internal financial control bodies. The standards used should be based on internationally accepted standards for financial management, accounting and internal audit.

It may also be considered to start activities outside the state financial control aiming at strengthening the prevention of financial violations.

3. The need to control the controllers

The Concept paper is not fully clear on the matter if and to what extent the “controllers” are to be controlled. How this is solved is usually very important as it may have direct financial consequences for the state. In-effective or corrupt tax, customs or social benefits officials may have substantial negative effects on the budget.

Properly functioning internal and external audits in the public sector of the type and with the remits proposed by the International Organisation of Supreme Audit Organisations (INTOSAI), are vital in order to make sure that such a control of the controllers are in place but also other arrangements should be put in place.

The Supreme Audit Organisation in a country should be independent from all executive parts of the public administration including the President administration.

Proposal: External and internal audit arrangements should be put in place in order to make sure the system for control of tax, customs and social benefit administrations are in place and functions well. Special control arrangements are normally needed inside such administrations.

It should be avoided to make the Presidential Control Department responsible for the planning of the Audit Chamber's audit activities.

4. Fight against fraud and corruption

Severe large-scale economic fraud activities have many times a cross border character involving exports and imports and/or complex multi national schemes for money laundering. And it is not unusual that a vital component is the corruption of public officials. The concept paper does not explicitly address how the fight against such large-scale fraud and corruption should be organised.

Proposal: A special investigation agency with considerable investigative powers and independence in its investigations could be set up focused on economic crime in the public sector and economic crime affecting the financial interests of Russia. The agency may have access to and work together with prosecutors fully dedicated to this type of crime. Such an agency may be modelled upon the experiences of the European Anti Fraud Office (OLAF).

5. Priorities

The Concept paper is ambitious and proposes fundamental changes or reforms of many functions and organisations. The broad scope of the reforms means that implementation will take several years. It is not clear from the Concept paper if or how the reforms will be prioritised over time.

Proposal: It is advisable that the reforms are implemented stepwise and consideration is given to available resources and the political backing needed. Reforms that have a considerable positive effect on the budget should if possible be implemented first.

ANNEX 2: COUNTRY DESCRIPTION

2.1 France

Introduction

This paper will be limited to taking a look at the level of control within the Government (Ministries) for at the level of the President and his Office; there is no control other than political. (The President himself cannot be prosecuted during his mandate).

It is almost the same at the parliamentary level, which has no permanent control system but only, from time to time and rather seldom, “investigative commissions”. These commissions, by law, do not have any special powers in their investigations. Parliament is not financially controlled either.

The Court of Audit is an external audit for the administration judging “accounts but not accountants”. There exists, on paper only a disciplinary Budgetary Court set up to judge the “ordonnateurs”³.

At Government level, we have to strongly distinguish (see comments on concept paper) between:

- Financial control in the administration: mainly on budgetary funds and generally on all public expenditure wherever it goes (including grants to private sector).
- The fight against fraud, corruption, economic crimes...etc.

I - Financial Control

Here, we can make a basic distinction:

- the control of public funds : regularity (legality) and use according to the designated budgetary purposes ;
- sound financial management : efficiency of public expenditure, fight against the waste of money, use according the designated objectives.

But the modern tendency is to link both distinctions. If “A” is only a budgetary control, “B and C” mix it with sound financial management.

“Public funds” = budget, extra budgetary funds, public money going to the private sector (grants for instance) etc.

Three different systems are in use or will be in use soon (probably in parallel).

A/ - The basic “budgetary control system” (from 1922) still in use

- before the commitment of any public money, whether at the central level or at the delegated levels (public services in regions, “departments” or public establishments) a “visa” of the financial controller (an official of the Ministry of Finance) is necessary in order and execute the operation (investments as well as salary expenses).

This “ex ante control” can be reduced to even smaller amounts for salaries or for some “global” expenses. In the latter case the manager receives a visa for a framework of expenses, which will be renewed after a periodic control of the fulfilment, i.e. ex post control. The “visa” is given after examining the regularity of the projected operation and the compliance with the budget authorisation.

³ “Ordonnateurs” : Officials intitled to give the order (engagement) to realise an operation and then to pay to the accountant, (mandate).

- before paying, the accountant must verify the correct matching of documents supporting the expenses (invoices, certificates of work, of physical control,...) with the expected operation (above) but he can pay only if funds are available.

B/ A new budgetary control system will be instituted in 2005 (for the Budget of 2006) – organic law of 1 August 2001.

It is a kind of PPBS (“Programming and Budgeting System”)

- “Programs” will be designed inside each Department based on the notion of coherence of objectives (and also on the concept of “chain of control” i.e. more or less “the audit trail” → see below) “Missions” will concern programs where several departments are involved - “ear markings” are a form of spending not suitable for the program ;
- Each program will receive a certain number of credits and a global authorisation for salaries (instead of a list of jobs). The manager can switch money from salaries to the rest of the program but not the contrary.
- Measurable indicators will be determinate in evaluating the results and comparing them to the objectives. The manager, the inspectorates and the audit levels (see below) will do these checks.

It is not yet settled that this system will take the place of the previous one (that is to say that ex post control will replace ex ante control). Most probably such as for European funds in France, both systems will be used together.

C/ The financial control of European funds in France

The result of European demands for financial control, is that for this kind of expenditure (only) we have added ⁽⁴⁾.

- linked with the “visa”, economic and financial advice on the project is delivered by the representative of the Ministry of Finance (TPG) ;
- an “audit trail” i.e. a permanent or “ongoing method of controlling the process used from the beginning of an operation to the end (including payment, control and evaluation) ;
- a special certificate (“work done certificate”) delivered by a technical and financial controller, is compulsory before any payment can be done ;
- a particular technique of on-the-spot control or checks based on scientifically determined samples (known as “5 % sample checks) ;
- a national audit in charge of delivering a periodic statement on the good or bad management of the whole system (one certificate for each different audit trail). In fact by its recommendations this audit (CICC) has considerably changed the system of financial control in France (a “guide” book but no law).

Addendum : the role of “inspectorates”

Every Ministry has its own inspectorate (or even several) for internal affairs. But their planning of investigation is neither the "sample checks method" nor the audit one in the sense of a periodic review of functioning processes. They deal with the “affairs” of the moment by random on the spot inspections.

⁴ European funds are mostly spend on the regional level.

The General Inspectorate of Finance (which is responsible only to the Minister of Finance) covers all the departments.

Inspectors - like any other officials - have to communicate to the prosecutor any evidence of criminal offence found during his duty - but inspections are not especially shaped to fight against fraud unless it has already been revealed (by the press for instance: see “affairs”).

II - Fight against Fraud

1 - Inside administration

Corruption (receiving bribes) is a criminal offence, which is seldom prosecuted. More often than not, the Administration uses its own procedure of “disciplinary committees” to impose sanctions on the career or the official (up to dismissal without pension).

Great progress has been made in the field of public procurement:

- instituting of a new criminal offence : “favouritism” ;
- creation of a special interdepartmental body of specialised officials that can be seized by any other official on the matter of public bids (tenders).

2 - Outside the administration

a - Enforcing financial laws

Taxes, customs, banking activities, securities market... have their own rules and a distinct separate body of “inspectorate” in each case is in charge to enforce them. However, they can only impose (often very important) penalties. Criminal offences have to be defined by a judge (see above).

b - Special bodies against economic crime

Very few:

- “Economic Police” is mostly composed of policemen trained to investigate financial activities. They are operative by helping the (also specialised) prosecutors but cannot inflict sanctions themselves ;
- “Tracfin” is a partly operative interdepartmental body (under the supervision of Ministry of Finance) which centralises information in the fight against money laundering.

3 - The link between inside corruption and private fraud occurs in the case of bribery (corruption)

The fact that on one hand this criminal offence has a statute of limitation (5 years) and is termed on the other hand as the “abuse of social property”, i.e. a private operator giving money to an official has no limitations, explains why rather old affairs of corruption can emerge at any time (without limitation) as we can see in many “affairs” in France to day.

2.2 Germany

1. General normative principles of accountability in the Government sector against the voters in a market economy and a democratic state.

Each institution in the German Government sector relies on the legitimacy of democratic elections. The democratically elected Parliaments of the different federal jurisdictions therefore, have the power to elect the respective Governments and to control their actions. If a Government cannot get a majority in Parliament a new one will be elected or even the Parliament itself will decide by its (new) majority to proceed forward with new elections.

The Federative Parliaments and Governments have — among others - the tasks to provide so-called public goods (i.e. performances of the Government sectors in favour of the citizens) and to guarantee a working private economy. From a normative point of view, they are only allowed to intervene if the private economy is not able to perform optimally. The financial sector is in general part of the private sector and it is essential for the total performance of the whole economy and its relations to other nations. Therefore, a special network of public institutions has been established to set the basic data of the financial markets and to guarantee a sufficient provision of the markets with money and foreign currencies. Another of its functions is to regulate and control private financial institutions checking as to whether they behave “correctly” in the sense of, security of the savings, but more and more to prevent international money-laundering and national tax evasion. If institutions and the people working in the institutions of the financial sectors behave in a way where criminal law sets sanctions, the judicial system (attorneys, police and courts) takes over the investigation and the criminal prosecution.

Special arrangements have to be implemented for the control of the use of “taxpayers’ money”. Governments take taxes, fees and other compulsory contributions, e.g. for the separately organised social insurance institutions to finance public goods and transfers in favour of the citizens. In this case, of public production of public goods, there are no market controls as to whether the resources are used efficiently and effectively because the market mechanism “fails” partly or totally from the beginning. Therefore, the Parliament decides about the volume, the structure and the quality of public goods - all the years in their votes for a certain budget again. They also decide by the budget law about the financial means, which a Governmental agency can spend over the next fiscal year to fulfil its legal tasks. The budgetary appropriations, therefore, are also an important instrument - among others - of administrative control.

In contrast to the Parliaments and Governments, the bureaucracy is not directly under the control of the voters because civil servants and other types of public employees have long lasting, mostly lifelong employment treaties. They also do not necessarily have the same intentions as the Parliaments and Governments in the use of public money. Governments under the assistance of Parliamentary majorities however, also often try to establish institutional arrangements (like public enterprises and their “daughters” and “grand-daughters”) to get out of the control of oppositions and of the public. A special type of control is therefore needed, which has the complete competence to review the levying and the expanding of public money and it is far-reaching and independent from direct influences of all other political and administrative actors.

2. Distinctions between the control of the private sectors financial transactions and banking systems and the financial control of tax payers' "public money".

As it was emphasised already in the first section, there are many reasons to implement different institutional designs to the control of the financial and the banking sectors in comparison to the control of tax payers' money in the public sector.

