

INTERNAL CONTROL SYSTEMS IN CANDIDATE COUNTRIES

VOLUME I

REPORT TO SUPREME AUDIT INSTITUTIONS
OF CENTRAL AND EASTERN EUROPEAN COUNTRIES, CYPRUS, MALTA, TURKEY AND
EUROPEAN COURT OF AUDITORS

Prepared by the PIFC Expert Group
- Working Group on Audit Manuals -

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LIST OF ABBREVIATIONS

| | |
|-----------------|---|
| CC | Candidate Countries ² |
| CCA | Canadian Institute of Chartered Accountants |
| CEEC | Central and Eastern European Countries |
| CHU | Central Harmonisation Unit |
| COSO | The US Committee of Sponsoring Organizations |
| EA | external audit |
| EC | European Commission |
| ECA | European Court of Auditors |
| EU | European Union |
| EU Funds | European Union Funds (SAPARD, ISPA, PHARE, CARDS, other) |
| EUIG | European Union Implementing Guidelines (for INTOSAI Auditing Standards) |
| EUROSAI | European Organization of Supreme Audit Institutions |
| FCD | Financial Control Department |
| IA | internal audit |
| IAS | Internal Auditing Standards |
| IAU | Internal Auditing Unit |
| IC | internal control |
| ICS | Internal Control System |
| IIA | Institute of Internal Auditors |
| INTOSAI | International Organization of Supreme Audit Institutions |
| ISPA | Instrument for Structural Policies for Pre-Accession |
| IT | information technology |
| MF | Ministry of Finance |
| PHARE | Poland and Hungary Assistance to the Reconstruction of the Economy (European Commission) |
| PIFC | Public Internal Financial Control |
| SAI | Supreme Audit Institution |
| SAPARD | Special Accession Programme for Agriculture and Rural Development |
| SCC | Supreme Chamber of Control |
| SIGMA | Support for Improvement in Governance and Management in Central and Eastern European Countries (European Union and OECD) |
| VAT | value added tax |

² Term "Candidate Countries" used in this Report conotates acceding, remaining and future candidates for EU accession: Albania, Bulgaria, Croatia, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovak Republic, Slovenia, and Turkey.

SUMMARY

Purpose of this Report is to provide an effective overview of the state of development in introducing internal control systems in candidate countries, promote the exchange of knowledge and experiences among SAIs and initiate discussions on further developments in the area concerned.

Chapter 1: describes background and objectives of the Group, provides key definitions, and describes methodologies used in its research and order of its activities in preparation of this Report.

Chapter 2: describes in short the main challenges of introducing modern controls in candidate countries, consistent with international and European criteria and best practices.

Chapter 3: Based on description of existing internal control systems, gives an opportunity to highlight current situation in candidate countries regarding introduction of changes and development of ICSs. It also gives main results and conclusions concerning existing situation and progress made, and main problems encountered through SAIs experience and issues to be addressed for further improvement and development.

Chapter 4: describes a need for development of harmonised principles supplemented by technical guidelines and good practice guide for all candidate countries, its possible content, and supporting activities as the new professional challenge.

Chapter 5: indicates possibilities of modification/amendment/extension of internationally accepted and widely used auditing standards and guidelines in the light of new developments.

Chapter 6: gives general conclusion and highlights the main issues needed to be improved and addressed by the SAIs, all summarized in nine recommendations.

Report is supplemented with annexes containing additional materials that assist in reading and comprehending of the Report, identify good practices and provides some stimulating examples.

CHAPTER I: INTRODUCTION

1. Background

The co-operation between Supreme Audit Institutions (SAIs) of Central and Eastern European Countries (CEEC) started in 1993 when the European Court of Auditors (ECA) organised first seminar of the heads of these SAIs in Berlin, with a goal of creating closer relations. At the following seminar in Luxembourg in 1996, the heads of SAIs agreed to deepen their relationships on a continuous base. During the Presidential Meeting, which took place in Warsaw, in March 1998, the Presidents of the SAIs involved agreed that co-operation would be implemented by working groups, consisted of representatives of interested SAIs, which prepared documents and materials. The output of those groups required approval by the gathering of Liaison Officers representing all SAIs involved in co-operation, while final decisions were made by the Presidents. At the next meeting in Prague in 1999, co-operation was enlarged towards two more candidate countries: Cyprus and Malta, while on the meeting in Cyprus in 2001 co-operation was extended to Turkey as well. Today, Group has 16 members: SAIs from Albania, Bulgaria, Croatia, the Czech Republic, Cyprus, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Romania, Slovakia, Slovenia, Turkey (hereinafter referred to as *SAIs of candidate countries*) and the ECA. Since the establishment, group of mentioned countries, co-ordinated and assisted by the ECA and SIGMA, was acting through different Working Groups. A number of different seminars and workshops have been organised as topics of common interest could be discussed and best solutions found. Reports of Working Groups were presented and further discussed on regular meetings of *liaison officers*, while their conclusions and recommendations for improvement based on the annual work and activities were presented on annual meetings of heads of SAIs and the ECA.

Almost 10 years latter, *member SAIs* were still showing the need for further, continuous developing and extending the exchange of experiences and practices in the field of their role in audit. One of the topics, on which all members of the Working Group expressed a unanimous interest in, was audit of Internal Control Systems.

Following that, the Presidents of the Supreme Audit Institutions of Central and Eastern European Countries, Cyprus, Malta, Turkey (hereafter: *candidate countries*) and the ECA, at the Meeting in Bucharest in December 2002, decided to extend the mandate of the Working Group on Audit Manuals by establishing the new sub-group on Internal Control Systems. The State Audit Office of Croatia was given the task to prepare a report on Internal Control Systems in above-mentioned countries.

After report has been presented and discussed on the Meeting of Liaison Officers in October 2003 in Luxembourg, sub-group has been extended and renamed in "The PIFC expert Group". Today Group is consisted of the following members:

Maria Kysucka, Head of EU Funds Audit Department / The Supreme Audit Office of the Slovak Republic
Jan Pieter Linggen, Head of Cabinet of Member of the Court/ European Court of Auditors
Mark Babington, Audit Manager / United Kingdom National Audit Office
Rolf Elm-Larsen, Director / The National Audit Office of Denmark
Lidija Pernar, Assistant Auditor General / The State Audit Office of the Republic of Croatia – **chair and rapporteur of the Group**;

with support from **Nick Treen** from SIGMA³/OECD and **Robert de Koning** from DG Budget – PIFC and Enlargement.

2. Objectives of the Group

The intention of the Group is to support the Working Group on Audit Manuals in considering and developing the topic of common interest of all its members, through the following objectives:

- providing an effective update on state of the development in external auditing of internal control systems (ICSs) in candidate countries with the purpose to identify most common problems and to find most appropriate solutions;
- initiating discussions on how to get acquainted with and harmonising of the internal control/internal audit methodology established within the European Union (EU) and meeting the EU requirements; and
- promoting the exchange of knowledge and experiences among SAIs within the Group but also with SAIs of EU Member States, with intention to ensure appropriate, timely and effective ICSs.

3. Methodology and order of activities

After careful consideration of this wide and complex subject and after consultations with other member SAIs, ECA, and SIGMA at the meetings of liaison officers in Malta and Bucharest, outline of the Report has been developed and focused on three major areas:

Audit experience in candidate countries. Based on the follow-up on the implementation of the 11th Recommendation⁴ concerning the functioning of SAIs in the context of the EU accession, adopted at the Meeting of SAIs' Presidents in Prague in 1999, Report should give a brief description of ICSs in countries concerned, position and role of SAIs regarding those systems, recent audits of IC/IA systems and major observations, recent changes in SAI's methodologies, organisation or powers related to auditing ICSs and development of relations between SAIs and Internal Audit Units (IAUs) in public sector.

Application of the Generally Accepted Standards in the management of EU funds. The Report reflects on the EU requirements for financial control and the question how to deal with them more easily. Namely, candidate countries need to adopt and strengthen their procedures for managing and controlling public funds. In this context, SAIs are being asked to be a more proactive in assisting their Countries to strengthen their internal control systems with the aim at meeting EC regulations.

³ SIGMA is a joint initiative of the OECD and the EU, principally financed by the EU to support SAIs.

⁴ See Annex 1 of the Report

To play such an active and important role, SAIs should provide the necessary powers by the legal framework, *complemented by practical guidance which explain how to do this work*. Fully developed control and audit guides for the sound financial management of EU funds have become necessary.

So, one of the questions arisen from this consideration was *Is there a need for development of manuals and/or guidelines for auditing EU funds on the common base for all candidate countries and for all EU funds?*

General principles – new developments? The Report elaborates the general principles for the audit of ICSs in the framework of new developments. They also suppose to be considered and discussed in the framework of EU requirement for public internal financial control (PIFC) and the SAIs' involvement in promoting the concepts of these systems, and technical support when it comes to the question of auditing them.

Existing generally accepted standards are sufficient for financial audit. However, additional attention should be given to the audit of external aid, especially since the concept of managing those funds is different in various countries. In that sense, SAI's standards are likely to be improved and adjusted in a manner to reflect the SAIs particular duties and responsibilities as laid down in the Treaty and the Financial Regulation, and to take the European Community context into account.

As the accomplishment of the presented tasks required precise information from SAIs, a detailed **questionnaire** has been prepared and, together with the letter to the Presidents with explanation of planned activities, sent to all fifteen SAIs concerned. In addition to assist in the drafting of the final report, SAIs have been asked to provide a **brief description** of the ICS that operate in their countries as well.

Based on completed questionnaires, system descriptions, and all other relevant materials, short report has been prepared and together with the first results presented and discussed at the EUROSAI Seminar on Evaluation of Internal Control Systems, held in Prague in May 2003. The draft report has been prepared for the meeting of *liaison officers* in Luxembourg, while final report will be prepared for the Meeting of the presidents of candidate countries to be held in April 2004 in Riga, Latvia, together with the conclusions and recommendations on:

- how to reaffirm benefits of an external audit by SAIs in the area of assessment and development of ICSs, and consequently, to improve the management of public funds,
- how to best promote the involvement of SAIs in control of EU funds, taking into account the varying auditing mandates and systems among countries,
- is there a need for specific guidance for auditing EU funds and how to best respond to that, and at last
- based on experiences and in the light of carrying out audits according to the highest professional demands, to consider whether the need for development of current audit standards has been recognised.

In preparation of the Report results of the following WG's workshops were also taken into account:

- Public Sector External Policies and Standards held on 23-26 June 2002 in Sofia, Bulgaria;
- Methodologies for Audits of Public Internal Financial Control Systems, held on 23-25 September 2002 in Bratislava, Slovak Republic;
- Audit Quality Control and Assurance held on 22-24 October 2002 in Gdansk, Poland.

Conclusions from mentioned workshops are included in the **Annex 7** of the Report.

4. Main areas of consideration

Based on the concept presented above, following issues remain the core of this paper:

4.1. The Definition of Internal Control

The system of internal control is that which is developed to properly control the financial and operational procedures of any entity. Internal control can provide reasonable but not absolute assurance that assets are safeguarded, and that transactions are authorised and properly recorded in a way that allows for the timely identification and correction of material errors. Internal control is based upon a system of management information, financial regulations, administrative procedures and a system of accountability as well as strong formal project management. Internal control also provides a framework for risk management within audited entities, to allow organisations to both identify and mitigate risks.

Internal control is vital to ensure that resources are properly managed, and that accountability is maintained. Internal control systems also contribute towards the regularity and probity of public expenditure and provide assurance that money has been spent and activities have been carried out in accordance with any regulations governing them. In a number of member states and candidate countries internal control systems are also responsible for the management of risk within an entity, namely to prevent the entity from risking financial loss, a risk of failing to deliver its agreed programme of activities, or a loss of reputation brought about by poor management, fraud or corruption. Risk management is not intended to prevent work being undertaken, but to ensure that when an entity undertakes a programme of activities it has considered the risks that it might face, and developed an appropriate system of internal controls to manage and minimize the risks to occur.

Any system of internal control has a number of components. Firstly the system has to be established through financial and procedural rules, the system has to be operated by responsible and appropriately trained personnel, and subjected to independent review to ensure and assess whether procedures are working as intended. Usually this checking and monitoring role will be undertaken by an internal audit unit. Key to the operation of effective internal control is the attitude of the people who are responsible and accountable for its operation.