The first can be controlled by the Governments because the task is a typical "public goods task," so therefore, control cannot be provided by private institutions. The legislator has to pass the legal base, and the Government has to establish an agency or a similar institution to provide effective supervision of the banking sector. It is important that there is also a working connection to legal criminal sanctions to prevent the actors of the banking system—without regard of the ownership of the financial institutions—to misuse their closeness to money. In Germany, the Federal Supervision Office undertakes the supervision of the banking sector for the Banking System. The legal base is set by the 'Banking Act' (<http://www.bakred.de/texte/gesetz/kwg>), which determines the actors and rules for the whole sector. Recently, it has come under political discussion as to whether the institutions falling under the 'Banking Act' should provide additional (electronic) information to the Federal Minister of Finance with concerns to money laundering and tax evasion.

The financial control of the public sector money is organised in a totally different institutional design. Here it is important that the Government and the executing administration themselves have object of the control. Therefore, financial control needs certain independence from the Government and from the Parliament: e.g. nobody should have the right to fire the responsible auditors if the audit results are not very agreeable for the Government. Additionally, Audit Courts need a certain working capacity of specially educated civil servants. They are established only for the control of the legally correct and efficient use of the financial resources by the administrations in the Government sector. In many countries, therefore, the Audit Courts are institutions of a unique institutional construction and are basically regulated in the constitution.

In Germany, the establishment of Audit Courts is regulated in the Constitution among other rules of public and federal finance (Art. 114(2), which determines the existence of an independent Federal Court of Audit: "The Federal Court of Audit, whose members shall enjoy judicial independence, shall audit the accounts and determine whether public finances have been properly and efficiently administered. It shall submit an annual report directly to the Bundestag and the Bundesrat as well as to the Federal Government. In other respects the powers of the Federal Court of Audit shall be regulated by a federal law."

3. Principles of financial control in the Government sector.

The system of financial control in Germany is constructed according to the following fundamental principles:

- The institution of the Court of Audit is *established by and in the constitution*. This guarantees its independence from interventions and changes of a simple majority of votes in the Parliament and would give eventual changes of its status, which needs a majority of two thirds of the representatives, a high interest in the public. Additionally, the constitutional establishment strengthens the role of the Constitutional Court to protect the Court of Audit against "uneven" interventions by the Government and a majority in Parliament.
- The Court of Audits is neither an "agency" of the Parliament nor of the Government. It addresses its reports to both Chambers of the Parliament and to the Government. Neither the Government nor the Parliament is allowed to give instructions to the Court of Audit. This construction

establishes its *institutional independence from each existing political institution* and puts the ideal focus of political accountability to the constitution and to the people.

- The President, the Vice President and the “heads of ministries” have the *status of judicial independence*. This means that they cannot be fired after their election by a majority of representatives in the Parliament or even by the Government.
- The task of the Court of Audits is the control of all subjects related with the levying and expanding of financial resources in the public sector. Particularly, it is to be controlled, as to whether the revenue and the expenditure side of the budget have been executed *according to specific legal rules* and whether the resources were used *efficiently*. All subjects of fraud and corruption related with the use of “public money” are part of and are included in that broad definition of the audit task.
- Although the task of the Court of Audit covers the financial control of whole the budget and even the legally correctness and efficient use of subsidies in favour of private enterprises, it is impossible to establish a personnel capacity of financial control to control each detail of public expenditure and revenue of each annual budget. Therefore, the Court of Audit selects each year, certain parts of the administration for a detailed control. It undertakes the financial control according to the principle of “spot checks”, but it also has the right to investigate the efficiency of the tax administration and of the expenditures of several years respectively, as a question of general importance, in so far as, the Court of Audits is also *independent* with concerns *to the choice of the administrations to be controlled*.
- The “normal” employees of the Court of Audits are members of the *civil service*. They follow all rules of the civil service and receive a salary sufficient to cover their private expenditures according to the status of their special job, which was in German history an important solution to prevent the civil service from corruption. The employees of the Court of Audit receive a special education to enable them to carry out efficiently their control job.

The Federal Republic of Germany is a federal state and each jurisdiction, federal (Bund) and regional (Länder), have established proper Courts of Audits. All are guaranteed by the respective constitutions and follow identical principles and almost identical details of construction. Therefore, the organisation of the Courts of Audits is a *federative* one, although the common principles have lead to comparable almost equal types of institutions. In the case of matched grants, there is a common right of financial control of the Federal and the State Court of Audit.

However, the Länder does have important differences concerning the financial control of local Government budgets. In some Länder (e.g. Rhineland-Palatinate) the state Court of Audit also covers the local financial control. In others (e.g. Hesse), local Governments have established proper agencies in their administrations (Rechnungsprüfungsämter). The latter do not follow the above mentioned principles of constructions because they are part of the local administration.

4. Main actors and procedures in the budgetary cycle

In Germany, the budget cycle is distinguished into the phases of preparation of the executive draft budget, parliamentary discussion and adoption, administrative execution, accounting and audit, and finally the parliamentary discussion of the audit report and final approval. Particularly the regulation of the execution of the budget is important for the financial control because certain procedures shall secure the regularity and efficiency of spending.

Although important changes have taken place in the field of budgeting during the last 10 years, which have a more flexible, decentralised and more efficient execution of the appropriations. Commonly, the basic rules of spending procedures have not changed. Also, there is no relevant change in the role

of the Courts of Audit although they could have taken the chance to follow the reforms. So, the following information about the actors in the budget cycle is almost untouched by the reforms.

5. Government administration:

The budgetary appropriations determine the frame of resources for the executing institutions (individual budget spenders). Until the given amount the executing agencies are allowed to execute expenditures and take in revenues of their budgets (chapter 3 and more of a Ministry's budget) during the fiscal year. Although the detailed commitment of the titles to the different types of expenditures (personnel, investment, etc.) has been released during the past year, the budget is still oriented to administrative control. So, the institutions which are entitled by the budget law to execute the budget by sending revenue and expenditure orders to the few centralised Government cash points. The orders have to be signed by the few persons, which have this particular financial competence order. Additionally, the forms contain affirmations that the expenditures/revenues are correct in the material and in the arithmetical sense. Material correctness covers the necessity of the expenditure/revenue in the context of the tasks of the agency as well as the efficiency. Decentralised cash collecting is in general forbidden; in the few cases of exemption, there is a special permit and special rules have to be followed. So, a system of control against corruption and fraud is already established by the rules of budget execution.

The lines Ministries are executing institutions like all others with regard to their proper budgets (chapter 1 of each Ministry's budget). They are also responsible for the execution (chapter 2) where all general appropriations in favour of third parties (subsidies, transfers, etc.) are allocated. The Ministries in general do not intervene into the execution of the budgets of agencies, which are under their control except in the cases of the personnel budget as the competence to hire personnel is traditionally centralised in the Ministry.

The Ministries of Finance are responsible for planning and co-ordinating the draft budget, to run the budget execution, and to provide and co-ordinate the accounting process. The intervention in the spending processes is an indirect one by determining the special rules of execution and special permits during the fiscal years. The control of tax collecting is connected directly to the Ministries of Finance because the taxation offices are agencies of the Ministries of Finance. After the end of the fiscal year the Ministries of Finance provides the final accounts across all budgetary chapters, which is published like the budget law and the related budgetary appropriation plan.

A. *The Parliaments*

The German Parliaments are the budgetary legislators. They have the power to decide about the distribution of appropriations among the Ministries and agencies. The Governments have to report to them during the fiscal year and thereafter. The Parliaments have the right to politically approve to the Governments' budget execution of a certain fiscal year and to finish the budget cycle by this important democratic ritual.

In reality, the representatives of the respective governing coalition parties narrowly collaborate with the Government. In many cases, the Government dominates them but in some important aspects they effectively control the Government. The mechanism of control is rather an indirect one because the Government constructs the draft budget in a way that a consensus with the majority in Parliament is secured.

The most important parliamentary control institution is the Budget Committee. The parties in Parliament according to the number of seats nominate the members. They discuss the draft budget title by title and decide whether they agree or whether they should change certain appropriations. They can

put certain appropriations under reservation and the approval may be given or refused later during the fiscal year after a special control. The members of the Budget Committee are informed about the budget execution during the fiscal year and prepare certain parliamentary budgetary decisions, which become necessary during the execution.

The ex post financial control is undertaken by the Audit Committee, which is an under committee of the Budget Committee. Here the report of the Court of Audit is discussed and the approval decision of the plenary prepared. By its construction that the members of the Audit Committee are members of the Budget Committee, the knowledge about the budget is effectively used for the purposes of the ex post financial control.

B. *The President/Chancellor/Minister Presidents not relevant for Germany*

C. *The Court of Audit*

The institutions responsible for the “technical” financial control are the Courts of Audit. They are constructed according to the above mentioned principles and undertake the proper work which is independent from other institutions in many important concerns. So, the Courts or Audits in the German budgetary system, assist for a legal and correct execution of public budgets already by their existence, by the fact that they review the accounts in details and look how the money was used according to the legal purposes (hind nothing else) and as to whether the resources were used efficiently. The financial control is directed to the Government as well as to the execution agencies and other persons responsible. In the cases where the Audit Courts find corruption and criminal use of public funds, the judicial system takes over any further criminal investigation and sanctions.

All results of the financial controls are discussed with the agencies and Ministries responsible for the respective budget chapters. In the annual report of the Courts of Audit, not all findings of the works are documented. For the public are reserved only those complaints where no agreement about the “quality” of the finding was found and which are of a general interest for other areas of the budgets. The publication of the complaints works as a threatening potential because no Ministry or agency wants to be cited in the annual report.

It should however be mentioned that there are certain problems and functional deficits of the financial control by the Courts of Audits. In reality, they are not totally independent from political parties and Governments. Many of the Presidents and other highly ranked Members of the Courts are members of political parties and were elected because of their membership. Only some Länder have started to limit the term of office for the President and to undertake a public calling procedure for the job. The main area of the audit work lies on the control of legality; deficiencies have to be stated in the field of efficiency controls or even evaluations of the use of public money. Most Courts of Audit belong to the more “conservative” actors in the public sector, only a very few are actively engaged in the modernisation of budget procedures and there is a loop-hole in the criminal law in Germany: the pure inefficient use of public money cannot be sanctioned or be punished because it is not subject of the criminal code.

Finally the political effects of the financial control are limited. If the majority in the Parliament does not agree with the complaints there will be no change in the appropriations of the next budgets. In Germany the refusal of the final approval has never happened. So, the effectiveness of the financial control depends on the political respect, which the Courts of Audits earns.

2.3 The United States

1. Financial Control in the United States

The United States has a federal system of Government in which the states have powers separate from those of the Federal Government. For example, the states have their own taxing powers and the structure and level of taxation differ widely from state to state.

The Federal Government consists of three branches: The Executive headed by the President; the Congress, consisting of the Senate and the House of Representatives; and the judiciary, headed by the Supreme Court. The President, subject to the approval of the Senate, appoints the heads of ministries and agencies, and most can be dismissed at the pleasure of the President. The President, with the assistance of the Office of Management and Budget (OMB), which is part of his office, proposes an annual budget for the Federal Government. It can take effect, however, only after approval by both houses of Congress, which invariably make substantial changes. Implementation is the responsibility of the ministries and agencies to which funds are allotted by the budget laws, subject to OMB's managerial guidance and the Treasury Department's (TD) accounting procedures.

Congress is elected separately from the President. It is quite common for one or both houses of Congress to be controlled by a party different from that of the President. Congress must enact all laws. If the President disapproves of a proposed law, it can still be enacted if it is passed again by both houses of Congress with a two-thirds majority. This is rare. Congress also monitors the execution of the laws and other activities of the Government. It is assisted by the General Accounting Office (USGAO), which is the Supreme Audit Institution (SAI) of the US. The Comptroller General, who heads USGAO, is appointed by the President, with the approval of the Senate. This appointment, however, is to a 15-year term and is not subject to arbitrary dismissal.

In the US, assuring proper collection and use of budget resource and other Government assets is completely separate from preventing or detecting unlawful private transactions. The former is a responsibility of those to whom the resources have been entrusted, who are held personally accountable for proper use and for the effectiveness of control systems to assure that outcome. Illegal activity in the private sector is a responsibility of the law enforcement authorities and the financial regulatory and supervisory agencies, but these are subject to rigorous controls to prevent unwarranted invasions of privacy. This is coupled with an aversion to strong, centralised police forces, leading to the creation of numerous specialised investigative agencies.

The sharp distinction in attitudes toward Government and the private sector reflects an important element of US social and political philosophy. With respect to Government, the presumption is that finances should be carefully controlled, transparent and subject to public scrutiny unless there is a compelling need to the contrary. With respect to the private sector, the presumption is precisely the opposite: an individual's private financial transactions should be a private matter unless there is a compelling need to the contrary. Neither presumption is absolute. The Government routinely restricts the disclosure of certain information on grounds such as national security, however, such exceptions are selective, not general. The national security exception, for example, does not prevent publication of detailed financial reports by the Defence Department, which are subject to audit by USGAO in the same fashion as other agencies.

The presumption of privacy in the private sector also has exceptions. The need for integrity in the securities markets, for example, has led to requirements that firms disclose their financial condition in audited financial statements. Criminal investigations also allow exceptions, such as the examination

of telephone records, banking records, etc. The more intrusive the investigative technique, the more rigorous are the controls over its use. For example, as a general rule, investigators can search a person's home or surreptitiously listen to telephone conversations only if authorised by a court order, which typically requires strong evidence of criminal activity.

2. Financial Controls within Government

The basic legal principle underlying these financial controls is that no entity or person may collect taxes or fees, or disburse Government funds or otherwise dispose of Government assets or incur debt on behalf of the Government, or permit another to take any of these actions, unless authorised to do so by laws enacted by Congress. There are criminal penalties for knowingly spending budget funds in excess of amounts appropriated by Congress. While these penalties are essential, they are rarely used and may properly be seen as one of the least important elements of the overall system.

Much more central in modern times has been the requirement that managers of each entity establish effective systems of internal control to assure that all transactions are properly authorised, approved, executed, recorded and reported. OMB (with related accounting requirements promulgated by TD) promulgates the overall standards for these controls, but the design and implementation of the particular controls for a specific entity or program are the clear responsibility of the leadership of the entity. The specific control techniques differ widely from one entity to another, depending on the operating environment and the nature of the transactions.

Auditing plays a vital role in assuring the effectiveness of internal controls. Each Government entity is required annually to produce audited financial statements. This audit process is managed by USGAO, which promulgates the relevant audit standards and performs certain of the audits, selected by importance or sensitivity. Others are performed by the internal audit staff (which all entities are required to have), typically with assistance from private firms. While the goal is to attest to the reliability of the statements, the actual focus is on the reliability of the systems that produced the data. This includes both the accounting systems in which transactions are recorded and the control systems and techniques that are intended to assure the propriety of the transactions. Each audit must include appropriate tests of the systems and must report the results. Individual transactions may be examined, but this is done only as part of testing the systems, or if one or more systems are determined to be unreliable. USGAO publishes a summary of the testing results in conjunction with its audit of the Government's consolidated financial statements.

The annual audit process is supplemented by individual audits. A primary responsibility of the internal audit staff is to monitor an entity's internal control systems on behalf of management, to identify weaknesses and to suggest ways of strengthening the controls. USGAO also may choose to audit specific elements or programs, including testing relevant internal controls. In planning such an audit, USGAO would usually review any relevant internal audit work.

The audit process often extends beyond the Government entity. Federal money flows to state and local Governments and to private organisations. The recipients are subject to audit to assure that the payment was proper and that the funds were used for the intended purposes. Such audits may be performed by USGAO or by the internal auditors of the administering entity. However, federal auditors are not empowered to audit state, local or private activities that are not financed by federal funds. That responsibility lies with state Government auditors and with the auditors typically employed by local Governments and private organisations.

3. Controlling Economic Crime

In general, this is a law enforcement function and is separate from assuring proper management of resources within Government. There is some overlap, as in the case of fraud against the Government or failure to pay required taxes but, for the most part, the two functions are not connected.

The prosecution in court of economic crimes is fulfilled by US Attorneys officers of the Department of Justice, but there is no single agency to conduct the related investigations. The Federal Bureau of Investigation (FBI) is the most widely known investigative agency, but there are many others, each with its own area of expertise. For example:

- Fraud against the Government is investigated by an entity's Inspector General.
- Agents of the Internal Revenue Service (IRS) investigate tax fraud.
- Cases of securities fraud are pursued by the Securities Exchange Commission or the Commodity Futures Trading Commission.
- Bank fraud is pursued by the several bank supervisory agencies.
- The Secret Service investigates currency counterfeiting.
- The Customs Service investigates illegal imports and exports. With regard to illegal drugs, Customs works closely with the Drug Enforcement Administration (DEA) and receives important assistance from the Coast Guard and the Navy.
- The Immigration and Naturalisation Service investigates illegal immigration, including the organised smuggling of aliens for a fee, with important assistance from the Coast Guard.
- Fraud against the US Postal Service and fraud committed through the mails is pursued by Postal Inspectors.

These (among others) all pursue economic crimes within their specific areas of responsibility. Despite the organisational separation, they do not work in isolation. In any case that appears to warrant prosecution in the courts, the investigator must consult with the appropriate US Attorney regarding the evidence that would be needed. In addition, the investigative agencies often co-operate, sharing information and lending expertise. The co-operation is far from perfect, but the needed flexibility has been demonstrated on many occasions, such as the pursuit of large money laundering cases. Money laundering is the process of turning illegal profits into apparently legal form. It can stem from many different types of illegal activity and can take many forms. The most common, perhaps (in the US) is the drug dealer, who must find a way of moving the cash proceeds of drug sales (typically involving large volumes of small denomination bills) into the hands of drug suppliers in other countries. DEA has primary responsibility for enforcement of drug laws but the related money laundering takes the issue into other areas.

To inhibit money laundering, for example, TD has required the reporting of any cash transaction or movement of cash across the borders that exceeds US\$10 000. The transaction itself is not necessarily illegal, but the failure to report it is a criminal offence. Banks have established rigorous controls to assure proper reporting. This reporting requirement has not put an end to money laundering, but it has made the process more difficult and less efficient. In addition, the resulting information, which is shared with investigators when anomalies are found, has helped identify potential targets of drug, tax fraud and other criminal investigations. Agencies co-operate in other areas. The FBI and IRS often work together against organised crime, where other crimes may be coupled with tax fraud. The same occurs with the FBI, DEA and IRS on major drug cases. Other specialised agencies may be involved in complex cases where the criminal activity extends to mail fraud, banks, the securities markets or trans-border activities. The decentralised approach responds to US aversion to centralised law enforcement and facilitates the development of specialised expertise, while permitting joint efforts when appropriate.

2.4 Sweden

Basic Principles for Financial Control

A characteristic feature of the Swedish central Government administration is that the implementation of the approved policies is decentralised and delegated from the Government to state executive agencies.

The financial control is based on *ex post* external audit of the Government agencies that execute the operations. Every head of a Government agency is responsible for ensuring that satisfactory systems for internal controls are in place. The internal audit in the agency assists the head of the organisation by supervising the systems for internal control and by making sure that they function in a proper way.

Presently, there are two state organisations that carry out external audits of the central Government operations. The dominating body is the Swedish National Audit Office that belongs to the executive branch. Parliament has a smaller body – The Parliamentary Auditors - that also audits state activities. This structure will be changed in 2003.

Roles and Responsibilities

Under the Government

The Government Agencies

Under the Government there are some 250 executive agencies, that on instructions from the Government implement the approved state budget. Every fiscal year the Government issues a letter of instruction to each agency specifying the available financial resources and expected non-financial results. The board and the head of an agency have wide authority. The financial resources for administrative purposes are given as a lump sum and it is the responsibility of the management to allocate the funds between the different expenditure categories.

It is the duty of the head of an agency to make sure that sound financial management is observed. Furthermore, the head must ensure that there is an adequate structure for the internal control of the finances and the operations. The agencies order their own payments that are executed without any further external control.

In the larger Government agencies there are separate units for internal auditing, that scrutinise the control and management systems and report to the head of the agency or its board. The internal auditors mainly pursue systems based control but of course, to some extent they also perform transactions control.

Every Government agency presents an annual report that includes revenue and expenditure statements, a balance sheet, a cash flow statement, and an appropriation statement.

The Swedish National Audit Office (SNAO)

External auditors examine the annual report and the accounting. They also examine if the management has observed all relevant rules for the operations. This examination is performed by the SNAO, that presently belongs to the executive branch. The duties of the SNAO are defined in a Government regulation where it is stated that the SNAO is the Supreme Audit Institution (SAI) of Sweden. The head of the SNAO and the deputy head are appointed by the Government for a period of six years

although, re-appointment for a shorter period is possible. The total number of staff amounts to some 300.

The SNAO carries out annual external financial audits of every Government agency. These audits are carried out in accordance with generally accepted auditing standards and are mainly focused on systems controls and seldom consist of transaction controls. The purpose is to verify if the annual report is reliable and correct and if the management's administration complies with the relevant rules. Also reported non-financial results are verified. The SNAO also carries out performance audits, i.e. value for money audits. The audit reports are presented to the Government and a copy is sent to the concerned agency.

The audits are mainly focused on the operations of Government agencies. The use of state grants can be examined if the beneficiary is accountable to the state or if there are specific rules for the use of the grants. According to the law, the SNAO is allowed to carry out audits regarding operations that the state pursues through state owned companies or state controlled foundations. Presently, some 50 objects of these categories are being examined.

The SNAO does not have the authority to impose sanctions when an examination reveals irregularities. Instead, this authority is held by the head of the concerned agency, or in extreme cases it is the responsibility of the Government to take action, for instance, to decide whether to impose an administrative sanction or to hand the matter over to a public prosecutor.