Management is responsible to establish and organize internal audit as a "supervisory function" within the organization's internal control system and connection between management, stakeholders and external audit., Internal audit also has a role in risk management, and can help in realization of the basic goals of an organization. In effect, internal audit is independent and objective, and provides assurance and consulting activity designed to add value and improve effectiveness of risk management, control and governance processes.⁵

The role of the external auditor will be to assess the work undertaken by internal audit and where possible rely on it. The external auditor may gain audit assurance from an effective internal control system, but to do so will need to ensure that it has operated correctly during the financial period. The external auditor will make a judgement on this following an assessment on the effectiveness of the internal control system, and also an assessment of the reliance that can be placed in the work of internal audit. Guidelines to help this assessment process are to be produced should the proposals made by the working group accepted.

It is important to remember that internal control systems are not just financial systems. They will also be designed to mitigate non-financial as well as financial risks, as it is important that an entity is both able to manage resources effectively, as well as implement an agreed programme. Once established internal control and risk management systems need to be regularly reviewed and updated to ensure their continuing effectiveness.

4.2. Definition of internal audit

Management of each organization (should) establish an internal audit unit in unique position to be able to furnish management with necessary analyses, appraisals, and recommendations. As such, it should provide a service of great value as regards the governance structure.

Internal audit is therefore defined as an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps in accomplishments of objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes⁶.

As such, it is an important aspect of an internal control structure. The management of public entities should be clearly responsible for defining the role of internal audit and ensuring that it has an appropriate level of authority and independence, including the right to report to the highest level of management.

A crucial instrument in developing and providing effective internal audit services should be the Central Harmonisation Unit (CHU) – as a centre of excellence and experience.

However, CHUs should not be in charge for internal audit area only. They should be responsible for developing and harmonizing of control and audit methodologies based on EU and international best practice, co-ordinating the further development of sound financial management by promoting best PIFC practice and quality assessment/compliance testing including internal control system and internal audit throughout the public sector.

Role and functioning of CHUs, lessons learned in the past and CHU networking are described more in detail in **Annex 6** of the Report.

4.3. Co-ordination of external and internal auditors

In evaluating the effectiveness of internal control, the external auditor can use the work of their internal audit colleagues, who form one part of the internal control structure, and are well placed to provide the external auditor with guidance as to the effectiveness of the systems that are in place. The external auditor must always remember however, that responsibility for the overall conclusion drawn is ultimately that of the external auditor based on an examination of the systems in place, the quality of the internal audit unit, and the attitudes towards internal control and risk management of the entity under review.

To allow the work of internal audit to be effectively assessed, the external auditor has to understand purpose (role), procedures and methods of internal audit's work, as well as considering the quality of staff and the independence and objectivity that they bring to their work.

4.4. Internal Control Standards

The establishment of those demanding internal control standards is necessary, particularly in government, in view of its size; diversity; the volume of transactions; the multiplicity of records and numerous rules, regulations and laws. Because statutory provisions govern the management and control of public resources and public programmes, standards that govern and ensure such compliance are required⁷.

As a "living document", auditing standards should reflect, to the extent possible, the current trends, issues and concerns in auditing methodology and practice. In our case: current trends in designing, implementing and evaluating ICSs connected with the EU rules and requirements.

5. Risk Management

A very important issue for the development of modern and effective internal control systems and one that should be stressed is the risk management process.

Risk management is the systematic application of management policies, procedures, and practices to the tasks of analyzing, evaluating, controlling, and communication about risk issues. Here risk is understood as the probability for not reaching the objective of the organization.

⁵ www.theiia.org

⁶ www.theiia.org

⁷ INTOSAI Guidelines for Internal Control Standards, Chapter III, par. 16.

This definition links risk management directly to the above mentioned definition of internal control and creates a better appreciation of the two concepts.

Namely, internal control is the system by which the management within an audited body will seek to manage risk. The process begins with an overall strategy which states what each audited body's approach and attitude to risk is, and the policies it has developed to manage risk within acceptable limits. A risk management framework will not totally remove risk, be it financial or non-financial, but the framework in place should explain what level of risk is acceptable to the entity and how it manages its operations to keep risk within this threshold.

In determining risk, it is important that definitions used to categorise and assess risk are clear and consistent within the entity, and that management is clear how it is going to obtain assurance that risk can be handled appropriately.

Risk will always be defined according to what is acceptable to stakeholders. These can be members of the public, management, or political stakeholders within Parliament. To identify and manage risk successfully, management will need to be aware of what risks are acceptable to all stakeholder groups.

For risk to be identified and addressed, it needs to be consistently identified and defined, and needs to be documented and considered by entity management. This allows management to realise that nature of relationships between risks, for instance as one risk increases, does another risk increase or decrease accordingly. When evaluating risk, the auditor and the entity management need to consider the impact of the risk should it occur, and the likelihood of the risk occurring to determine a proportionate response. When considering risks it is important to evaluate possible financial or value for money issues, as well as risks to the delivery of services, the ability to overturn the risk at a later date, the quality of evidence you have about the nature and scale of the risk, as well as its potential impact.

Every risk needs a response. This can range from internal controls to prevent the risk from happening in the first place, to a decision by management that it is willing to accept the level of risk that an activity or project represents. Responses to risk need to be communicated to all of those involved in the risk management process, and the controls in place need to be regularly reviewed to ensure that they remain effective, provide good value for money and are clearly documented so that they can be reviewed by management and auditors alike. The review process should regularly consider the appropriateness of risks, and any changes to the perceived levels of risk need to be clearly explained to allow responses to be amended accordingly. It is important that an independent process of assurance is operated, perhaps through the use of internal audit to advice management whether their selection, evaluation and response to risk is appropriate.

At **Annex 10** is the SIGMA short paper which provides a simple but fuller description and explanation of what is risk management.

6. Rapporteur's note

Sincere thanks to all of colleagues from *member SAIs* who found space, within their busy schedules, to reply on questionnaire and through brief descriptions of ICSs reflect upon the situation in their respective countries and their SAI's approach.

Positive and supporting assistance and ideas given by Dieter Boeckem from the ECA and Ulrika Klingenstierna, Nick Treen, Roger Cazala and Lage Olofsson from SIGMA are also much appreciated and were taken into account in preparation of this Report.

Thanks to all other colleagues from SAIs of both EU Member States and candidate countries, as well as to the experts from European Commission for interesting discussions and useful suggestions made during the EUROSAI Seminar on Evaluation of Internal Control Systems held on 26-28 May 2003 in Prague.

The best way of learning is from the constructive examples and experiences that could be shared among SAIs. That is why we hope that further, more extensive discussions on the areas presented in this Report and continues exchange of relevant information will contribute to a better understanding so that existing problems can be identified, recommendations for improvements made and finally – easier solutions and remedial actions encouraged.

On behalf of the Group,

Lidija Pernar, State Audit Office of Croatia

CHAPTER II: INTERNAL CONTROL SYSTEMS – THE EUROPEAN UNION APPROACH

1. Introduction

There is a crucial role for the external audit to play in the development of effective internal control and risk management (see definitions in Chapter 1). For many reasons, SAIs often have a clearer perception of the challenges and requirements of sound systems of both financial and non-financial control than the government administration. It should be regarded as important part of their role to contribute positively to the enhancement of internal control systems. And it should be done not only by checking existence and evaluating relevance and performance of the systems, but also by disseminating the good practices identified in their audit work.

Raising Parliamentary awareness of the importance of risk management and effective internal control, as well as the awareness in other stakeholder groups should also be important task of SAIs.

In respect of that, the European Commission in the Chapter 28 (Financial Control) negotiations established the main criteria as follows:

- o Strong financial management and control systems and procedures covering "inter alia" managerial accountability and ex-ante control procedures (this means that management must devise systems to both prevent and detect breaches of internal controls, as well as having adequate internal and external audit arrangements to provide independent assurance that internal control systems have operated effectively, and mitigate risks to a level acceptable to all stakeholders);
- o Effective internal audit in place in budget institutions;
- o A central harmonisation and co-ordination function, for both financial management and control and internal audit, in place, preferably located in the Ministry of Finance (this is intended to provide consistency in the quality of internal control systems in place within the public sector, as well as providing a focal point for the dissemination of best practice and developing new and enhanced guidance).

The term financial control usually refers to the financial aspects of internal control. Such controls may be either ex ante (e.g. a pre-commitment visa control system) or ex post (e.g. after the event) (see also **Annex 8**). The European Commission attaches a slightly different meaning to the term "financial control". In this context, "financial control" covers both what the Commission terms "internal financial control" and "external audit". The former term is synonymous with what is usually referred to as financial control or control procedures devised and implemented by the management of an entity, adding the internal audit as an assessment tool of the financial management and control systems efficiency. The key difference between the terms financial control and audit is that financial control includes both ex ante and ex post controls, whereas audit is mostly ex post.⁸ Based on the experience in candidate countries, The Commission has developed and uses the term "Public Financial Internal Control" (PIFC),⁹ today frequently used in assessing the progress made by candidate countries in meeting the requirements for EU membership. A practical framework for key elements of PIFC is given in the **Annex 5** of the Report.

The concept of PIFC should not, however, be exclusive, and should not exclude auditors from considering operational, financial, business and reputational risks, to develop a risk management framework as outlined below. The objective of the risk management framework is to improve internal financial and non-financial control, and therefore it is equally important to consider controls over non-financial as well as financial risks. The risk to the ability of an audited entity to deliver a programme of work may not result in financial risk but may damage the delivery of important activity programmes, or may result in reputational risk. These factors are particularly important to consider when delivering major EU funded programmes.

The setting up of a PIFC systems and procedures is a long term process, that should rely on a strategic approach, involving not only the administrative actors starting with the Ministry of Finance, but also the political decision-makers within the ongoing public administration processes.

The major challenge is to a large extent to build an "audit culture" as much as introducing/developing new audit techniques and establishing a legal framework. This implies especially:

- to raise the awareness of managers in the usefulness of solid control system and internal auditing;
- to direct newly established internal audit units to start work effectively in order to establish their legitimacy and demonstrate their usefulness;
- to create a Central Co-ordination Unit for organisation of adequate co-operation and networking activities for internal audit (e.g. within the Ministry of Finance), with the purpose of professional development of internal audit within the public sector and providing a solid basis for independent status of internal auditors.

2. The key components of an ideal financial control system in public sector

For a solid platform of an effective financial control system to be ensured, a number of key components needs to be in place. Ideally, these would include:

⁸ "Managing Public Expenditures – A reference Book for Transition Countries", issued by SIGMA, 2001

⁹ According to the European Commission, DG-Financial Control, April 2000, PIFC covers:

Public, covering all control activities in the public sector.

Internal, covering controls exercised by centralized and decentralized government agencies as opposed to external controls exercised by a body outside the government.

Financial, to stress the financial character of the activities to be checked.

Control, meaning all activities to oversee the entire field of financial management (comprising all control tools such as ex ante control and ex post audit).

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

- a) Management awareness and responsibility to establish sound and efficient financial control system.
- b) A strong central institution/organisation (preferably Ministry responsible for finance) responsible for the direction and co-ordination of public finances.
- c) Centrally established standards (preferably by the same institution/organisation as stated above) for accounting, financial statements and reporting and controls including internal audit.
- d) Clear procedures and transparent lines of responsibility and accountability in internal and external control environment.
- e) Risk assessment based systems and procedures of preventive, detective and directive controls, such as public procurement, countering of fraud and corruption, programming and selection of projects, etc.
- f) Clear and transparent rules for financial and performance reporting by the government and other public sector entities.
- g) An effective internal audit function.
- h) Strong and continuing external oversight (by parliament and supreme audit institutions) and sound professional relationship between internal and external audit.

It is clear that level of success in establishment of such system depends on how it is supported by staff (qualifications, recruitment, and training), IT systems and technical equipment, etc. For effective internal control and risk management it is also important to evaluate the effectiveness of –

- An endorsed risk management strategy for each audited entity (basically an organisational policy towards risk explaining why it has been set and the issues that were considered by management)
- Consideration of the context for risk management – for instance who is involved and what the objectives of the process are
- The identification and evaluation of risk (how were risks identified, and who fed into the process)
- Criteria for evaluating risk (what were the assessment criteria, these could be for instance the scale of the impact of any likely risk, and the likelihood of it happening. This does not need to be an absolute reference, more and objective assessment of high or low, and a relative ranking of the risks identified)
- Risk control mechanisms (what procedures has management put in place to mitigate against the risks that have been identified, these could be additional controls, or stronger monitoring arrangements)
- Review and assurance mechanisms – (what opportunities are there to review the risks identified, and have they been subject to any independent review and validation by internal or external audit) a detailed explanation is provided in Chapter 1 under the definition of Risk Management

Probably a few countries can claim to fully adhere to these processes and standards.

However, high standards related to the development of ICS have been recommended to candidate countries. Effective and well-functioning internal audit arrangements have also been proposed as a key component to provide assurance on the effectiveness of public financial internal control (PIFC) systems.

In a view of the significant progress achieved in a relatively short period since the introduction of reforms in candidate countries, the setting of lesser targets would neither satisfy nor stimulate their ambitions to become equally treated members of EU, nor sufficiently exploit their potentials. Nevertheless it is also important to acknowledge that the development of a full system of internal control and risk management goes much further than pure financial controls. Furthermore, as the capacity of candidate countries for developing their respective systems increases, they will be able to further enhance the procedures they have in place.

Categories and practice of modern Internal Control are shown more in detail in **Annex 8** of the Report.

3. The COSO framework of internal control

As mentioned before, corporate governance's requirement that good internal control should exist in an organization, has led to organizations taking a wider view of the whole control framework for which they are responsible, and using this as a tool to manage and mitigate against risk. This has resulted in a move to providing an overall assessment of an organization's control activities with the aim of giving an assurance as to the effectiveness of its internal control systems. A number of frameworks have been established and adapted according to the individual characteristics of an organisation. Perhaps the one that has attracted the greatest attention and usage is the COSO framework of internal controls developed by the Committee of Sponsoring Organizations of the Tradeway Committee in the USA.

This framework is built around five main control areas:

- control environment;
- identification of risks and priorities for control;
- financial strategy and management;
- control activities and
- monitoring and corrective action.

As such, the COSO framework is providing useful in the elaboration and conceptualisation of internal control standards and could be used in this way in candidate countries. A few of them have prepared standards on this basis already and the European Commission has also made use of its concepts.

The executive summary of integrated COSO framework for internal control is given in the **Annex 11** of this Report, while more information can be found on the following web-site: www.coso.org .

4. The key foundations of internal audit as a part of financial control systems

Historically, internal auditing has focused on financial systems and financial controls within an organization. However, the focus of internal auditing has shifted and is continuing to shift, quite dramatically in modern direction. This is closely associated with the greater understanding and relative importance being placed on internal control, good stewardship and corporate governance.

Some of the key changes that have taken place are:

Historic role

Policemen
Financial focus
Focus on hard controls
Focus on tangible assets
Compliance based
Functional focus
Self-sufficient
Reactive

Modern role

Partners in the organization
Business focus
Focus on soft controls
Focus on intangible assets
Risk based
Process focus
Sharers of best practice
Proactive

In order to achieve internal audit developments mentioned above, the following foundations need to be in place:

- general pre-requisites
- staff conditions
- audit practice development
- professional development and training.

The general prerequisites (implementation varies from country to country):

- The legislative framework in place and consolidated;
- Methodology development unit (preferably within Ministry of Finance) exist;
- Internal audit units exist and large enough to provide efficient audit service;
- Independence of internal audit units putted in place;
- Resources are sufficient;
- Central monitoring exist;
- Ethical base established;
- Management objectives clear and management awareness on satisfactory level;
- Tracking of recommendations and
- Risk management for institution.

Staff conditions

- Specific rules on recruitment of internal auditors settled out;
- The standard professional certification carefully managed (as staff evaporation would be avoided);
- Salary levels relevant to qualifications and responsibilities of internal auditors and
- Career structure for internal auditors developed.

Audit practice

- assessment of audit needs;
- documentation standards;
- organised spread of good practices;
- quality assurance;
- system/risk based approach;
- relationship between internal and external audit;
- follow-up and
- action plans for implementation of recommendations.

Professional development and training

- professional qualifications gained;
- professional networking established;
- skills and training profiles continuously under development and
- manuals developed and introduced in practice.

5. Options for Providing an Internal Audit Service

Several options exist for providing an internal audit service.

The conventional arrangement is to have an internal team which is directly employed by the organisation. Size and cost of providing the service are among the determining factors when considering in-house provision. The in-house team may be reinforced by contractors who can provide specialist skills and additional resources as appropriate.

Alternatively the whole service can be contracted out.

Smaller organisations should consider the use of consortia to take advantage of the flexibility this arrangement can produce. Additional skills or expertise can be brought in on a short or long term basis.

In some countries it is possible that there will be a central strong function, perhaps under the Ministry of Finance, which could be used to provide an internal audit service whilst the in-house facility is being developed. It is also possible that this additional expertise could be called on when an area demands specific expertise, as in some IT Audit situations. In other countries, although the Ministry of Finance is not responsible for the development of a government-wide IAS, the ministry does play the lead role in developing guidance or standards which should be applied when executing internal audit assignments.

6. Benefits of internal auditing

To a great extent, the benefits and need for internal auditing are apparent when examining the profession's purpose and scope of work. However, there are certain additional benefits of internal audit:

- **provides continuity in the monitoring process.** Internal audit's evaluations, recommendations, and reports, being on a continuous basis throughout the year, provide stakeholders with valuable additional comfort. Also, thanks to continuity, management is able to implement corrective measures and improvements on a timely basis;
- **has a considerable insight and knowledge of the organization.** This enables internal auditor's to combine their professional skills with an understanding of the organization's operations in order to make judgements about the effectiveness and efficiency of those operations and management's achievements of defined objectives and goals;
- **contributes to the organization's quality assurance.** The quality of operations, including compliance of policies, procedures, and internal regulations is of fundamental importance if the organization is to achieve its objectives in an economical and efficient manner. Internal auditors have an important role in periodically monitoring compliance with internally defined control procedures and regulations;
- **represents a service to the organization.** Internal auditors are in a unique position to furnish management with necessary analyses, appraisals, and recommendations. As such internal audit provides a service of great value as regards the governance structure.

It is clear that internal audit is an important aspect of internal control structure. The management of public entities should be clearly responsible for defining the role of internal audit and ensuring that it has an appropriate level of authority and independence, including the right to report to the highest level of management.

Therefore, in the document known as the Sydney Statement, INTOSAI stated that SAIs should strongly encourage and support introduction of internal audit where doesn't exist, and strengthen internal audit by appropriate training of internal audit staff.

Practical examples of the development of internal audit in the public administration of candidate countries are given in the Chapter 3 of the Report.

CHAPTER III: DESCRIPTION OF INTERNAL CONTROL SYSTEMS IN CANDIDATE COUNTRIES

1. Introduction

Internal controls are certainly not a new term in candidate countries. They were always presented in functioning of their public administration, in one way or another. But what made things difficult when it came to negotiations for accession to the EU was obligation to introduce internal audit. It used to be one of the most unclear concepts for the public sector of candidate countries. Actually the concept of financial control as such has often been confused with the internal audit, whereas it is only a component of a financial control system. This distinction has been drawn in Chapter 1 of this Report, where we have explained the integral role of Internal Audit within Internal Control, but confirmed clearly that they are not the same, and that Internal Audit is a tool to monitor, assess and improve internal control within audited bodies.

Of course no internal audit capacity was in place amongst candidate countries from the outset, but rather control/inspection bodies tasked in general with a narrow scope of activities; investigation of alleged individual irregularities, or even of complaints of fraudulent behaviour. By definition this activity was not use a pro-active approach based on risk analysis. Moreover, these concept did not allow systematic feedback (recommendations + follow-up), aimed at improving the management and control system and procedures¹⁰.

As financial control is considered as one of the biggest issues in ensuring confidence in the construction of EU, in their preparation for the enlargement process candidate countries started to struggle to convert from that basically transaction-oriented inspection approach to a new structure in which accountability of management and functional independence of internal audit would play key roles.

Evaluation of existing situation and progress made in mentioned area during the last ten years in acceding, remaining and future candidate countries is based on the questionnaire. Replies on questionnaire have been collected during the April 2003. The main outcome of this "research" is that the situation regarding ICSs is still very different from country to country and from SAI to SAI, but regardless of that, shows big efforts and great improvement made in this area at all levels.

Besides giving an opportunity to highlight current situation in candidate countries regarding implementing changes and development of ICSs and SAIs' role in these processes, intention of this Report is to identify good practices and provide some stimulating examples.

2. Internal control structure modelling

In general the term Internal Control System (ICS) are all forms of control exercised at the level of public entity, including internal audit, established by the management. It comprises procedures, methods and responsibilities which aim to assure compliance with regulation, transparency, economy, efficiency and effectiveness of an entity.

European Union

Inside of European Union a couple of different "models" of systems are identified corresponding the internal (management) control and internal audit as a concept which logically flows from internal (management) control.

There is *southern* model system in which the Ministry of Finance does not only play a key role in preparing and allocating the state budget to line ministries, but also carries out ex-ante controls by its own staff in the line ministries. It has the Inspectorate General for Finance which depends directly on the minister of finance and is responsible for financial control of all public revenues and expenditures. In addition, in the line ministries Internal Audit Units exist.

In the *northern* model system, line ministries take full responsibility for spending their own budgets with appropriate checking through their ICSs, which are ex-post checked by Internal Audit. Internal auditors are co-ordinated by the Ministry of Finance and carry out mainly financial audits. They take account of the work of internal auditors at regional level. Their reports are usually received and used by external auditors. Ministries reports on their ICSs to the Parliament annually. The internal audit service of the Ministry of Finance, besides auditing of its own ICS, also provides guidance and co-ordination for the IAUs of the line ministries.

Internal financial control system of European Union, then Austria, France, Netherlands and Portugal as EU Member States, and Canada and USA as examples of non-European practices are described in **Annex 4** of this Report.

Candidate Countries

The preparation for the accession to EU on budgeting and financial control in candidate countries has begun long before acceding with pre-accession aid. In Central and Eastern European Countries it means in the early 90's, after the beginning of the reform processes. During the last decade those countries with a centralized state system in which a uniform and consistent system of internal controls within the public administration was missing and the role of internal controls in the management was very limited, were streamlining to adopt a new institutional approaches and methodologies of the control of public funds, similar to those within the EU.

The main idea was to establish such systems in which managers would be able to trace errors and irregularities in the administering of public funds and to reduce the risk of corruption, what is a good guarantee that public administration units perform their tasks correctly and handle public resources, including EU funds, in a useful and economic way.

¹⁰ R. Cazala: *General considerations on the situation of (internal) financial control in the candidate countries to the European Union in the light of the SIGMA peer reviews*, Seminar on "Evaluation of ICSs", Prague, 26-28 May 2003

Internal Control Systems within the candidate countries today are organized and functioning in different ways (Comparative scheme of ICS models in Candidate Countries is given in **Annex 3**), more close to the *southern* model, but mostly consisted of elements of systems represented in both southern and northern EU Member States, including "classic" external control in a form of supreme audit institution reporting independently to Parliament. Most of them represent combination of an old, "pre-transition" institutional structures and new development requirements.

For example, internal control system of the Czech Republic is currently created on the basis of a "two layer" system consisting of public administration reviews as an "old layer" and internal audit as a "new layer", and is under development.

The public finance system of Slovenia and within it the internal control systems is based on the Public Finance Act. The main role in internal control system is given to the Ministry of Finance, which is responsible for controlling the budget funds also through the Budget inspection function in the Budget Supervisory Service responsible for development, harmonization and co-ordination of Public Internal Financial Control. It supervises implementation of regulations and guidelines for financial management, control and internal audit by on-the-spot checks and based on reports of Internal Audit Services annually submitted to the Ministry of Finance. The external review of existence and operation of internal controls is additionally done by the Slovenian Court of Audit.

Internal audit services in Slovenia are established in all ministries and in some major bodies within ministries. The budget spending centres with the budget which exceeds 500 million SIT must ensure regular annual internal auditing of their operations by their own Internal Audit Service, joint Internal Audit Service or by external provision of internal auditing (hiring a private audit company); in performing internal audit, the private company must comply with the Guidelines for internal audit of budget spending centres.

The internal control framework in Albania comprises controls exercised by the budget department, the Treasury (in charge of ex-ante controls of budget execution), the Internal Audit Units within the line ministries (in charge of ex-post compliance audit and reporting to the line minister) and the Central Internal Financial Control Department within the Ministry of Finance, which provides oversight of the IAUs within the line ministries. It also carries out internal audit work within the Ministry of Finance and entities under the Ministry's control. In addition, the SAI carries out an independent external audit of budget execution.

*The Albanian Minister of Finance – as person with overall responsibility for ensuring proper internal controls – submits an **annual assurance letter to the Council of Ministers** indicating if effective internal control framework is in place. This enhances the ministers' understanding of the state management and provides positive incentives for ministries to correct any deficiencies reported by internal controls.*

The internal control system in Malta is made up of an intricate system of internal and external financial control checks. The various key players and systems enable the internal and external auditors, as well as management of the entities concerned and other stakeholders, to follow the path of transactions, controls, processes and reporting within a system.