The Line Ministries

The line ministries do not have separate resources for financial control of their respective Government agencies. For monitoring the operations and the implementation of the budget they use reports from the agencies and the audit reports presented by the SNAO. They also receive monthly reports on the spending of appropriated funds within their area of responsibility. Through frequent written and verbal communications with the agencies, a line ministry gathers a good picture of how the operations are developing.

The Ministry of Finance (MoF)

Within the MoF itself there are no separate resources for exercising financial control over the Government agencies. But the Budget Department monitors on a monthly basis the development of revenue and expenditure on the same level as Parliament has approved the budget, i.e. some 500 appropriations and 150 revenue items. To some extent also the development of the operations is monitored. At the request of the Government the SNAO can carry out directed investigations. Assignments of this kind are financed separately.

The MoF is supported by two agencies when implementing the state budget. One is the *Swedish National Debt Office* (SNDO) that is responsible for the management of the state debt, for short and long-term borrowing, cash management, and for the state payment system. All payments to and from the state are channelled through a Treasury Single Account (TSA) system.

The other supporting agency is the *Swedish National Financial Management Authority* (SNFMA) that provides aggregated current and annual financial reporting within the state, develops accounting methods and issues rules on accounting procedures and reporting.

These two agencies participate in the financial control mainly in a preventive manner by ensuring suitable administrative systems, techniques, rules and procedures are available.

The annual reports from the Government agencies and the corresponding audit reports form an important basis for the annual budget preparation in the ministries. These documents are available to the MoF and the line ministries in February and March. The Government presents an annual consolidated financial report to Parliament in April, that is timely with respect to the budget procedure.

If the SNAO has presented a qualified report, the concerned agency must inform the Government of what it intends to do in order to eliminate the deficiencies, and in the Budget Bill the Government informs Parliament of the actions taken as a consequence of the observations made by the SNAO.

Parliament

Parliament has an auditing body called the Parliamentary Auditors (PA), the organisation and mission are regulated in the Constitution. The PA can examine all state operations but the main purpose is to contribute to an effective use of the state's resources.

The PA has a board consisting of twelve members or former members of Parliament and a staff of some 30 audit and administrative professionals. The modest size imposes a firm restriction on the scope of investigations.

The PA mainly carries out performance audits. Some 20 investigations are presented annually. The PA also pursues annual financial audits of, for example, the Central Bank, the Parliamentary Administration, the Government Offices (including the Prime Minister's Office) and the Royal Court (i.e. the Head of State). Contracted commercial audit firms carry out all the financial audits. The PA reports are submitted to Parliament.

New Structure for the External Audit

In order to strengthen the controlling powers of Parliament and also to strengthen the independence of the external audit, Parliament has decided to shut down the PA and in 2003 create a new parliamentary audit body that will also take over the majority of the tasks presently performed by the SNAO. The SNAO will subsequently be shut down.

The organisation, duties and operations of the *New Parliamentary Auditors* (NPA) will be regulated through the Constitution, the House Standing Orders, a law on the auditing of state operations and a law with the instructions for the NPA. The auditing activities shall be independent of both Parliament and the Government and of the objects for the examinations.

The NPA will be managed by three Auditor Generals appointed by Parliament for a term of seven years without possibility of re-election. There will be a board consisting of members, or former members, of Parliament that is elected by Parliament.

The NPA, that will take over the auditing mandates from the SNAO and the PA, shall carry out both annual financial audits of state bodies and performance audits. It is also instructed to audit the annual consolidated financial report that the Government submits to Parliament. Reports from the annual audit of agencies belonging to the executive branch shall be submitted to the Government. Reports from performance audits of executive operations shall be submitted to the Government and then be dealt with by the board of the NPA. All reports are to be public. The NPA shall be the Swedish SAI and represent Sweden as the national audit institution in international fora. The described reform will reduce the Government's capacity for financial control of the executive agencies. These continue to be considerations, which resources the Government needs and how they should be organised.

2.5 Canada

Basic Principles

Canada is a parliamentary democracy, operating under the Westminster structure that reflects its roots as a British Commonwealth country. There are three fundamental principles underlying any Westminster-based parliamentary system:

1. Only Parliament can grant funds to the Executive (i.e. the Government of the day)
2. All receipts of the Government must be deposited in the single Government account (the Consolidated Revenue Fund)
3. Funds may only be expended for the purposes identified when Parliament granted

All of the participants in the budget and control system operate within the context of these rules. Before going into the details of their individual responsibilities, it is useful to describe the process of budget formulation and the submission of requests for funds from the Government to the Parliament.

The Budget and Supply Processes

It is the responsibility of the Government to prepare a macroeconomic budget and forecast for the upcoming year and the medium term. This is traditionally done in February of each year, prior to the beginning of the financial year on April 1st. The Minister of Finance submits the budget to Parliament for approval. The budget vote is a confidence vote in the House of Commons, where the budget is first tabled. There is good transparency in the budget analysis and conclusions, with an accompanying economic report with detailed analyses of the economy, the fiscal forecasts, and Government spending. Extensive consultation across the Government and all sectors of the Canadian economy precedes the budget formulation by the Ministry of Finance.

Individual ministries prepare their spending plans based on advance information provided by the Ministry of Finance. These forecasts are reviewed and consolidated in Estimates of Expenditure by staff in the Treasury Board Secretariat, adjusted to fit the spending plans outlined in the budget, and submitted by the President of the Treasury Board on behalf of the Government by February 28th of each year. A Supply Bill reflecting the requests accompanies the estimates.

Estimates committees of the House of Commons review the individual ministry estimates. These committees are composed of members of all parties represented in the House, and are chaired by a member of the governing party. The respective Ministers and Government officials appear as witnesses before these committees in support of their spending plans. The committees then vote on the estimate requests and submit a report back to the House. This is then consolidated with all other committee reports on the estimate reviews for a final vote in the House of Commons. The Senate also conducts its own hearings into the budget and estimates and votes on their approval.

Although individual committees may recommend variations in funding in their reports, in practice, the estimates are not varied from the Government's requests. The consolidated vote is a confidence measure and the Government, if in a majority situation, obtains approval. Once approved by both the House of Commons and the Senate, the Supply process has been completed and the Government has authority to spend the monies approved by Parliament.

Spending and Oversight

There is a high degree of transparency in the processes of budgeting and supplying the Government with the necessary funds to support its operations. Funds are voted in logically related blocks, called votes, for a given purpose. In the past, these Votes were quite detailed, and because approval of Parliament is required to move funds between votes, the flexibility of management to respond quickly to changed circumstances was inhibited. Today, the Votes are broader and more comprehensive (i.e. Operating Funds, Capital and Grants and Contributions for say, the Department of Transport), affording greater flexibility for the Government and the public servants to manage their programs.

Each program has a set of objectives and performance measures, in keeping with the Planning, Programming and Budgeting System (PPBS) roots. Individual program spending plans are submitted to Parliament to support the Government's requests for funds. Reports on the performance of the program in the most recently completed financial year are also tabled in Parliament. Both are reviewed by the appropriate estimates committees of the House of Commons and the Senate as part of the Government's accountability to Parliament for the economic, efficient and effective use of the funds. The Public Accounts Committee, chaired by a member of the official Opposition party, also conducts an ex-post review of the Government's performance. Again, Ministers, and particularly bureaucrats, appear as witnesses before this committee to assist the committee members in their reviews. The Committee makes its recommendations in a report back to the House of Commons, where a vote of the House decides on implementation of recommendations.

The Government of Canada has for the last 23 years prepared a consolidated set of financial statements covering its operations. The Auditor General audits these external financial statements, and expresses his opinion on the fairness and accuracy of them. In the 1980s, extensive efforts by the federal and provincial Governments, their external auditors and the accounting profession in Canada led to generally accepted accounting and auditing principles for Governments. These have been adopted across the country, and external auditors use them in their audits of the financial statements and their opinions as to the fairness of the statements. A detailed set of Public Accounts for the past fiscal year are prepared and released with the summary financial statements.

Roles and Responsibilities

Parliament and the Supreme Audit Institution

Parliament is supreme when it comes to approving the Budget and the corresponding Supply Bill requesting funds for the upcoming fiscal year. If either of these are not approved, the Government is deemed to have lost the confidence of the House of Commons, and it falls. Parliamentarians are assisted in their control over the Government spending by the Auditor General of Canada.

The Auditor General is the independent external auditor, appointed for a seven-year term as an officer of Parliament. A separate legislative act establishes his role and functions. His office (the SAI) conducts attest and compliance audits, as well as performance audits to assess the value for money achieved by the Government's operations. The office issues reports four times per year, attracting much attention from the media, the general public, the Government and the opposition members in Parliament. Unlike the European Courts of Accounts, the Auditor General has no judicial powers, and informs law enforcement agencies when fraud, corruption or other criminal acts are detected.

The Public Accounts Committee reviews the audit reports, examines the spending requests for the Auditor General during the estimates review process and, in rare cases where the audit office feels that the Government has not accorded sufficient funds through the Estimates to sustain its operations,

hears its requests for additional funds. Public Accounts committee meetings, like the majority of parliamentary estimates committees, are conducted in public. Their interests cover the full range of management control issues – compliance, attest and performance of programs audited by the Auditor General – as an integral part of the accountability process of the Executive to Parliament. The Senate also reviews the auditor's report, and conducts hearings on items of interest to the senators.

The Minister of Finance

The Minister of Finance is accountable for managing the fiscal health of the Canadian economy, preparing the fiscal plan and the annual Budget. It is the Department of Finance that undertakes the macroeconomic and fiscal analysis for the budget, as well as formulating tax policy and fiscal relations with the Canadian provinces and territories, regulation of the financial institutions in Canada, managing relationships with International Financial Institutions, and the new money laundering agency. The Minister is a senior Cabinet Minister, serving at the pleasure of the Prime Minister, who performs the Treasury functions of the Government of Canada, assisted by the Receiver General of Canada, who operates the payment processes and manages the Consolidated Revenue Fund.

The President of the Treasury Board

The Treasury Board of Canada was the first committee of Cabinet, created by Order-in-Council the day after Canada was created. A senior Cabinet Minister is appointed as President. He/she is accountable for resource allocations within the structure of the budget, as well as the management aspects of running a Government – human resource, official language policies, financial policies and controls, internal audit, program evaluation, risk management and information technology. Procurement policies are part of the financial policy framework. The President could be considered as the general manager of Government. Governing acts include the Financial Administration Act, that serves as the basis for the financial management and control in Government and in state-owned enterprises owned or controlled by the Government.

The Line Ministries and Management

Individual ministers derive their powers from departmental legislation and from Government-wide acts in a variety of areas, including financial management. They in turn delegate their responsibilities to the public servants through a formal delegation process. Thus, departmental heads, called Deputy Ministers, have the authority to operate their ministries, spend funds in accordance with the instruments of delegation and their respective financial and other limits, and are accountable to their minister for the performance of the programs under their control, for compliance with the laws of Parliament and for achieving value for money for the resources utilised. Individual budget managers operate with their budgets under an ex-ante control on commitments (funds are available for a given expenditure, the proposed expenditure is consistent with the purposes of the vote from which the budget derives its monies) and ex-post before payment is made (goods or services received are as required).