The key players of the System of Controls in Malta:

- The Management of the Ministry/Department concerned;
- The Ministry responsible for Finance;
- The Treasury, headed by the Accountant General;
- The Central Bank of Malta;
- The Department of Contracts, headed by the Director General Contracts;
- The Internal Audit and Investigations Directorate, performing the internal audit function;
- The National Audit Office, performing the external audit (or external financial control) function, and
- "Additional" key players (The National Aid Coordinator; The EU Directorate; The Inter Ministerial Committee; The National Authorising Officer; The Central Financing and Contracting Unit; the Senior Programme Officer; The Implementing Agency; The Joint Monitoring Committee).

In **Cyprus** internal control systems are in place, based on relevant law, financial rules and regulations as well as instructions and circulars issued by the Ministry of Finance and the Treasury. In July 2003 the law pertaining the creation of an Internal Audit Service with a mandate to perform internal audit of Government and report to the Council of Ministers was passed.

In Estonia, the Ministry of Finance is appointed by the Government as the leading ministry in the area of internal control and internal audit in the government sector. Financial Control Department (FCD) of the Ministry of Finance acts as the internal auditor of the Government. It monitors using of the state budget and external funds. Also co-ordinates and analyses implementation of the ICS and organization of internal audit in government institutions and proposes improvements. In major government institution have established internal audit function. Internal control systems and internal audit functions in public sector are evaluated by the SAO during its audits and assessment of their organization is given in the SAO's annual overview on the use and preservation of state assets.

Each minister, county governor (15 of them) and head of government agency in Estonia had to ensure the establishment of internal control system; they are responsible for its accurate and purposeful implementation. They should ensure the implementation of internal audit and appoint the internal auditor or if necessary set up the relevant unit. Internal auditor and the head of the internal audit unit are directly accountable to the head of the institution.

At the moment about 200 internal auditors are working in government institutions. Reporting system is in place: FCD receives strategic

plans, work schedules and quarterly reports. FCD devises a consolidated report which is submitted to the Minister and the Government.

Internal Control Systems in all candidate countries are based on the relevant laws, which commonly lay down basic requirements for setting up the internal control systems in ministries and institutions, as well as key tasks of an internal audit structure (its head, issues related to internal auditors' independence, responsibilities and rights in conducting an internal control and audit work).

However, the primary legislation concerning internal control system is sometimes not enough supported by necessary secondary legislation. This is certainly an area where, partially because of need for compliance with European practice and partially because of fast changes in living and working environment, constant developments and improvements are needed, what is, for instance, recognized in good Romanian practice.

In 1999 the Romanian Government issued the Ordinance no. 119 on internal audit and preventive financial control. In this context, the Ministry of Public Finance issued in 2000 the Order on the general methodological Norms regarding the organizing and functioning of the internal audit.

In December 2002, the Ordinance no.119/1999 was modified by the Law no. 672 on internal public audit, taking into account the international standards in this field. In application of the provisions of mentioned Law, it was issued the Order of the Minister of Public Finance no.38/2003 for approval the general Norms on internal public audit activity.

Examples from Polish and Lithuanian practice purport on the importance of developing regulations, methodological guidelines and directives for assisting institutions and their management in effective organizing and efficient maintaining of internal controls' functions. Also they show how important can the role of Supreme Audit Institution be in this process.

The Law on Internal Control and Internal Audit adopted by the Lithuanian Parliament in December 2002, it has obliged every public sector entity to introduce and maintain effective IC system. This law defines IC concept, determines management's responsibility for establishment and development of IC system, and states IC objectives and IC efficiency criteria. However in Lithuanian SAI opinion additional efforts are necessary for providing more detail methodological guidance for managers of public sector entities. It is necessary to recommend public sector institutions either to follow IC guidelines that were developed by the INTOSAI Internal Control Standards Committee, or to develop national IC guidelines adapted to local environment. Such document should practically help managers of public sector entities to fulfil functions imposed by the Law on Internal Control and Internal Audit.

During Poland's negotiations with the Commission in Chapter 28 („Financial Control”) the Commission requested Poland to regulate financial control in a uniform way so that it would cover collecting and spending public funds and public assets management in line with internationally acknowledged standards and requirements. Following all those recommendations the Ministry of Finance drafted an amendment of the Public Finance Law, concerning internal controls and audit. The amended law entered into force in January 2002.

At the turn of 2001/2002 the Supreme Chamber of Control (SCC) in the Ministry of Finance carried out an audit of internal control of funds from the EU. SCC found that the Minister failed to issue necessary secondary legislation concerning internal audit. In June 2002 the President of SCC and the Minister signed therefore an agreement on harmonisation and co-ordination of financial control and internal and external audit. Following that agreement, the Ministry issued all necessary secondary legislation for the amended Public Finance Law and developed „Internal Audit Manual”, „Financial control standards in the public finance sector”, „Code of Ethics of Internal Auditors” and „Internal Audit Charter”. While preparing all those documents the Ministry of Finance used the SCC's experience in internal controls auditing and also the SCC Auditing Standards.

Conclusion

According to the "research" described above, we can say in general terms that today in candidate countries legal framework for the ICSs is put in place, new structures in the public administration are introduced, and awareness of importance of their existence raised within both the management structures in public sector institutions and the citizens. But there are still some weaknesses that need to be eliminated in order to ensure more effective operation of ICSs. A number of control procedures and mechanisms that need to be improved are discussed more in detail in chapters below.

When structuring their ICSs the ongoing objective for all candidate countries has to be the development of as harmonized and as common model of the concepts of internal control systems as possible. Process of harmonization implies both: finding similar solutions between candidate countries themselves and in compliance with the best European practices. It is therefore important to keep in view that, while full adaptation to existing EU systems and structures is still in the process, the framework of EU is in constant evolution. This is a fact that at the same time also demands permanent adaptation on the part of the national administration structures in line with European progress.

Therefore, the European Union should have to continue with contributing to this complex and long-term process by providing advices and technical assistance and – what is very important - by offering clear models for relevant public institutions which candidate countries could adopt to their particular traditions and environmental circumstances, based on the best EU practices.

3. Analyses of current situation in candidate countries

Analyses of current situation regarding development of ICSs in candidate countries is mostly based on the SAIs' replies on the Questionnaire prepared by the sub-group and are related to the situation in spring 2003¹¹.

3.1. Legal framework for and role of ICSs

Definition of internal control and internal audit

Common understanding of definition of internal control (and internal audit) and objectives to be achieved can be assured only by legislation.

Based on replies of SAIs of candidate countries, **Internal Control and Internal Audit are legally defined in the great majority (13 of 15) of countries**, in two countries internal control is not defined by law, while in one country both definition are under preparation. However, responses in the questionnaires highlighted **variations between countries and SAIs in the way in which IC and IA are defined** and because of that – plasticized, reflecting administrative culture and tradition. In some countries provision for internal control is purely internal financial control, in others it includes a wider range of responsibilities, as well as playing an important role in the formulation of risk management policies.

Box 1. Various Internationally Used Definitions of Internal Control:

- According to *INTOSAI Guidelines for Internal Control Standards*, Internal Control is a management tool used to provide reasonable assurance that management's objectives are being achieved. It can be organized as:

- a) accounting control – cover the procedures and documentation concerned with the safeguarding of assets and the reliability of financial records;
- b) administrative control – procedures and records concerning the decision making processes that leads employees to carry out authorized activities in achieving the organization's objectives;
- c) management control – all the plans, policies, procedures, and practices needed for employees to achieve entity's objectives.

The intended purpose of Internal Control is to prevent errors, to detect errors, to correct errors that have been detected or to compensate for weak controls where the risk of loss is high and additional controls are needed.

- Following a recommendation in the *INTOSAI Guidelines for Internal Control Standards*, *SIGMA* has decided to use the term "management control" when referring to internal control. This term management control offers the advantage of avoiding confusion with the term internal audit. It also makes it very clear that internal control – management control – is a responsibility of the management.

Management Control may be briefly defined as the organization, policies, and procedures used to help ensure that government programmes achieve their intended results; that the resources used to deliver those programmes are consistent with the stated aims and objectives of the organizations 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.¹²

- For use in audits of *European Community* activities Internal Control is defined as all the instruments, procedures, methods and systems arranged by the organization with a view to achieving the following objectives:

- a) adherence to rules, both external and internal;
- b) safeguarding resources against abuses, waste, mismanagement and frauds, international as well as noninternational;
- c) promoting methodical, economical, efficient and effective operations; developing, displaying and maintaining reliable financial and management information and indicators.

¹¹ Questionnaire and country replies – in Volume III of the Report.

¹² Richard Allen in *SIGMA Papers No. 4, Management control in modern government administration*, p. 9

- *The Canadian Institute of Chartered Accountants (CCA):* "Control comprises those elements of an organization (including its resources, systems, processes, culture, structures, and tasks) that, taken together, support people in the achievement of the organization's objectives"¹³

- *The US Committee of Sponsoring Organizations (COSO):* "Internal Control is a process, effected by an entity's board of directors, management, and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations; reliability of financial reporting; and compliance with applicable laws and regulations".¹⁴

Definitions by countries are given in the **Annex 2** of the Report.

Different definitions (even though in the field of Internal Audit not significant) implicate that models of Internal Control and Internal Audit are various. This variety still limits the standardisation of audit techniques and approaches to ICSs, depending very much on the legal framework the systems are placed.

In respect of that, this Report gives opportunity to compare existing definitions of IC and IA, to highlight main differences and, if necessary, to open "new chapter" for discussion on this matter.

Box 2. Definition of Internal Audit developed by The Institute of Internal Auditors (IIA):

"Internal Auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It helps an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."

The INTOSAI Guidelines for Internal Control Standards states that "*a specific authority should be assigned the responsibility for developing and promulgating a government wide definition of an internal control structure... Wherever the authority is assigned, the SAI has a vital role to play in the development of the ICS. This role will be played directly or indirectly, largely depending on the SAI's legal mandate and the organizational structure of the country's management system.*"

According to the responses on the questionnaire, the **responsibility for developing definition of IC and IA is mostly on Ministry of Finance (Croatia, the Czech republic, Estonia, Hungary, Latvia, Lithuania, Poland – with assistance of General Internal Auditor, Romania, Slovakia, Slovenia) or some centralized government body (The Public Internal Financial Agency in Bulgaria, The Internal Audit and Investigation Directorate as centralized government body in Malta)**. Responsibility for developing definition of IA in Cyprus lies with the Internal Audit Service.

Even though only in the role of external consultants, in some **countries** (Albania, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland and Turkey) **SAIs have been (or are) involved in the process of definition development**, what shows SAIs' awareness and interest in development of solid and reliable ICSs within the public sector in their countries.

Responsibility for promulgation of definitions is different; somewhere, like for example, in Latvia and Slovakia, it **lies on the Ministry of Finance, somewhere on Parliament** (Estonia, Hungary, Lithuania). Regarding **responsibility for implementing IC/IA in practice**, it is more equal – it is mostly **on Ministry of Finance (occasionally on Treasury or some other MF's Department) and somewhere** (Croatia, the Czech Republic) **also on the heads of the entity**, while in Lithuania this responsibility lies on the head of the legal public entity only.

Standards

INTOSAI guidelines points out that, in establishing the framework for IC structures, a specific authority should be assigned the responsibility for developing and promulgating the standards to be followed when designing an IC structures. This responsibility should be assigned through constitutional or other legal enactment and given to a central organization with authority across various government organizations.

From the SAIs' replies, it is evident that in almost all countries ICSs are based on the relevant professional standards, even though they sometimes refer to the international standards on Internal Audit (Croatia, the Czech Republic, Latvia). Exception is Turkey, whose ICS is not operational at the moment, but proper legal base for setting it up is to be adopted in the near future, and Malta, where the definition of Internal Control is based on international Guidelines and Standards, such as those defined by INTOSAI and IFAC.

Issuing standards and providing technical advice for ICSs in most of countries is in charge of Ministry of Finance (in Poland with assistance of General Internal Auditor). In Bulgaria this is Public Internal Financial Agency, in Slovenia their national Institute of Auditors, while in Albania, it is still not clear which authority should be responsible for this issue.

In 10 countries, SAIs participated/participate in development and promulgation of IC standards, directly or indirectly (mostly in consultative role or by involvement in professional discussions).

Internal control should not be imposed but accepted, established and implemented on voluntary bases by management of each organization. It means that managers at all levels have to provide the proper control environment within the organization.

¹³ The Canadian Institute of Chartered Accountants Criteria of Control (CoCo) Board – Control and Governance – Number 1: Guidance on Control (November 1995)

¹⁴ The Internal Control – Integrated Framework – Committee of Sponsoring Organizations (COSO) US – Executive Summary

Indeed, all SAIs except one have found it helpful to have legislation that establishes an overall requirement and objectives for maintaining effective internal controls, i.e. still recognize the importance of having legislative underpinning to promote effective internal controls.

Important fact in modern audit theory and practice is professional ethics or request for professional auditor's behaviour. Code of Professional Ethics establishes system of general values and rules that should have to be accepted by auditors in their relation to the public, clients and colleagues. Their existence at the same time encourages external audit in relying on professional and honest approach of internal auditors in their work.

Referring to responses on questionnaire, Code of Professional Ethics for Internal Auditors today exist in most of candidate countries.

Role of internal audit in control of public revenue and expenditure

Management often establishes an internal audit unit as a part of its internal control structure.¹⁵ Internal Audit is, therefore, a service to the organization, in unique position to be able to furnish management with necessary analyses, appraisals, and recommendations. As such it provides a service of great value as regards the governance structure. As mentioned in Chapter II, there are also some other needs and benefits for Internal Audit. For instance:

- IA has a considerable knowledge of the organization;
- IA provides continuity in the monitoring process;
- IA contributes to the organization's quality assurance, etc.

The scope and objectives of Internal Audit vary widely depending on size and structure of entity and the requirements of management. However, there is a certain amount of common understanding about the areas of Internal Audit activity in international standards:

- review of accounting systems and related internal controls;
- examination of financial and operating information; and
- examination of the economy, efficiency and effectiveness of operation of all controls.

Referring to replies on questionnaire, **establishment of Internal Audit Units (IAUs) within the public sector is (or will be soon) a legal obligation in all countries**, except in Cyprus and Malta where such obligation doesn't exist. In 9 countries this obligation lies also on all other spending units if they are not served by that in the line ministry (in Lithuania depending on the size of an entity).

Regardless of legal obligation, IAUs are established in most of - or even in all line ministries in 11 countries, in two countries (Bulgaria, Cyprus) only in some of them, while Malta responded negatively because Internal Audit is a centralized function: it falls under the responsibility of the Internal Audit Investigation Directorate.

Further on, regardless of legal obligation, **IAUs are established also in other revenue and spending units**: in Latvia - in all of them, in Albania, Croatia, the Czech Republic, Estonia, Hungary, Lithuania, Poland, Romania and Slovenia - in most of them, and in Bulgaria, Cyprus, Slovakia and Turkey IAUs are established only in some of revenue and spending units if this is not obliged by the law.

In practice the internal audit should cover two main types of audits: financial audit and performance audit, but may also cover a specific analyses of staff resources with the judgement on extent to which they correspond to the objectives of the ministry or other government entity and the tasks it is required to carry out.

In almost all countries internal auditors are today doing their work by looking into how a selection of the transactions have been processed but also by assessing how the systems and procedures that built up the internal control function. In other words, IAUs have a **mandate to carry out all types of audits**, in two countries (Albania and Cyprus) have a mandate for financial and performance audit, while in another two countries (Poland and Turkey) - only for financial audit. In addition, in Poland other internal control units are also responsible for larger scope of audit, including performance audit.

Referring to the mandate of IAUs, in all countries, except Albania where mandate for auditing EU funds are not yet included and in Bulgaria where this mandate is given to the Public Financial Internal Agency, **IAUs have the legal mandate to audit all relevant funds, including EU funds.**

Concerning reporting practice, it varies from one country to another. In some countries, like for example in Estonia, Romania, Slovakia and Slovenia IAUs report directly to the minister. In some others, like Croatia and Lithuania, reports can be sent or given on insight to the other state bodies as well if prescribed by special regulation (e.g. Ministry of Finance). In the Czech Republic reports are sent to the head of public authority, who then report generally on financial control results to the Ministry of Finance. In Latvia, however, IAUs report to the State Secretary of the Ministry and to the IA Department of the Ministry of Finance, while the annual report is also sent to the IA Council and the State Audit Office.

Starting from the basic goals which every Internal Audit should have to wish to accomplish, the basic rule should be that IAUs reports is sent to all members of the organization who can assure consideration of audit results with due care. It means to the persons who are in position to organize corrective actions (heads of departments, head of organization, minister). IAU's report could also be sent to other interested stakeholders, among which are external auditors.

According to Internal Auditing Standards, head of IAU (or Internal Auditor General) is obliged to assure a base for development of manual/instructions for internal audit work. In that manual, procedures, standards for maintenance and managing of internal audit should be described more in detail (concrete instructions to team members on audit planning techniques, collecting of audit evidence and working documentation structuring, preparing of report, etc.).

According to replies, **working methodology of most of IAUs is explained through their own manuals or guides** in big majority of countries.

¹⁵ INTOSAI Guidelines for Internal Control Standards, par. 74.

3.2. Role of SAIs in assessment of Internal Control Systems

Mandate and organization

As stated in the INTOSAI Guidelines for Internal Control Standards, Internal Control is a management tool and therefore responsibility for its adequacy and effectiveness rests with management. But the Supreme Audit Institution is not excluded of responsibility in this part.

SAI should gear its work toward assessing the adequacy in principal and the effectiveness in practice of existing ICs in auditees. It should encourage and support:

- the establishment of detailed organizational internal control structures for each governmental unit based on relevant standards and
- a review of that structure to assure that controls are working as intended and are adequate to achieve the desired results.

The Guidelines also emphasize the SAI's interest in ensuring that strong Internal Audit Units exist "where needed" and cite as problems the nonexistent or weak nature of Internal Audit and the lack of independence. They recommend a number of ways in which SAIs can offer assistance and guidance in order to strengthen Internal Audit function.

The first step for assessing the ICSs of the national administration is the legal right to do so.

Based on SAIs responses to questionnaire, **all SAIs are empowered to audit ICSs** (one SAI will be empowered in very near future). **Besides SAIs**, in 11 countries some **other state agencies or governmental bodies (mainly specific departments within the MF or/and Government Control Office) also have the responsibility to control/assess ICSs.**

The implementation of audits with regard to ICS is not very different from SAI to SAI, which is quite big improvement in comparison with research done in 2000, when three SAIs reported that they had not evaluated ICSs at all. Also, only four SAIs have looked at the ICSs during the regular audits and only two have performed specific audits for the assessment of those systems. **Today all SAIs**, except Turkey who will implement such audits after the relevant draft law pass, **implement audits of ICSs**: 13 of them during the regular audits plus, in 7 SAIs, specific audits, while one SAI perform only specific audits for the assessment of ICS.

In Albanian and Hungarian SAIs **a special department for auditing ICSs was established**. In other SAIs there is no special department, but all auditors or majority of audit staff is involved in audits of ICSs, what is understandable with regard to the fact that review of ICSs is a part of regularity audits.

"Auditing standards" in a form of **specific audit guidelines for ICSs or as a part of general audit manual, do exist in all SAIs** except one. Those manuals/guidelines on audit of ICS developed by the SAIs are a **reflection of existing INTOSAI control standards and European guidelines for their implementation**. They use these guidelines as a tool for evaluating the adequacy and effectiveness of the ICSs of the auditees and made recommendations for improvements on the basis of internationally accepted standards, what implicates that approaches and methodologies are close to be harmonised. As a conclusion, it can be stated that SAIs use INTOSAI and EU requirements and the best European and worldwide practices in the auditing, directly or indirectly – by adapting them to the local or national characteristics, as a framework of reference.

Relationship between Supreme Audit Institution and Internal Audit Units

Internal Audit is important to the well-being of an organization/entity, but it can not and should not substitute for a good Internal Control System. It can only assist management through identification and improvement of internal controls. Also, external auditors have their own role: to review the organization's internal control system, including Internal Audit, and recommend areas of improvement. Therefore, there is a mutual interest for good co-operation between internal and external auditors.

Short description of co-operation in practice is given in **Annex 9** of the Report, while well developed example of *Good Practice Guide on co-operation between internal and external auditors* can be found on the UK National Audit Office's web site: www.nao.gov.uk .

Eight SAIs (Albania, Bulgaria, Croatia, Cyprus, Estonia, Hungary, Lithuania, Romania) reported that they **assist in establishment and development of IAU**, in one way or another. Mostly mentioned ways were:

- *by lending IAUs materials and equipment for education (Albania, Bulgaria, Croatia, Hungary, Lithuania),*
- *by helping in education of IAU's staff within the SAI (Albania, Estonia, Hungary),*
- *by helping in education of IAU's staff through lectures or seminars in IAUs (Albania, Bulgaria, Cyprus, Estonia),*
- *by organizing joint training in working methodology with IAUs (Bulgaria, Croatia, Hungary),*
- *by secondment of its staff (Albania, Estonia),*
- *by providing IAUs with materials for developing methodological guidelines (Hungary),*
- *by providing recommendations for proper establishment of IAUs in public sector entities (Croatia, Lithuania), and in other different ways.*

However, roles of internal and external audit often overlaps and effective co-operation in fact demands willingness from both sides to ensure that work is properly co-ordinated. Eight SAIs (Albania, Bulgaria, Cyprus, Estonia, Hungary, Latvia, Lithuania – partially, and Slovakia) reported that **joint actions to avoid duplication of work have been taken**, such as:

- *frequently contacts, consultations and meetings,*
- *co-ordination of annual audit activities/harmonization of audit plans,*
- *signing of co-operation and assistance agreement between SAI and centralized governmental body on audit related activities, and so on.*

According to the INTOSAI Guidelines for Internal Control Standards, SAIs should ensure that they have access to internal auditors' reports, related working papers, and audit resolution information. Referring to that, **all SAIs reported that have access to all Internal Audit plans, reports and other related working papers.**

Management response to SAI review of Internal Control System

All managers should realize that a strong IC structure, part of which is IA, is fundamental to their control of the organization and its purpose, operations and resources.

SAIs should educate management on its responsibility for IC and to encourage and support management to establish internal control system. SAI should also audit those systems to assure that controls are in place and adequate to achieve desired results.

While three years ago only a few SAIs reported that they had discussed with the ministries how the ICSs could be improved, today all of them **discuss identified weaknesses or failures with the management and**, what is important, **with IAUs** too, and give recommendations for the improvements.

Further on, **all SAIs** responded that they **report and give recommendations on these weaknesses and failures**, either in the audit report or as pointed out in the annual report. **Management mostly or even always** like in Slovakia, Slovenia and Turkey, **follow those recommendations referring to the ICS in their organizations.**

All SAIs stated that have established a sort of **monitoring the auditees' progress in implementation of given recommendations**. From the experience based on those monitoring systems, most SAIs stated that **management of audited entities have a positive and encouraging attitude relating to ICs, and** - what is very important, **actively encourage and support co-operation between internal and external audit.**

In the case of a general conclusion that ICSs are weak in most or in a big number of auditees, **all SAIs reported that they have a mandate to give a sign** (in a form of warning, advice, recommendation for improvement, etc.) **to the responsible authorities**, which - when come to specific experiences - in some countries resulted with significant impact on development of legal regulations and on improvement of ICSs in general (e.g. Hungary and Romania).

Almost all SAIs (except Cyprus and Estonia) reported that **specific barriers or problems during the audit of ICSs arisen**. The most frequent were:

- lack of qualified staff in ICs and IAUs (*Albania, Bulgaria, Croatia, the Czech Republic, Hungary, Lithuania, Poland, Romania, Slovakia, Slovenia*);
- overlapping of work (*Bulgaria, the Czech Republic, Latvia, Malta, Poland, Romania*);
- weak communication (*Latvia, Malta, Poland, Romania, Slovakia*);
- lack of relevant guides and procedures for audit ICS (*Albania, Croatia, Romania, Slovakia*);
- various definitions of IC and IA in public sector (*Croatia, the Czech Republic, Hungary*);
- lack of understanding of ICSs by the staff or management in audited entities (*the Czech Republic, Lithuania, Poland*), but sometimes also the lack of the same understanding by the staff in the SAI (*the Czech Republic, Lithuania, Poland*);
- access to the reports and documents (the Czech Republic).

It is evident from the replies that **all SAIs are putting great efforts to deal with problems/barriers** mentioned above. In this respect, following actions have been taken:

- relevant guidance on auditing ICSs developed (*Albania*),
- special publication about IC and IA for managers issued (*Lithuania*),
- consultations regarding development of relevant methodological guidelines held (*Hungary*)
- mutual organization and/or attendance on annual audit seminars or conferences (*Croatia, Slovenia*),
- efforts to highlight the matter in the Parliament and Government (*the Czech Republic*),
- audit meetings (*Croatia, Cyprus, Hungary, Latvia, Poland*),
- Recommendation for improvement given in the audit reports or management letters (*Bulgaria, Croatia, Cyprus, Poland, Slovakia, etc.*),
- training courses for internal and/or SAI's auditors organized (*Hungary, Latvia, Slovenia*),
- part in the improvement of PIFC as advisor taken (*Hungary, Romania*),
- internal rules for SAI developed (*Latvia*),
- education of the top-management and staff of the auditees organized (*Lithuania*),
- web-site for methodology on ICS established (*Lithuania*),
- a Task Force was set up with members from both the SAI and governmental centralized organization for internal audit in order to improve co-operation between the two bodies (*Malta*),
- helping Ministry of Finance in development of education for State Internal Auditor's Certificates (*Slovenia*), etc.