Where the expenditure is above the level delegated to the budget owner, he/she must seek approval from management that has the requisite authority. In some cases, this may be the Treasury Board cabinet committee itself.

Internal controls are well established and administered by both the functional specialists and line management. There is a common set of values that pervades the public service, and the proper administration of public resources is prominent among them. This permits a risk-based management approach to internal controls and audit.

Each department has an internal audit and a program evaluation group to be used as a tool by management in discharging their program responsibilities. These units report to the department in which they operate, under the functional direction of the Treasury Board Secretariat. Internal auditors focus on attest and compliance audits, with a recent emphasis on attesting on the reliability of management representations regarding the performance of their programs. Should the auditors encounter any evidence of fraud, corruption or other illegal acts, the audit is suspended and the police are notified.

The external auditor, when appropriate during an audit, will rely on the work of the internal auditors where it is appropriate to do so. Program evaluations focus on the effectiveness of the programs in meeting their program objectives and levels of service. All audit and program evaluation reports are available to the public through access to information requests.

Addendum

The financial control system is the process that makes operational the budget, insofar as the allocation of resources to the Government is concerned. Every step in the process after supply is granted, from the departmental votes to the individual budgets of managers, and all aspects of commitment, expenditure and reporting are an integral to the internal financial controls in place. Provincial Governments operate independently of the federal Government, but all have similar control regimes in place to control their operations. Block grants and transfers are made by the federal Government to cover certain services that are the constitutional responsibilities of the Provinces; these are the subjects of extensive consultations between the Governments involved.

2.6 European Union

1. Background

The fall of the European Commission (EC) – in a sense the “Government” of the European Union - in early 1999 is primarily explained by its inability to deal with and clear out the growing accusations of mismanagement, irregularities and fraud inside the EC administration itself and in the management of EC funds transferred to the fifteen Member States. The no-confidence from the European Parliament that led to the fall of the EC, meant not only that all the Commissioners (the “ministers”) had to stand down and an appointment of a new Commission, but also to overhaul and fundamental restructuring of the entire system for financial management, control and audit. One part of the system, the external audit, has not been changed.

This paper outlines briefly some of the objectives and arguments for the new control system and explains then the role and function of some of its key elements. Most of these elements are now in place or well underway to being implemented. Intentionally, the description leaves out some elements of the new system and the description of other elements have been simplified, all with the ambition to make it easier for a reader not familiar with the daily functions and administrative practices of the EC to understand the broad lines of the new system for control.

2. What was wrong and which are the objectives of the new system?

Different analyses of the functioning of the “old” system of financial management, control and audit of the finances gave several explanations as to the failure of the system. Perhaps, the most fundamental one, is that, the old control system, being highly centralised with special institutions checking a substantial part of the financial transactions in all details and giving a sense of a “watertight” control system, had in fact created a situation of “non-responsibility” amongst the managers at all levels, who had been appointed to carry through the policies, activities or operations of the EC. In addition, the old system was unable to meet the requirements of a modern administration and its needs for rapid decision making capacity and the ability to handle millions of transactions. The system was slow and formalistic and did not answer or handle the question if the money spent gave the results the Parliament, the EC, the Member States and the European taxpayers had asked for and wanted to have.

Also, other explanations were given and the new Commission, the Council and the European Parliament decided that the new control system must be updated. The perspective of the control system must change its focus from merely taking action on individual cases of mismanagement, irregularities, corruption or fraud but should be more pro-active and make sure all parts of the prevention, detection and follow up chain functions well together and are strengthened. Some of the old control institutions were abolished and others are in the process of closing down. New control institutions are replacing them equipped with new competencies, resources and sophisticated control/investigative tools. The legal framework, on which the different parts of the control system rest, is in the process of being fundamentally renewed. It was underlined that the information exchange between the different EC institutions and between these institutions and the relevant organisations in the Member States must become more efficient.

3. The new system of financial control and audit

An overview of the new financial control and audit system is shown in Annex I. The system consists of entities and procedures for Financial Control, Internal Audit, fight against Fraud and Corruption and External Audit. The role, mandate and relations between the different components are described below. Each component of the system is given a specific number in the annex and the description refers to these numbers.

Financial Control (part of the internal control system)

The Commission has about 35 **General Directorates** (see no 1 in appendix) and they are responsible for carrying out the decisions taken by the Commission and delegated to them. (If the Commission is seen as the “Government” the Directorates may be seen as the ministries of this Government). A Director General heads a Directorate.

The Commission bears the overall responsibility for internal control. A key building block for the internal control within the Commission, is the Authorising Officer, who, as a rule, is the Director General or the head of a service. The authorising officer is delegated powers by the Commission. A Director General’s responsibilities as an authorising officer covers the entire management process, starting from the proposing of the objectives to be decided upon by the College of Commissioners to the delivery of results. This includes the ultimate responsibility ensuring the legality, regularity and effectiveness of all the financial decisions he/she takes. A Director General may delegate powers to other officials inside the Directorate as appropriate. In these cases, the Director General will still have the utmost responsibility and also remain responsible for the financial management and control system as a whole.

It is an obligation for every Director General to establish effective internal control systems appropriate to their circumstances and complying with the Commissions obligatory minimum standards defined by the “Central Financial Service” (see 2). Each directorate will have to set out in writing its financial management and control systems. This document must be accessible to all staff and kept up to date.

A Directorate is in the new system responsible for all its financial operations and for establishing the necessary controls for making sure these operations are both effective and regular. Specialised financial units (resource units) in the Directorate will define the internal rules and procedures, which have to be followed on the basis of Commission wide standards, set by entities, which are independent of and external to the Directorate. Depending on the model chosen for a Directorate the financial units will either only give advice or, also, control all commitments and transactions including giving financial assessments. It is also possible to chose a solution where the financial unit gives ex-ante visas in order for a commitment or payment order to be valid and possible to be executed. The financial controller may be obliged to refund eventual money lost because of mismanagement, gross negligence, irregular treatment or fraud.

Each Directorate has to have a specialised “audit capability” (see 3) reporting directly to the Director General. This audit capability should among other things carry out reviews of the internal control system of the Directorate.

Each Directorate must also regularly carry out reviews of the management and use of EC funds committed to external beneficiaries (companies, NGO's and others). Such reviews may have a wide scope although they concern entities in the private sphere but the possible scope must be based on law and clearly laid out in the contractual arrangements between the EC, the relevant authorities in the Member States and the respective entity. The European Anti Fraud Office or the competent national authorities may investigate on the spot suspicion of irregular or fraudulent use of such funds.

To support the overall responsibility for internal control, which rests upon the Commission, a method has been put in place to provide information to the Commission on the status on internal control within all its services. Therefore, each Director General has yearly to deliver, starting with the financial year 2001, an Annual Activity Report including the annual accounts of the Directorate. This report should also include a Declaration by the Director General expressing to what extent adequate internal controls have been in place during the year. By signing the Annual report, the Director General declares his/her responsibility that the information in the report gives a true view of the situation in the Directorate. The signature is also a confirmation that the resources were used as intended and that the internal control procedures in place gave adequate assurance as to the legality and regularity of the underlying operations whether financial or non-financial.

The standards for all aspects of financial management to be applied by the respective Directorates are proposed by the **Directorate for Budget** (the "Ministry of Finance") (see no 2) and decided by the Commission. Two functions in this Directorate should be mentioned as they have an important impact on the control environment.

The "**Accountant**" sets the standards for accounting to be applied by all EC entities and activities. All payments are centralised to this function, which also must be consulted before a Directorate decides to implement any auxiliary system (a system feeding the accounting system with essential data). All Directorates have to use the central accounting system either directly or by using an interface to am/or from the auxiliary systems. The Accountant function consolidates the accounts and is responsible for all legal reporting on finances.

The "**Central Financial Service**" assist the Directorates in their financial management and control activities by a) defining rules and manuals, issuing instructions in the field of budgetary and financial management b) provide advice and assistance to the Directorates, promote experience sharing and best practices in order to improve budgetary and financial management c) disseminate information and know-how and train all the actors in the financial processes and d) shall deliver efficient tools to be used in financial management and control in all parts of the EC including giving advice on the use of the central accounting system. This Service takes care of the definition of the common minimum standards for internal control, rules and manuals on procurement spending, grants, setting up of databases which will contain information on all contracts, financial agreements, contractors, beneficiaries and the state of implementation of the individual contracts.

Internal Audit (part of the Internal Control System)

An "**Audit Capability**" (see no 3) is set up within each Directorate to assist the Director General to make sure the internal controls are in place and functions well, and to enable him/her to sign the above mentioned Declaration. The primary objective of the Audit Capability is to provide assurance to the Director General as to the adequacy and reliability of internal controls over the activities of the Directorate. The Audit Capability must operate in accordance with internationally accepted professional standards for internal audit. The Head of the Audit Capability reports directly to the Director General and the audits done will cover all systems of control established by the Director General and applied to all activities of the Directorate, not just the controls over financial accounting

and reporting, but all operational and management controls. The Audit Capability must be independent of the activities it reviews and therefore has no executive responsibility. It has access to people, systems, documents and property inside the Directorate, as it considers necessary for the proper fulfilment of its responsibilities. The modus operandi for each Audit Capability is laid down in an Audit Charter.

The “**Internal Audit Service**” (the IAS) (see no 4) is the supervisor of the quality, independence and effectiveness of the Audit Capabilities. It provides general audit guidance to them and co-ordinates training in internal audit. The IAS reports directly to the Commission and is independent from all other Services of the Commission. The independence and work-practices are confirmed in a so-called Internal Audit Charter.

The IAS has to operate in accordance with internationally accepted professional standards for internal audit. Its mission within the EC is to assist management in controlling risks and monitoring compliance with relevant decisions and regulations. It fulfils its mission by providing independent opinions on the quality of management and control systems, and making recommendations in order to improve the economy, efficiency and effectiveness of operations. The IAS audit scope is all EC activities, notably the independent appraisal of the adequacy and quality of the Commission’s internal control systems as well as the examination of the adequacy and effectiveness of systems and operations. The IAS should also follow the audit trail and may investigate operations on the ground when necessary.

The Head of the IAS must immediately report to the Head of the European Anti Fraud Office (see 6) any evidence which gives rise to presumption of the existence of cases of irregularity, fraud, corruption or any other illegal activity. The IAS forward copies of all its reports to the European Court of Auditors (see 7).

The “**Audit Progress Committee**” (see no 5) has been established within the Commission. It is an advisory body for the Commission. Its primary function is to ensure the independence of the Internal Audit Service. It has also a function to help to make sure the results and recommendations of the internal and external audit activities, formally accepted by the Commission, are implemented. This Committee is also monitoring the quality of audit work inside the EC.

4. Fight against Fraud and Corruption

The objective of the “**European Anti Fraud Office**” (OLAF) (see no 6) is to protect the financial and other interests of the EC against fraud and irregular conduct liable to result in administrative or criminal proceedings. OLAF is an administrative body doing administrative investigations why it does not have all the powers that usually rests with the police or other investigation bodies. OLAF replaced an earlier strictly internal anti fraud and corruption organisation. The motive behind the creation of OLAF as a part of the new control system was a growing awareness of the impact of fraudulent activity on the interest of the EC, particularly with regard to the growth of organised crime syndicates in the context of increasing globalisation. It was clear for the creators of OLAF that in order to be truly effective OLAF would need to be seen to be legitimate, with safeguards protecting the rights of the individuals concerned, and that investigations would have to be conducted objectively, on the basis of independence and impartiality. Thus OLAF was created with three principles in mind: effectiveness and transparency in all its operations and complete independence from the political and administrative systems in its investigations.

OLAF is competent to fight against fraud, corruption and any other illegal activity affecting the financial interests of the EC. This includes the budget, budgets administered by or on the behalf of the EC and certain funds that are not part of the budget. The Office has also to combat any infringement of a provision of EC law resulting from an act of omission, which has or would have an effect on the EC budgets either by reducing or losing revenues or by an unjustified item of expenditure or by affecting the value of assets.

But the responsibility of the Office extends beyond the protection of financial interests to include all activities relating to safeguarding EC interests against irregular conduct liable to result in administrative or criminal proceedings. The office therefore participates in the protection against money laundering, counterfeiting, and forging of the Euro etc.

OLAF undertakes four categories of casework. Internal investigations are cases related to the irregular conduct of individuals working within the European Institutions, bodies, offices or agencies. External investigations are cases relating to irregular conduct of individuals working outside the European Institutions etc. and where OLAF is providing the majority of the investigative input. Co-ordination cases are cases of the same type as the external ones but where OLAF is acting purely in a co-ordination role in relation to other investigation bodies of the European Union. Criminal Assistance cases are cases where OLAF either is asked by national authorities to assist them in conducting criminal investigations, or where OLAF asks the authorities to open criminal cases.

In order to fulfil its role as an autonomous impartial organisation, free from outside interference, the legislative basis of OLAF enshrines the principle of independence. The Office is a part of the Commission even though it exercises its operational powers in full independence. The Head of OLAF has a responsibility to neither seek nor take instructions from the Commission, any Government or any other institution or body. Should the Head of the Office feel that a measure taken by the Commission calls his independence into question then he is entitled to bring an action before the Court of Justice. The office also has budgetary independence and the freedom to appoint staff within the frame of some general rules.

A Supervisory Committee consisting of five persons elected for three years monitors on a regular basis the investigative role of the Office. This committee is of crucial importance in reinforcing the independence of the Office in relation to any Government, institution, body or agency.

The Director General of OLAF reports regularly and at the same time to the European Parliament, the Council, the Commission and the Court of Auditors on the findings of investigations (casework) carried out by the Office. These reports must respect the confidentiality of those investigations, the legitimate rights of the persons concerned and, when appropriate, legal provisions in the Member States applicable to judicial proceedings. At the request of the special control committee in the European Parliament the Director of OLAF may attend meetings of the committee to give oral progress reports on specific cases. These reports are given in private.

Reports from the internal Audit Capabilities and the Internal Audit Service are regularly sent to OLAF. Presumption of the existence of irregularity, fraud corruption or any other illegal activity must immediately be reported to OLAF from all entities in the EC. The European Court of Auditors (see 7) forwards to the Office certain types of information on its own initiative. OLAF on the other hand has a duty to give a feedback to the Court about every case involving information addressed by the Court. OLAF operates a free-phone service open in every Member State via which individual citizens may give indications to the Office on suspected fraud or irregularities detrimental to the financial interest of the European Union.

OLAF is subject to the control of the European Court of Auditors (see 7) in the same way as any other Commission service. The actions of OLAF can be subject to the control of the Court of Justice as any natural or legal person may for the purpose of protecting their prerogatives, institute proceedings against a decision addressed to or of individual concern to the person. The Office is also subject to the powers of the European Ombudsman.

5. External Audit

The “**European Court of Auditors**” (ECA) (see no 7) is the external auditor of the EC and all other institutions within the Community. The ECA examines all revenue and expenditure to determine whether all revenue has been received and expenditure incurred in a lawful and regular manner, and whether financial management has been sound. The ECA’s audit covers not only the use of resources for the administration of the Commission and its Directorates but as well all use of EC funds by national and local administrations in Member States and any other recipient of funds in both the public and private sector. The Court has a right of access to all bodies that has received funding from the EC irrespective of their legal status.

The main products of ECA’s audit work are the Statement of Assurance and special audit reports and so called sector letters on the revenue and expenditure programmes of the EC. In beginning of May each year (will be changed to end March) the Commission is required to present to the Parliament, Council and the ECA accounts of revenue and expenditure, assets and liabilities, to show how the budget for the previous year was implemented. These accounts form the basis for the ECA’s audit work for the Statement of Assurance. This together with other special audit work on the revenue and expenditure programmes of the EC is brought together in the Annual Report published by the Court in November the same year.

The Annual Report and Statement of Assurance coming from ECA are the starting points for the discharge procedure that completes the cycle of accountability for all EC funds. In essence this requires the Parliament and the Council to give their opinion on the EC’s stewardship of the funds, and then for the Parliament to decide by the end of the following April on a recommendation by the Council, whether formally to discharge the Commission from any further responsibility for the Budget. The granting of discharge indicates acceptance that the Commission’s stewardship of the resources has been sound, expenditure lawful and regular, financial management effective, and appropriations utilised in accordance with objectives set when the Budget was adopted. The Parliament takes also a specific decision about the “closure of the accounts”.

6. Summing up of some basic principles of the new system

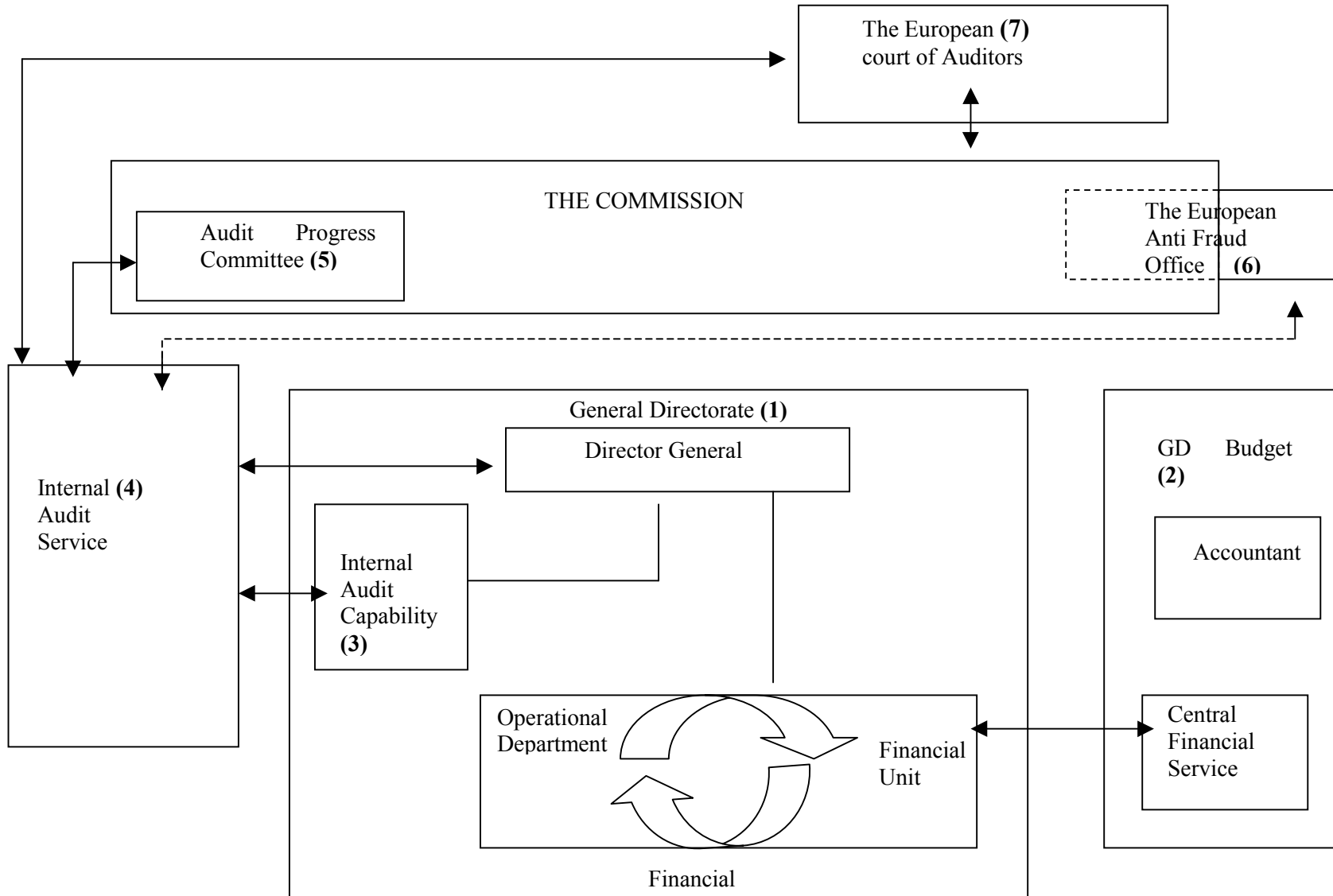
The new system for financial management and control which is now under implementation;

- Gives the line managers a clear individual responsibility for all aspects of their operations including the ultimate financial responsibility.
- Gives more emphasis on output and result compared to the earlier focus on control of the input factors.
- Acknowledge the need for a systematic approach to financial control covering as well actions to strengthen prevention and detection as the administrative, economic and legal follow up of money lost by mismanagement, irregularities and fraud.
- Is based on a new legal framework and consists of new institutions and departments with more clear and broader mandates and establishes new procedures and standards to be followed in the daily operations and in the control activities.

- Is based on and follows internationally accepted standards for accounting, internal and external audit.
- Supports the building up of good internal control procedures and standards by investing in training and advice.
- Makes a clear distinction between the responsibilities of controllers and auditors in so far as audit is primarily checking if the needed internal control systems are in place and are effective. All controlling activities are subject to audit.
- Internal control and the different audit activities are based on risk assessments and different other methods for selection of what should be subject to control.
- Makes sure the audit entities and their auditors are highly independent, has a legal position that makes it possible to resist undue pressure and are not involved to any extent in the daily operations.
- Focus the audit activities not only on the financial or regularity aspects of the operations but also on their economy, efficiency and effectiveness aspects
- Has a specialised institution with certain investigative powers that independently deals with suspected irregularities, corruption and fraud and reports its findings to institutions for disciplinary procedures or to courts.
- Gives the basic information for the yearly discharge procedure of the Commission, which completes the cycle of accountability for EC funds.