3.3. Recent changes

Several SAIs, like for example Bulgarian, Croatian and Estonian, already made some form of **self-assessment to review their position regarding development of high-quality and effective ICSs in auditees.**

Also, they **recently introduced some changes for the purpose of carrying out audits of ICSs and cooperation with IAUs:** from organization of training courses and seminars for auditors (*Bulgaria, the Czech Republic, Hungary, Lithuania¹⁶, Malta, Romania*), development of manuals/guidelines for auditing ICs (*Bulgaria, Latvia, Lithuania*), organization of discussion forums with IAUs (*Latvia*), carrying out audit on the assessment of the ICs within public sector (*Lithuania*), changes of procedures and workflow (*the Czech Republic*) to establishment of a special unit for auditing ICS, like it has been done in *Hungary*, etc.

Besides within their own organizations, SAIs intend to take certain **serious steps for improvement of IC structures in the public sector**. In this respect, they plan as follows:

- organizing meetings with ministers,
- training and workshops on application of standards,
- developing common audit methodologies,
- supportive training programmes for spreading new knowledge and methods throughout the SAIs,
- developing relevant guidelines,

¹⁶ Example of internal audit training modules developed in one of Candidate Countries (Lithuania) is given in Annex 11 of the Report.

- participate in development of relevant draft laws,
- dissemination of knowledge of the best auditing practice, etc.

3.4. The role of the SAI with regard to EU funds (SAPARD, ISPA, PHARE, OTHER)

The application for EU membership by candidate countries and current provisions of pre-accession funds have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

When it comes to the EU perspective, an important cornerstone is a sound and efficient financial management in the execution of the budget. In the Partnership Agreements the governments of applicant countries and the European Commission agreed upon the need for strengthening the chain of management control, including external audit.

The SAI itself has interest in effective management control system so that:

- it can anticipate and prevent errors and omissions, fraud and irregularities in earlier stages than external audit, and
- the reliability and effectiveness of management control systems can save the SAIs resources.

To fulfil this need, it is crucial that the legal mandate of SAIs includes the responsibility to audit and to focus on the quality of management of EU funds.

Mandates

According to the responses on questionnaire, the situation in this area seems to be very positive. Namely, concerning the implementation of active approach with regard to the EU-requirements for external audit, all SAIs, except Albanian, have reached this important stage: **mandate for auditing EU funds** in their countries (although in Malta it is not directly referred to in the SAI's legislation, but it is interpreted as audit of overseas funds administered or held directly or indirectly by Government) - down to the level of the final beneficiary (in Romania only if final beneficiary is not a natural person).

The certification of paying agencies for SAPARD funds is a particular area. Only two SAIs (*Hungarian and Romanian*) have decided to take on this task of being **involved formally in the accreditation of SAPARD Agency**, while four SAIs have been **appointed as the certifying body for pre-accession funds** (Hungary, Lithuania, Romania, Slovakia).

Audits carried out

Twelve SAIs have reported that they have already **carried out audits of EU funds** in their country. Some of these audits were legality or financial audits, some were performance audits, and in some SAIs this was reinforced by carrying out of special investigations. The possibility of **joint or parallel audits with the ECA** or with SAIs from EU member states was also used (*e.g. in Estonia and Romania*).

Replies to how many audits of EU funds have SAIs performed so far, differs very from one SAI to another: from 2 to 35 audits, depending on the fact if auditing EU funds was a part of regular audits.

Referring to the **subject of the audits**: seven SAIs (*Bulgarian, Estonian, Hungarian, Latvian, Lithuanian, Polish and Slovenian*) were auditing both, administrative preparedness to receive EU funds and management of received EU funds. Four other SAIs (*Albanian, Czech, Romanian and Slovakian*) reported that they audited only management of such funds or some other topics (*Romania*).

Reports on auditing EU funds with observations and recommendations were **addressed widely**: mostly to the national authorities such as auditees, Parliament and Ministry of Finance. In 9 cases reports were sent to ECA or EC also, and in some cases also to some other stakeholders such as government (in the Czech Republic), or special investigation services and other ministries involved (Lithuania). In all countries except Romania **those reports have been published** (although in Albania – partially, in Lithuania - only some of reports, and in Slovakia – in the form of brief extraction).

Follow-up on those audits have been made in seven SAIs so far, in following forms:

- auditing of measures taken for implementation of recommendations from previous audits (*Albania, Hungary, Slovakia*),
- reports on the implementation of the recommendations of the audit report (*Bulgaria*),
- monitoring, in some cases repeated or additional audit (*the Czech Republic, Romania*), and
- changes made to legal acts (*Latvia*).

Resources

Concerning the reorganization of the SAIs considering the audit of EU funds, seven SAIs (*Albanian, Bulgarian, Hungarian, Latvian, Lithuanian, Romanian, Slovakian*) have organized a separate unit/department for carrying out such audits, while a few others (e.g. *Croatian SAI*) are in the process of reorganization or intend to do made more efforts in this respect in the near future.

As regards the staff involved in EU matters and requirements related to the audits of pre-accession funds, the **number of auditors involved** in these audits starts from 3 auditors (in Albania and Slovenia for instance). Staff carrying out EU related audits are still higher than the **number of auditors actually trained** for such tasks. Namely, percentage of auditors specifically trained for auditing EU related funds is at present very different. In some countries (*the Czech Republic, Slovakia*) it was hard to precise, because training is still in the process. Stated numbers certainly shows the need for further investments in term of human (and consequently financial) resources development in this area.

Manuals and training

Eleven SAIs reported that they **developed Audit Manuals for auditing EU funds**, either in a form of specific manual or as a part of general Audit Manual. In six of them (*Bulgaria, Hungary, Latvia, Poland, Romania, Slovenia*) development of such manuals was part of TWINNING projects, while Hungarian, Latvian and Slovakian SAI even set up **detailed procedures to audit ICs in connection with EU funded projects**. **Main sources used for preparation** of manuals were: INTOSAI Auditing Standards, European Implementation Guidelines for INTOSAI Auditing Standards, IFAC Auditing Standards, Reports of WG on AM, various materials developed by SIGMA and SAIs from EU member states, relevant EU and national regulations and guidelines, instructions of experts of European Commission, international agreements, etc.

In SAIs of *Bulgaria, the Czech Republic, Hungary and Slovakia* **training has been organized to assist in the implementation of Audit Manual** for auditing EU funds and in 6 SAIs (*Bulgarian, Estonian, Latvian, Lithuanian, Romanian, Slovakian*) **pilot audit(s) on management of EU funds have been performed**, mostly assisted by the SAIs of member states (Croatian and Slovenian SAI stated that plan to do the same in the near future). Five SAIs **recognized pilot audits as useful tool** in providing the required experience in the implementation of certain audit methodologies and techniques, while two of them also found them good in providing useful input for preparation of Audit Manuals on EU matters.

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organization by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. In this respect, the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

Totally in compliance with this recommendation based on EU accession requirements, eleven SAIs recognized, mostly based on their practice, importance of developing a **common audit manual for all EU funds**, while Estonian and Polish SAIs stated that there is no need for such Manual. As a rule, they think that it should be based on good practice and experiences, and supplemented by technical guidelines with worked examples and case studies, to help promote practical use of Manual.

All SAIs stressed that Audit Manual and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (e.g. through the pilot audits).

Future development

When it comes to the question is there a **need to continue with development of ICS's auditing practice**, only one SAI doesn't think that the ICS/PIFC issue should be further developed, while **all others found it desirable**, either through the **establishment of the new sub-group for development of Audit Manuals for EU funds** or through the **establishment of the special Strategic Committee**. Also, there have been some other proposals such as: **on-the-job training in more experienced SAIs, long term advisory work by experts from member countries, learning-by-teaching programmes, web discussions through an electronic network**, etc. This is obviously an area where all SAIs would like to invest more in the future, in one way or another.

Recommendations for improvements of Internal Control Systems in candidate countries and strengthening of SAIs role in that area based on the analysis of replies, are given in the Chapter VI of the Report.

CHAPTER IV: STATEMENT OF PRINCIPLES AND TECHNICAL GUIDELINES

The efforts in streamlining and strengthening of ICSs as an important area of the ongoing enlargement process, should proceed from a solid conceptual basis and specific benchmarks reflecting best practices. Such a framework should be provided by the **a statement of principles governing the way in which this should be addressed, supplemented by a series of technical guidelines** which will capture the standards essential for the effective Internal Control management of EU resources, supported by **a good practice guide**.

As stated in the Chapter III, SAIs of candidate countries have shown interest in and need for development of a common system for the audit of internal control systems, supplemented by the technical guidelines and good practice guide. Such guidance could have a useful additional role in helping the SAIs to easier "switch into" the EU system.

The Statement of principles and/or Guidelines should cover issues such as:

- setting out an audit arrangements for pre-accession and structural funds;
- roles and responsibilities of different bodies involved in the audit of pre-accession and structural funds;
- requirements for Member states' internal control systems;
- standard framework for the audit of internal control systems (methodologies and procedures), including tests of control and questionnaires especially adopted to EU requirements;
- presentation of audit reports;
- a good practice guide as additional part.

It is important to emphasize that these Guidelines:

- a) are based on the using of commonly understood audit terminology;
- b) are build upon and supplement the INTOSAI Standards and European Implementing Guidelines;
- c) are communicated to all audit units and to the staff within SAIs as well;
- a) quality assurance measures are set up to assure that the guidance has been:
 - understood by all audit staff and
 - being followed by all audit staff.

The need for establishment of the specific sub-group/committee for development of mentioned document(s) has also been determined. The opportunities of such group/committee to contribute are numerous. It could:

- Organize a workshop with the goal to define type and propose content of Guidance;
- Collect and process the appropriate materials (such as existing manuals - examples of good practice, experts advice and other useful materials) for inclusion in guidance as well as for good practice guide (it is needed to start with this activity as soon as possible);
- Try to unify and to set a framework for guidance;
- Propose relevant supportive trainings;
- Organize seminars where the SAIs from Member States and also from Candidate Countries who have already completed their Audit Manuals in this field or are to finish the process of their preparation, could have presentations with explanation of their approaches in achieving this task.

Development of uniform guidance for all SAIs and all EU funds supported by sufficiently clear and timely documents in a form of technical guidelines and a good practice guides is a complex task. As such, it represents great professional challenge, but also demands more extensive discussions and systematic work.

CHAPTER V: THE PUBLIC SECTOR AUDITING STANDARDS - NEW DEVELOPMENTS?

1. Introduction

The establishment of those demanding internal control standards is necessary, particularly in government, in view of its size; diversity; the volume of transactions; the multiplicity of records and numerous rules, regulations and laws. Because statutory provisions govern the management and control of public resources and public programmes, standards that govern and ensure such compliance are required¹⁷.

As a "living document", auditing standards should reflect, to the extent possible, the current trends, issues and concerns in auditing methodology and practice. In our case: current trends in designing, implementing and evaluating ICSs connected with the EU rules and requirements.

Based on the experience in candidate countries, research done by the PIFC Expert Group and discussions with the members of the Working Group on Audit Manuals, some ideas in the light of the improvement of existing standards have arisen. Ideas are maybe not new, but their presentation as a framework for consideration, however, may be new. Those ideas together with proposals for further consideration are stated in this Chapter.

2. Proposals

2.1. Co-ordination of external and internal auditors

Even though there exist quite significant differences between private sector (commercial) audit, public (state) sector audit and internal audit, external auditors in their work can use work of internal auditors.

External auditor is responsible for his report, as well as for stating the type, time schedule and audit scope of his audit activities. In that work, certain procedures and results of Internal Audit can be useful. This is why external auditor has to understand purpose (role), procedures and methods of internal audit's work, what can help in audit planning and can enable efficient audit approach.

Because of the significance of good co-operation between internal and external auditors in both directions, the Internal Audit Standards gives special attention to mentioned co-operation, while in the INTOSAI Auditing Standards this is not a case - they refers only to the co-operation with internal controls:

Internal Control Standards

The Internal Audit standards of the Institute of Internal Auditors presently in force are systematized in the following main areas:

Attribute Standards:

- 1000 – Purpose, Authority, and Responsibility
- 1100 – Independence and Objectivity
- 1200 – Proficiency and Due Professional Care
- 1300 – Quality Assurance and Improvement Program

Performance Standards:

- 2000 – Managing the Internal Audit Activity
- 2100 – Nature of Work
- 2200 – Engagement Planning
- 2300 – Performing the Engagement
- 2400 – Communicating Results
- 2500 – Monitoring Progress
- 2600 – Resolution of Management's Acceptance of Risks.