Attachment

Over view of control and audit structures in the Commission



ANNEX 3 GLOSSARY

Accountability a Government policy or management concept that means (i) politicians and public officials have to respond periodically to questions concerning their activities (answerability) and (ii) must be held responsible for the exercise of the authority provided to them. For effective accountability, clear lines of responsibility must be firmly established and consistently maintained. Accountability measures should address three questions: accountability by whom; accountability for what; and accountability to whom. To ensure that accountability is properly enforced, there is a need for predictable and meaningful consequences related to performance. In the public sector, accountability of individual officials, within their organisation and to external controlling bodies, is applied most often to how money has been spent and what results have been achieved. Crucial too in democratic systems is the general accountability of ministers to parliament and to the public at large.

Accounting the theory and systems of organising and summarising information about financial and economic activities. Good accounting systems are essential for budget management, financial accountability and efficient decision-making. See also accounting basis and accounting system.

Accounting basis defined in IFAC (2000) as “the body of accounting principles that determine when the effects of transactions or events should be recognised for financial reporting purposes. It relates to the timing of the measurements made, regardless of the nature of the measurement.” There are many variations of the basis of accounting. IFAC identifies two basic reference points (cash and accrual) and two variations (modified cash and modified accrual) in the spectrum of accounting bases. Cash-based accounting systems recognise transactions and events when cash is received or paid. Accrual-based systems recognise transactions or events at the time economic value is created, transformed, exchanged, transferred, or extinguished and when all economic flows (not just cash) are recorded. Certain modifications of the cash basis recognise receipts and disbursements committed in the budget year and allow a specified period after year-end for payments of these to be recorded and reported (the so-called “complementary period”). Under certain modifications of the accrual-based methods, physical assets are expensed at the time of purchase.

Accounting controls procedures and documentation concerned with safeguarding of assets, the conduct and recording of financial transactions and the reliability of financial records. They are frequently based on standards issued by the ministry of finance or the supreme audit institution to ensure comparability of accounting practices across all ministries and conformity with national and/or international conventions.

Accounting system the set of accounting procedures, internal mechanisms of control, books of account, and plan and chart of accounts that are used for administering, recording, and reporting on financial transactions. Systems should embody double entry bookkeeping, record all stages of the payments and receipts process needed to recognise accounting transactions, integrate asset and liability accounts with operating accounts, and maintain records in a form that can be audited.

Accrual budgeting this term can be interpreted in two ways: (i) budgetary documents that include in addition to cash-based appropriations accrual accounting information; or (ii) budgetary appropriations based on accrual accounting information, e.g. including provision for depreciation. In the United Kingdom, accrual accounting/budgeting is referred to as resource accounting/budgeting.

Acquis communautaire comprises the entire body of European Community legislation that has accumulated, and been revised, over the last 40 years. It includes the founding Treaty of Rome as revised by the Single Act and the Treaty of Maastricht and Treaty of Amsterdam; all the regulations and directives passed by the Council of Ministers; and the judgements of the European Court of Justice.

Administrative controls non-financial procedures and records of ministries, which ensure compliance with rules on:

- appointment, promotion, pay, and disciplining of personnel;
- public procurement (bids, tenders, contract management, etc.);
- equal opportunities for minority groups;
- the handling of information flows;
- travel and entertainment allowances, etc.

Allocate efficiency refers to the capacity of the Government to allocate resources and select programmes and projects in conformity with its objectives. In economic theory, allocative efficiency, also called “Pareto efficiency”, occurs when resources are allocated in such a way that any change in the amounts or type of outputs currently produced would make someone worse off.

Appraisal examination of the details of a policy proposal or capital investment project on the basis of an analysis of its economic, financial and other effects. Policy/project appraisal is sometimes called ex ante evaluation.

Appropriation refers to an authority granted under a law by the legislature to the executive to spend public funds, up to a set limit, for a specified purpose. Annual appropriations are made through annual budget laws or, in some countries, separate appropriation acts consistent with the budget. Supplementary budgets/appropriations are sometimes granted subsequent to the annual law if the annual appropriation is insufficient to meet the specified purpose. The term “standing appropriation” is sometimes used to define an authority extending beyond a single budget year under separate legislation (such as social security legislation). In most countries, agencies and departments require specific executive authorisation (“apportionment, allotment, or warrant”) to actually incur an obligation against an appropriation.

Audit expert examination of legal and financial compliance or performance carried out to satisfy the requirements of management (internal audit), or an external audit entity, or any other independent auditor, to meet statutory obligations (external audit). A particular task of internal audit is to monitor management control systems and report to senior management on weaknesses and recommend improvements. The scope of audits varies widely, as does the terminology in this area, and includes (according to the auditing standards prepared by the International Organisation of Supreme Audit Institutions (INTOSAI):

1) Financial audit (regularity audit) comprising:

- Attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions of financial statements.
- Attestation of financial accountability of the Government administration as a whole.

- Audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations.
- Audit of internal control and internal audit functions.
- Audit of the probity and propriety of administrative decisions taken within the audited entity.
- Reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed.

Note that the first two items above are commonly known as attestation audit. The third and fifth items are commonly known as compliance audit.

2) Performance audit (value for money audit) comprising:

- Audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies.
- Audit of the efficiency of utilisation of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements, and procedures followed by audited entities for remedying identified deficiencies.
- Audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity, and audit of the actual impact of activities compared with the intended impact.

Audit finding Pertinent statements of fact. Audit findings emerge by a process of comparing “what should be” with “what is”.

Audit risk the risk that the procedures carried out by the auditor will not detect matters, which, if known, would require the auditor’s report to be altered.

Audit sampling audit procedures carried out on a sample of an underlying population relevant to the audit work being carried out, rather than the whole of that population.

Balance sheet a financial statement showing the values of the stocks of assets and liabilities held by an entity at a particular point in time. A balance sheet is typically compiled at the beginning and end of an accounting period. Balance sheets summarising starting balances, incomes and outflows, and ending balances are generally required for each distinct fund within a Government’s accounting structure. However, in practice, very few Governments prepare statements of their financial position that can genuinely be described as comprehensive balance sheets covering all assets and liabilities. See also net worth

Baseline budget the amount of funding for current programmes or existing policies — often adjusted for inflation, one-time expenditures, legally mandated requirements under changed demographic conditions — from which increases and decreases in expenditures are negotiated during budget preparation. In a narrow and cautious definition, this baseline budget includes the costs of the current level of activity, that is the costs of ongoing programmes adjusted for inflation services, legally mandated requirements, one-time expenditures, and the impact on a full year basis of decisions made the current year. In addition, account can be taken of the current level of services and, therefore, the baseline budget can also include changes in clients served in various programmes (e.g. school children, etc.).

Benchmarking methods and procedures for comparing one organisation with another as a means of improving performance. Process benchmarking is the study and comparisons of the processes and activities that turn inputs into outputs. Results benchmarking compares actual performance of organisations using performance indicators or measures.

Budget Document(s) that include the plan of the future financial activities of the Government or a Governmental organisation. The budget is generally prepared annually, and comprises a statement of the Government's proposed expenditures, revenues, borrowing and other financial transactions in the following year and, in many countries, for two or three further years. The budget is prepared on a cash basis in most countries. It is submitted to parliament, which authorises expenditure by approving either a budget act or an appropriation act that is consistent with the budget proposals.

Budget examination The process of reviewing budget requests from ministries and agencies by a staff member of a central budget department in the ministry of finance, in which the budget request is analysed, alternatives are developed, conclusions are reached, and recommendations are made.

Budget formulation The steps and processes for preparing a Government's budget, from preliminary analyses and forecasts, through submission of budget requests by ministries and other Government bodies and the review and decision of the executive, to its official presentation to the legislature.

Central agencies those organisations in the executive branch that co-ordinate the activities of, and provide policy direction and operational guidance to the line ministries and agencies. Practice varies widely from country to country, but "central agencies" generally include: the ministry of finance; the office that reports directly to the prime minister or the council of ministers in the development and co-ordination of policy; the ministry or agency responsible for developing and co-ordinating policies in relation to human resource management within the public sector; the ministry of foreign affairs, in certain areas of work such as international co-operation; and the ministry of justice, in relation to work on legal norms and law drafting.

Central Government All units of Government that exercise authority over the entire economic territory of a country. In general, the central Government is responsible for those functions that affect the country as a whole: for example, national defence, conduct of relations with other countries and international organisations, establishment of legislative, executive and judicial functions that cover the entire country, and delivery of public services such as healthcare and education. Non-market, non-profit institutions controlled and mainly financed by the central Government are included in the central Government. See also general Government, local Government, state Government and subnational Government.

Centre of Government the centre of Government encompasses the body or group of bodies that provide direct support and advice to the head of Government and the council of ministers, or cabinet.

Chart of accounts the classification of transactions and events (payments, revenues, depreciation, losses, etc.) according to their economic, legal, or accounting nature. It defines the organisation of the ledgers kept by Government accountants.

Commitment In accounting terms, a commitment refers to a stage in the expenditure process at which a contract or other form of legally binding agreement is entered into, generally for future delivery of goods or services. A liability will not be recognised until delivery of the item, but the Government is contractually committed to meeting the obligation once delivery is made. In some budget systems, the term commitment refers to a stage in the expenditure cycle different from the commitment stage in its accounting sense (e.g. reservation of appropriations or the verification stage). The term commitment is also used in a more general, non-contractual sense to mean a firm promise of the Government made in policy statements.

Consolidation the process of eliminating transactions between different ministries/agencies/units of Government and combining in a common set of categories the sum of their “external” transactions to and from the rest of the economy.

Corporate governance The rules and procedures to ensure that a company is properly and efficiently managed, including that directors and staff behave appropriately and in accordance with law and best practice.

Corruption There are many different definitions of this concept. The simplest, and broadest, is “the misuse of public or private position for direct or indirect personal gain”.

Cost-effectiveness analysis A type of analysis that compares projects or programmes having broadly common outcomes or outputs. Used to compare alternatives for which major outputs can be identified but not valued. Cost-effectiveness indicators include the cost per unit of output, or units of output per unit of costs, and is aimed at identifying the least costly method of achieving a particular good or objective. See also least-cost analysis.

Decentralisation The transfer of responsibility to democratically independent lower levels of Government, thereby giving them more managerial discretion, but not necessarily more financial independence.

Effectiveness The extent to which programmes achieve their expected objectives, or “outcomes”. Effectiveness is the most important element of value for money in the public sector. Goods or services may be provided economically and efficiently but, if they do not achieve their intended objectives, the resources used will be largely wasted.

Efficiency The relationship between the goods and services produced by a programme or an activity (outputs) and the resources used to produce them (inputs). Efficiency is measured by the cost per unit of output.

Evaluation Programme evaluation is an in-depth examination of the economic, financial, social, etc. effects of a programme or policy initiative. Summative evaluations are carried out when the programme has been in place for some time (ex post evaluation) to study its effectiveness and judge its overall value. Formative evaluations are usually undertaken during the implementation of the programme (intermediate evaluation) in order to improve its effectiveness.