Detailed information on what does internal auditor's independence mean, how should the internal audit service be organized, which professional qualification and skills of internal auditors are desirable, what activities should audit work consisted of, who and how should manage the Internal Audit Service's work, co-ordinate work of internal auditors, communicate with external auditors, etc. is given.

As concerning the relationship between internal and external auditors, the following standard has to be mentioned:

2050 – Coordination

The chief audit executive should share information and coordinate activities with other internal and external providers of relevant assurance and consulting services to ensure proper coverage and minimize duplication of efforts.

INTOSAI Auditing Standards

INTOSAI Auditing Standards are consisted of four parts:

- a) Basic Postulates,
- b) General Standards,
- c) Field Standards and
- d) Reporting Standards.

Field Standards includes that the auditor, in determining the extent and scope of the audit, should study and evaluate the reliability of internal control¹⁸. The study and evaluation of internal control should be carried out according to the type of audit undertaken¹⁹. The extent of the study and evaluation depends on the objectives of the audit and on the degree of reliance intended²⁰.

¹⁷ INTOSAI Guidelines for Internal Control Standards, Chapter III, par. 16.

¹⁸ INTOSAI Auditing Standards, Chapter III – Field Standards, par. 131 (c).

¹⁹ INTOSAI Auditing Standards, Chapter III – Field Standards, par. 142.

²⁰ INTOSAI Auditing Standards, Chapter III – Field Standards, par. 143.

As mentioned above, Field Standards explain the issue of examination and evaluation of assurance of internal control systems. However, those Standards don't directly look over neither in practical sense explains co-operation with internal auditor. Moreover, internal audit is not directly mentioned at all.

Even though it hasn't been stated explicitly, those activities should be referred to Internal Audit as well.

Referring to the fact that INTOSAI Auditing Standards constitute the criteria or yardstick against which the audit results are evaluated, **significance and importance of good relations and effective co-operation of external and internal auditors for achievement of good results, should be stated in them more specifically.**

Co-operation of external (public) auditors and internal auditors would be more effective if, in conducting of common activities, they would use similar techniques, methods and terminology. In respect of that, **harmonization of part of Standards common to private sector (commercial) audit, state audit and internal audit** is also possible.

2.2. Definition of internal Audit

Management organizes internal audit as a "supervision" under the organization's internal control system and connection between management, stakeholders and external audit. In its modern perception, internal audit can help in realization of the basic goals of an organization. This result from the new definition of Internal Audit (1999): Internal audit is independent, objective, assurance and consulting activity designed to add value and improve effectiveness of risk management, control and governance processes".²¹

Concerning the INTOSAI Auditing Standards, there is no standard defining internal audit. It is only mentioned in the INTOSAI Guidelines for Internal Control Standards (par. 84.) as an important element of internal control by providing a continuous means for improving an organization's operations.

If the external auditor is to understand purpose procedures and methods of internal audit and use this in audit planning and establishing of audit approach, he has to know its definition. Namely, definition - as substantial determination or description of the concept - should show which role does Internal Audit have in the organizational structure and what is their intended purpose.

As the general framework for public audit work in most of the countries, INTOSAI Auditing Standards, in accordance with growing importance and development of internal audit in public sector, should provide a definition of internal audit function and its relation to external (public) auditor's work.

Therefore, **definition of Internal Audit should be embedded in INTOSAI Auditing Standards.** Also, definition should, to the maximum possible extent, be harmonized with definitions determined and used in private sector's and in internal audit's field.

2.3. Other possibilities

In consideration of possible modifications or even expanding of existing Standards and Guidelines for their implementation, it would be important to also include issues arisen during the last year's workshops and meetings, like is:

- the need to emphasize the importance and impact of Information Technology and Computer Assisted Auditing Techniques,
- to include the concept of quality assurance,
- to pay attention to auditing external aid,
- judicial process (in the case of Court structures),
- detailed and specific contradiction procedures for public sector,
- to develop comprehensive performance audit standards,
- more detailed Audit Sampling Standards, etc.

For most of these last detailed areas the EU Implementing Guidelines (EUIG) for the INTOSAI Standards provide more detailed, relevant guidance, although the EUIG also could benefit from updating and extension on certain aspects. Active consideration needs to be given as to how the EUIG can be further developed and made even more relevant and useful.

In the preparatory phase, a questionnaire to both SAIs from this Working Group and from EU Member States could be created in order to:

- do a survey on the situation and problems related to the implementation of the INTOSAI Auditing Standards, INTOSAI Guidelines for Internal Control Standards and European Implementing Guidelines for INTOSAI Auditing Standards in the individual states and
- to determine the expectations and the possible needs for their development, and whether they consider it necessary to amend them in any possible direction, especially when it comes to the control of EU funds and the relative detailed control procedures.

Report on the results of survey should be followed by discussions regarding the possible development of currently accepted standards and guidelines. On the basis of the survey, if significant ideas arise, recommendations could be prepared. In that case, Working Group on Audit Manuals should liaise with the INTOSAI Auditing Standards Committee and the INTOSAI Internal Standards Committee (whose major project at the moment is a revision and updating of existing Guidelines for Internal Control Standards adopted by INTOSAI in 1992) as well as with other relevant institutions and organizations responsible for development of standards/guidelines for analyzing.

²¹ www.theiia.org

CHAPTER VI: THE GENERAL CONCLUSION

Most of conclusions presented here are not new ideas. Many of them are already incorporated in some countries. However, their presentation as a framework for improvement may be new in countries where they are not fully incorporated.

Nevertheless, it is evident that the SAIs of the Candidate countries, have already taken concrete measures to improve their situation regarding the improvement and development of effective internal control and risk management systems in their countries - either by efforts made by themselves or through the co-operation with ECA, SAIs from EU member states or SIGMA – and achieved a significant progress in this area. The present situation shows constantly improving situation and development in the direction to meet the EU requirements. All countries are obviously eager to ensure that audit methodologies are in line with INTOSAI audit and other related standards, thus being acceptable to the ECA, the EC and other EU bodies. In this respect, additional actions for further improvements are planned to be implemented.

In short, one can conclude that degree of satisfaction that the EU wishes to derive from the CCs in establishment of sound financial management and control systems for their national income and spending, including EU-funds, based on economy, efficiency and effectiveness, everyday is getting closer to the expectations.

However, the review of progress, current position and experiences gained to date by SAIs of all countries has revealed number of issues that still need to be improved and addressed by the SAIs. The most important needs were summarized in the following recommendations:

- Recommendation 1:** *Definitions of "internal control" and "internal audit" need to be clearly understood and applied consistently.*
- Recommendation 2:** *SAIs should continue to focus on the development of effective and efficient ICSs in public sector entities and, where an internal audit function does not exist, to strongly encourage and support its introduction.*
- Recommendation 3:** *SAIs should persuade management of auditees of the importance of internal audit functions undertaking the full scope of its role, where this is not currently the case.*
- Recommendation 4:** *SAIs should encourage management to share internal audit reports with all stakeholders that have some influence on the recommendations made and corrective actions that may be taken thereon.*
- Recommendation 5:** *SAIs should continuously endeavour to develop good working relations and effective coordination with internal audit units (IAUs) and that common practices, carefully taking into account SAI's independence, could be developed.*
- Recommendation 6:** *In the light of the audit of EU funds, further investment in human resource development should be undertaken by both SAIs and IAUs.*
- Recommendation 7:** *Training practice through pilot or other test audits in specific audit areas (particularly to those related to EU funds), should be undertaken by both SAIs and IAUs, and that the experience gained should be translated into technical guidelines and procedures for guiding future audits.*
- Recommendation 8:** *Technical guidelines and good practice guides on specific EU-related areas (such as Structural and Cohesion Funds, VAT and Customs "Own Resources", etc) should continue to be developed and further discussed.*
- Recommendation 9:** *SAIs should cooperate on determining the needs for improvement and development of current international standards and guidelines in the area of internal control system, particularly in terms of undertaking risk and materiality assessments.*

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INTERNAL CONTROL SYSTEMS IN CANDIDATE COUNTRIES

VOLUME II

ANNEXES

Prepared by the PIFC Expert Group
- Working Group on Audit Manuals -

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ANNEX 1:

**RECOMMENDATIONS CONCERNING THE FUNCTIONING OF SAIs
IN THE CONTEXT OF EUROPEAN INTEGRATION: Recommendation 11**

Recommendation 11:

Supreme Audit Institutions should focus on the development of high-quality, effective internal (management) control systems in audited entities.

Internal (management) control refers to the organization, 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 organizations concerned; that programmes are protected from waste, fraud and mismanagement; and the reliable and timely information is obtained, maintained, reported and used for decision-making.

In the responsibility of an organization's management to establish, develop and monitor internal control systems. Internal audit is an integral part of the internal control system and plays a key role in the evaluation of the control system inside the entity.

The preamble to the Lima Declaration states explicitly that overriding, inherent objective of an SAI should be the development of sound financial management. Section 1 of the Declaration states: "Audit is not an end in itself but an indispensable part of a regulator system whose aim is reveal deviations from accepted standards and violations of the principles of legality, efficiency, effectiveness and economy of financial management early enough to make it possible to take corrective action in individual cases, to make those accountable accept responsibility, to obtain compensation, or to take steps to prevent – or at least render more difficult – such breaches".

From the Treaty, inter-institutional agreements, declaration and the Financial Regulations, an important EU rule is a sound and efficient financial management in the execution of the budget. In partnership agreement the governments of candidate countries and the Commission agreed on the need to establish appropriate control at all level of the chain of internal control, as well as external audit.

The SAI itself has an interest in effective internal control systems because:

- a) it can anticipate and prevent errors and omissions, fraud and irregularities at earlier stages than external audit could do; and
- b) the reliability and effectiveness of internal control systems can economize on the SAI's resources.

How can the development of internal control encouraged by an SAI?

It is crucial that the legal mandate of an SAI includes the responsibility to audit and to focus on the quality of internal control systems. An SAI's legal mandate can restrict the organization's possibilities of action in assessments or in the development of the internal control systems. The crucial matter for the SAI is to take active standpoints regarding the role it is able and intends to play and to conduct its work in line with good European practice.

This role could be played in different ways, such as:

a) developing systematic and specific tests and evaluations of the reliability and effectiveness of internal control systems, it is recommended:

- in audit of focus on quality systems approaches of individual transactions;
- to include recommendations in reports regarding the implementation and performance of internal control and internal audit bodies;
- to introduce a more co-operative way of implementing the audit, including discussion with auditees regarding their own internal control standards,

b) establishing a law which states the management's responsibility for building up, maintaining and developing an effective internal control system, the main role of the SAI being to test its functioning in the following ways:

- participating in the development and promulgation of internal control standards (for example by the provision of opinions on financial regulations);
- collaboration in different kinds of comprehensive development work, for example developing different pieces of guidance on auditing (planning, collecting evidence, reporting, etc.) and developing training programmes for internal auditors or inviting them to the SAI's own training courses;

c) checking that the SAI has the right to access the plans and reports of internal audit bodies, and that these can be used in the SAIs planning of the audit. The SAI can be empowered:

- to encourage acts of co-ordination of plans and harmonization of criteria between internal audit bodies and the external audit;
- to asses the quality of the internal audit;
- to establish co-operation in the actual audit work;

d) playing an active role by monitoring the national implementation of the partnership agreement and, in the execution of the EU budget, by being involved in screening (testing) the procedures applicable to the use of such funds, certifications of national reports, etc.

The aim behind all work related to internal control system should be provide the responsible managers with recommendations and information allowing them to fulfill their obligations more effectively. It is therefore necessary that any recommendations formulated

clearly identify the problem or the failure in the system, as well as the entity and procedures concerned.

It is recommended to assess and report on internal control on a periodical basis. Follow-up of previous observations allows the SAI to analyze improvements in the control system and the application of recommendations of previous audits.

The method for auditing internal control systems should be regulated by the SAI's auditing standards and the code of conduct, which should sufficiently prevent the auditor from interfering directly in the management responsibilities of the auditee.

ANNEX 2:

**DEFINITIONS OF INTERNAL CONTROL AND INTERNAL AUDIT
IN CANDIDATE COUNTRIES**

DEFINITIONS OF INTERNAL CONTROL AND INTERNAL AUDIT IN CANDIDATE COUNTRIES

1. Albania

Internal Control: is the organisation, policies and procedures used to help ensure that Government programs achieve their intended results, that the resources used to deliver these programs are consistent with the aims and objectives of the organization, that the programs are protected from fraud, waste and mismanagement, and that reliable and timely information is obtained, maintained, reported and used for decision-making.