Ex ante control (a priori audit) Prior authorisation of a specific expenditure. Payment orders and supporting documentation received are checked to verify that the transaction is properly authorised, is legal and regular, and that there are sufficient provisions in the budget. Such inspections may be carried out by central authority of the ministry of finance or by line ministries/agencies.

External audit Refers to audit carried out by a body that is external to, and independent of, the organisation being audited, the purpose being to give an opinion and report on the organisation’s accounts and financial statements, the legality and regularity of its operations, and its financial management procedures and financial performance. Organisations responsible for external audit of Government activities most often report directly to parliament, and are often referred to as supreme audit institutions (SAI).

Financial control Aspects of internal (or management) control that relate to financial issues and performance. See also internal (management) control

Financial reporting the communication of financial information by an entity (e.g. the Government, a line ministry) to interested parties (e.g. parliament, the ministry of finance). It encompasses all reports that contain financial information based on data generally found in the financial accounting and reporting system.

Financial statements The accounting statements prepared by a reporting entity to communicate information about its financial performance and position. An accrual accounting system commonly entails the preparation of a Financial Position Statement, or Balance Sheet, which shows the total assets, liabilities and the net worth; a Financial Performance Statement, or Operating Statement, which shows the revenues and expenses of the period; and a Statement of Changes of Net Worth, which explains movements in the opening and closing balances. These accrual-based statements are supplemented with a Statement of Cash Flows. They include those notes and schedules that are needed in order to clarify or further explain items in the statements. Similarly, the analytical framework in GFS 2000 includes the following tables: Government Operations, which is a summary of the transactions of the general Government in a given accounting period; Statement of Other Economic Flows, which tabulates influences, other than transactions, on the Government's financial position; and a Balance Sheet and Statement of Sources and Uses of Cash.

Fraud The severest form of an irregularity. In respect of expenditure, it includes any intentional act or omission relating to:

- The use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the misappropriation or wrongful retention of funds.
- Non-disclosure of information in violation of a specific obligation, with the same effect.
- The application of funds for purposes other than those for which they were originally granted, with the same effect.
- In respect of revenue, fraud includes any intentional act or omission relating to:
- The use or presentation of false, incorrect or incomplete statements or documents, which has as its effect the illegal diminution of the resources of the budget.
- Non-disclosure of information in violation of a specific obligation, with the same effect.
- Misapplication of a legally obtained benefit, with the same effect.

General Government According to the System of National Accounts, "general Government" is the grouping of Government units at different levels: central, state (in federalist countries), local authorities and social security funds. Government units are units that, in addition to fulfilling their political responsibilities and their role in economic regulation, produce principally public services for individual or collective consumption and redistribute income and wealth. A defining characteristic of Government units is the ability to impose, directly or indirectly, taxes and other compulsory levies for which there is no direct quid pro quo on other sectors of the economy. See also central Government, local Government, state Government, subnational Government.

Goals and objectives Both terms are used to describe the desired, measurable results to be achieved from Government programmes or activities. "Goals" (or "general objectives") typically refer to broad results which may take a number of years to achieve and often involved many people, activities, processes, and intermediate achievements. "Objectives" (or "specific objectives") tend to refer to more specific results, often precisely measured (time, cost, number, quality), which can usually be accomplished in a shorter time period, and are often an intermediate step in achieving a broader goal.

Governance Governance is the exercise of political powers to manage a nation's affairs. Sound governance invokes as essential elements political accountability; freedom of association and

participation; reliable and equitable legal frameworks; transparency; and effective and efficient public sector management.

Government financial management information systems

The information systems that assist ministries/agencies manage their programmes efficiently and effectively, and in accordance with the law. At the core of these systems are the procedures for accounting and reporting that keep the ledger into which all inflows and outflows of funds are recorded. Under an integrated approach, other information systems must be seen as supportive of these core accounting systems by adhering to their data exchange standards. Management information systems form a key element of management controls, and must themselves be efficient and cost-effective. See also general ledger system.

Internal audit Refers to audit carried out by a department or unit within a ministry or another Government organisation, entrusted by its management with carrying out checks and assessing the organisation's systems and procedures in order to minimise the likelihood of errors, fraud and inefficient practices. Internal audit units must be functionally independent within the organisation they audit and report directly to the organisation's management. The primary role of an internal audit function is to provide reasonable assurance to executive management and the board about the adequacy and effectiveness of the risk management control framework in operation. This assurance should ideally be provided in the form of written opinion. The secondary role of an internal audit function is to strive relentlessly to strengthen and improve the risk management and control framework through the promulgation of best practice. As such, an effective internal audit function acts as a change advocate.

Internal (management) control Defined as "the organisation, policies and procedures used to help ensure that Government programmes achieve their intended results; that the resources used to deliver these programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision-making" (INTOSAI). In practice, internal control systems embrace a wide range of specific procedures, including, for example, controls on accounting, processes, procurement, separation of duties and financial reporting. Internal control systems require effective communications within an organisation and need to be supported by sound internal audit procedures. It is the responsibility of an organisation's management to establish and monitor internal control systems, not that of the external auditor. However, an external auditor should comment on the absence or adequacy of such systems since a consequence of good internal controls is that less detailed auditing of individual documents and transactions will be necessary. See also accounting controls, administrative controls and financial control.

Legitimacy Legitimacy means that decision-makers who can change policies during implementation must take part in and agree to the original policy decision, whether it is made during the process of formulating the budget or at some other time.

Outcomes Economic or social changes brought about by a policy measure, programme or activity. Outcomes are distinct from outputs, which measure the immediate effects of a programme or activity. For example, the outcome of a random breath-testing campaign conducted by the police may be a decline in drunk driving, while one of the outputs could be the number of drivers charged with exceeding the legal alcohol limit. Programmes usually have two types of outcomes: (i) End outcomes that reflect the desired end or ultimate results that the programme or activity aims to achieve;

(ii) Intermediate outcomes that are expected to lead to the ends desired, but are not themselves ends. See also impact, outputs, performance indicators and performance measurement.

Outputs The products and services produced directly by a programme or activity. Outputs are important e.g. in setting targets for staff to achieve and measuring performance, but do not in themselves indicate the extent to which progress has occurred toward achieving a programme's ultimate purpose. Depending on their nature, outputs may or may not be easy to measure, e.g. the number of hospital cases is easier to measure than the quality of advice on a policy issue submitted by a health official to the minister concerned.

Performance budgeting Performance budgeting consists of classifying Government transactions into functions and programmes in relation to the Government's policy goals and objectives; establishing performance indicators for each programme or activity; and measuring the costs of these activities and the outputs delivered. The terms "performance budgeting" and "programme budgeting" are often used interchangeably, but programme budgeting can also be defined as a form of performance budgeting giving greater emphasis to the classification of programmes according to the Government's policy objectives and the needs of efficient resource allocation. A full system of performance budgeting is difficult to realise, in large part because of the high information requirements and complex management systems that are needed. See also planning programming budgeting system (PPBS).

Performance indicators Performance can be monitored and assessed through measures or indicators. Measures correspond to direct records of inputs, outputs and outcomes (e.g. the number of police patrols carried out in a given period is an output measure). Indicators are used as a proxy when direct measures are difficult or costly to obtain (e.g. the "street" price of illegal drugs is an indicator of the outcome of an anti-drug programme). In practice, however, the terms "measures" and "indicators" are often used interchangeably. "Performance indicators" may be used to evaluate inputs, processes, outputs and outcomes. See also performance measurement.

Performance measurement Assessment of the efficiency and effectiveness of a programme or the activities of an organisation by measuring the relevant inputs, processes, outputs and outcomes. "Performance measures" or "performance indicators" may be used for this purpose.

Planning programming

budgeting system (PPBS) A systemic programme budgeting approach that was developed in the US in 1965, and later in many other countries. The PPBS processes consist essentially of three phases: 1) In the planning phase, systems analysis is used to establish the objectives of the programme and identify related solutions. 2) At the programming stage, means are reviewed and compared to the solutions identified at the planning stage. Sets of activities are grouped into multi-year programmes, which are appraised and compared. Cost-benefit and cost-effectiveness analyses are used to compare the various programmes and activities as competing means of achieving a given objective. 3) In the budgeting phase, these programmes are translated into the annual budget. After years of efforts and discouraging results, the PPBS was largely abandoned by the countries that have experimented with it, though elements of the system can still be found (e.g. in performance budgeting systems). See also performance budgeting.

Public expenditure management the term can be broken down into its parts. Public expenditure is generally understood to mean expenditure by: general Government, central Government through the national budget and other budgetary instruments, and local Government. Public expenditure in this book does not include the activities of public enterprises, which are essentially commercial enterprises, and financial institutions owned by the state. The

management of public expenditure covers: the preparation, management, and execution of the budget. Budget execution includes ex ante control, ex post control, internal and external audit, and evaluation, with various types of reporting at each stage.

Risk analysis/assessment A systematic process for assessing and integrating judgements about possible adverse conditions and/or events, as a basis for the appropriate budgetary treatment of those conditions or events. Examples include the risk of war, bank failures, floods and other natural disasters, epidemics of virulent disease, etc. See also contingent liability.

Subsidy According to the GFS and the SNA, the term “subsidy” is narrowly defined as current, unrequited transfers that the Government makes to enterprises either on the basis of the levels of their production activities or on the basis of the quantities or values of the goods and services that they produce. More broadly, the term “subsidy is also often used to in the sense of payments or tax credits to individuals on the basis of their personal circumstances, according to criteria laid down in law or regulations (e.g. if they are unemployed or disabled).

Supreme audit institution (SAI) A public organisation, normally independent of Government and accountable to the legislature, that is responsible for auditing the Government’s financial operations. The SAI may carry out different types of audit activity: financial, compliance and regularity, and performance audits. See also audit.

Verification (certification) Once a bill for goods or services has been received, the relevant line ministry/agency must confirm that the bill is correct and that the goods or services have in fact been received. At this point, the bill becomes a liability of the public sector. In accrual accounting terms, an expenditure is recognised even though the bill has not yet been paid.

NOTE

1. Main sources for this glossary are: Everard, Patrick and Diane Wolter (1989), Glossary: Selection of Terms and Expressions Used in the External Audit of the Public Sector. Luxembourg: Court of Auditors of the European Communities; IFAC (2000), Governmental Financial Reporting. Accounting Issues and Practices. Study 11. New York; IMF (2000), A Manual on Government Finance Statistics. Washington DC; SIGMA (1997), SIGMA Paper No. 19: Effects of European Union Accession: Part 1. Budgeting and Financial Control, OECD/GD(97)163, Paris: OECD; EC, IMF, OECD, UN, and the World Bank (1993), System of National Accounts, Brussels, Luxembourg, Paris, New York, Washington DC; World Bank (1998), Public Expenditure Management Handbook, Washington DC.