Internal Audit: Internal audit is an objective, independent assurance activity for management, designed to increase value and to improve a public entity's operations. By applying a systematic and disciplined approach it helps entity to evaluate and improve the effectiveness of the risk management, controls and governance.

2. Bulgaria

The definitions are detailed in the Public Internal Financial Control (PIFC) Act.

Internal control includes financial management and control systems, internal audit performed by the Public Internal Financial Control Agency (PIFCA) authorities and preventive control.

Internal audit is the audit performed by the executive power independently of the audited entities.

3. Croatia

Internal Audit is determination of fulfilment of tasks and activities of budget user done by independent and objective unit that gives a warning on irregularities and non-compliance with laws and regulation that determines user's activity, and recommends measures for their removal and for improvement of budget user's work.

Public internal financial control describes the overall, consolidated system established for controlling, auditing and reporting on the use of national budgetary and EU means.

4. Cyprus

Internal Control. There is no legal definition on internal control. However, in designing the audit approach and conducting the audit, the definition adopted by INTOSAI as well as generally accepted auditing practices are followed.

Internal Audit. As per Internal Audit Act (voted in June 2003) internal audit is an independent and objective exercise of a consultative nature designed to add value and help to improve the operations of the auditee. It assists the auditee to achieve its objectives through a systematic, disciplined approach to evaluate and upgrade the effectiveness of risk management, the internal control and management systems and procedures.

5. Czech Republic

It is a Czech transcription of the IIA definition.

6. Estonia

Internal Control System

(1) An internal control system is a comprehensive set of measures implemented in the directing of government agencies and state agencies administered by government agencies in order to achieve lawfulness and purposefulness and to ensure:

- 1) compliance with legislation;
- 2) protection of property from damage caused by squandering, non-purposeful use, incompetent management, etc.;
- 3) the purposefulness of the activities of the agencies in the performance of their duties;
- 4) collection, storage and publication of truthful, updated and reliable information concerning the activities of the agencies.

(2) The head of a government agency or a state agency administered by a government agency shall implement the internal control system in the agency and is liable for the efficiency of the system.

Internal audit

(1) Internal audits are activities involving assessment and analysis of the existence of an internal control system in an agency of executive power, the efficiency of the system and its compliance with the requirements established by legislation.

(2) The head of an agency of executive power is liable for the organisation of internal audits.

(3) The general rules for the conduct of internal audits in government agencies and in state agencies administered by government agencies, including provisions for reporting, shall be established by the Government of the Republic.

(4) In order to conduct an internal audit, a person responsible for the internal audit shall be appointed and, if necessary, a corresponding structural unit shall be formed in direct subordination to the head of the government agency or the state agency administered by a government agency.

(5) Internal audits shall be conducted by the internal auditor. Additional requirements for the employment of internal auditors shall be established by the Government of the Republic.

7. Latvia

Definitions stated in the Internal Audit Law and in the Internal Audit Manual used in government internal audit services.

8. Lithuania

Internal Control is the entire set of controls established by the management of a public legal entity in order to provide reasonable assurance that the operations of the public legal entity are legal, economic, efficient, effective and transparent, that the strategic and other plans are implemented, that assets are safeguarded, that financial information and reporting are reliable and exhaustive, that contractual liabilities to third persons are satisfied and that all identified risks are managed.

Internal Audit is the part of the internal control system of a public legal entity which provides an independent, objective assessment (examination, evaluation and consulting) by the internal auditors with a view to improving the performance of the public legal entity.

9. Hungary

The Public Internal Financial Control involves system of financial control, system of internal audit and tools for harmonisation and co-ordination of methodologies and procedures of above mentioned two systems.

Explanation:

The "Public Internal Financial Control" is the entire consolidated public system (central and local) established by the government for control, audit and reporting on the use of national budgetary instruments.

Internal audit is an objective and independent tool for management designed to add value and improve an organisation's activities. It helps an organisation to better accomplish its objectives by bringing a systematic and disciplined approach to evaluate and improve the efficiency, effectiveness and economy of risk management, control and management functionality. The internal audit is an independent function and auditors report directly to the HPO.

10. Malta

- (1) There is no legal definition of IC. However, the National Audit Office (Malta) Audit Manual defines internal control as "all the policies and procedures conceived and put in place by an entity's management to ensure:
 - The economical, efficient and effective achievement of the entity's objectives;
 - The adherence of external rules (laws, regulations, etc) and to management policies;
 - The safeguarding of assets and information;
 - The prevention and detection of fraud and error; and
 - The quality of accounting records and the timely production of reliable financial and management information."
- (2) In terms of draft legislation entitled "Internal Audit and Investigations Act", internal audit is defined as "an independent, objective assurance and consulting activity designed to add value and improve the operations of auditees, helping the auditee to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."

11. Romania

Internal Control is all forms of control exercised at the level of public entity, including internal audit, established by the management in conformity with its objective and legal regulations with the view of ensuring economy, efficiency and effectiveness management of the funds; ICS also include the organisational structures, methods and procedures.

Internal Public Audit is the activity functionally independent and objective which gives assurances and advises the management for a good management of the public revenues and expenditures, improving the public entity activities; helps the public entity to achieve its objectives with a systematic and methodical activity which assess and improve the efficiency and effectiveness of the management system based on the risk management, control and management processes.

12. Slovenia

Internal control system comprises procedures, methods and responsibilities which aim to assure compliance with regulation, transparency, economy, efficiency and effectiveness.

Internal audit is independent examination of financial management systems, financial controls, regularity, and performance as well as advice to the management on improvements of efficiency of its operations.

**ANNEX 3: BRIEF DESCRIPTIONS OF INTERNAL CONTROL SYSTEMS IN
CANDIDATE COUNTRIES
(Sent by the SAIs)**

Box 1. Comparative scheme of models of ICS in some of candidate countries

| COUNTRY | LEGAL FRAMEWORK/REGULATIONS COMPETENCES/RESPONSIBILITIES | INSTITUTIONS/BODIES |
|--|--|---|
| 1. Albania | The Law on Public Sector Internal Audit | The Central Internal Financial Control department (within the MF); |
| 2. | The Treasury; | |
| 3. | IAUs within the line ministries; Finance offices within budget institutions. | > oversight over the IAUs within the line ministries; internal audit of the MF and entities under control of MF. |
| | | > ex-ante controls over the expenditures. > ex-post compliance audits; report to the line ministers. > first level of control in the budget execution. |
| 1. Croatia | The Budget Law | |
| 2. | The Budget Execution Law | |
| 3. | The Rules on the Internal and Budget supervision | |
| 4. | Regulation on the System of the Treasury Main Book | |
| 1. | Ministry of Finance; | |
| 2. | Office for Internal Supervision and State Property Office; | |
| | Internal Audit Units within the budget using entities | > coordinate and ensure the proper functioning of the system through the competent departments. > organized within the Government. |
| | | > internal audit function within the budget using entities. |
| 1. | The Czech Republic The Financial Control in the Public Administration Law | |
| 2. | Decree on the Execution of the Financial Control Law | |
| 1. | Ministry of Finance ; | |
| | IAUs within the line ministries, agencies, and regional and municipal bodies | > "public administration reviews" and internal audit in the public sector. |
| 1. Cyprus | Annual Budget Law | |
| 2. | Public Procurement Law | |
| 3. | Financial Instructions and Stores Regulations | |
| 1. | Internal Audit Act Ministry of Finance | |
| 2. | Ministry of Finance/Treasury | |
| 3. | Treasury | |
| | Internal Audit Service | > monitor budget execution. > monitor public procurement and award of contracts. > monitor control systems and implementation of regulations; upgrade control procedures as necessary. > independent review and assessment of ICSs and financial procedures. |
| 1. Estonia | The Government of the Republic Act | |
| 2. | General Rules of Procedure of Internal Audit in Government Institutions and State Agencies | |
| 1. | relevant decrees of the Minister of Finance | Ministry of Finance; |
| 2. | Financial Control Department (within the MF); | |
| | Internal auditors/internal audit units (within the major government institutions). | > analyses and coordinates the organization of implementation of ICSs and IAs in the government sector. > internal auditor of the Government. |
| | | > internal audit function within the government institutions. |
| 1. Hungary | The Public Finance Act | Financial Management and Control Services (within public organizations); |
| 2. | Inspection; | |
| 3. Internal Auditors | | > preparation of documents for financial decisions; ex-ante financial control and accounting of financial transactions. |
| | | > detects irregularities and generates financial sanctions and corrections > internal audit function; functionally independent; report directly to the head of organization. |
| 1. Latvia | The Internal Audit Law | |
| 2. | Regulations on Internal Audit | |
| 1. | The Ministry of Finance; | |
| 2. Internal Audit (within public institutions) | | > overall coordination of internal audit and development of audit methodology. > providing assurance that objectives of the institution are being met. |
| 1. Lithuania | The Law on Internal Control and Internal Audit | |

2. Resolution of the Government on the implementation of the Law and Charter of the Internal Audit Unit
 Relevant decrees of the Minister of Finance 1. The Ministry of Finance;
2. The Department of Methodology of the Financial Control within the MF;
3. Internal Audit Units (within the public entities);
4. Head of the public entity. > ex-ante controls over the expenditure.
 > overall control of internal audit and development of audit methodology.
- > providing assurance that objectives of the institution are being met.
- > establishing internal control procedures.
1. Malta Chapter 9 (Finance) of the Constitution of Malta
2. Financial Administration and Audit Act, 1962
3. General Financial Regulations, 1966
4. Ministry of Finance and Economic Affairs / Treasury Circulars
5. Public Service (Procurement)
 Internal Audit and Financial Investigations Act, 2003 1. The Ministry of Finance;
2. The Treasury;
3. The Central Bank;
4. The Department of Contracts (within the MF);
5. The Internal Audit and Investigations Directorate (under the Cabinet Office).
 > ensuring the proper functioning of the system.
- > supervising, regulating and recording all government financial transactions.
- > keeping the money pertaining to the Government and all funds advanced by EU to finance programmes/projects.
- > administration of procurement procedures.
- > providing assurance that proper controls and procedures in government departments are in place and meet set procedures; carrying out ex-post performance auditing; certifying body on ICSs for EU purposes.
1. Slovakia The Financial Control and Internal Audit Law
1. Internal Audit Regulation on implementation of the law The Ministry of Finance
 IAUs of all ministries > ex ante control; on going control
- > ex post control; definition of audits (financial, compliance, performance...)
- Slovenia The Public Finance Act 1. Ministry of Finance;
2. The Public Accounting Service (at the MF);
3. The Budget Supervisory Service (within the MF);
4. The Budget Inspection Department;
5. Internal Audit Services (within line ministries).
 > controlling of budget funds.
- > various types of control over bookkeeping and accounting controls.
- > supervises implementation of regulations and guidelines for financial management, control and internal audit by on-the-spot checks and based on reports of Internal Audit Services.
 > the budget inspection function.

A brief description of ICS in Albania

The internal control framework comprises controls exercised by the budget department, the treasury, internal audit units within the line ministries and the central internal financial control department. In addition, the SAI carries out an independent external audit of budget execution.

Each budget institution has a finance office that is responsible for first level controls in the budget execution. The finance officer ensures completeness of documentation, availability of budget allocation and compliance with departmental rules. The treasury exercises the following ex-ante controls over the expenditures: verification of documents submitted by the budget institution to ascertain correctness and completeness, availability of budget appropriation, cross-verification with receipts (taxes deducted at source and its subsequent deposit). It is important to remember that even a well-designed system of internal controls can be circumvented by employee collusion and management fraud.

Currently, all line ministries have their own internal audit units. The internal auditors mainly carry out compliance work on ex-post basis. The internal audit units develop their own audit programs and prepare audit reports after completion of each audit for representation to the head of department. Mostly the report is sent to the line minister. The internal audit is still in the formative stage. The internal audit units in line ministries lack proper recruitment policies and structured training and professional development opportunities.

In 2000, a central internal financial control department was set up within the Ministry of Finance. This department has a staff of 22 and is evolving and expected to provide oversight over the internal audit units within the line ministries. It also carries out internal audit within the finance ministry and entities under the control of the MoF.

In February 2003 was created the legislative framework basis for ICS and internal audit by approval of the Law on Public Sector Internal Audit, there are uttered concepts on Internal Control and Internal Control Systems as well. This legal act defined internal control and internal audit and stressed their significance and influence to the economy as a whole. It will influence the line managers to pay more attention to the internal control systems and consequently require them to strengthen internal audit units within their ministries as one of the key functions of internal audit is to continuously assess the internal controls and make recommendations for improving it.

As the Finance Minister has the overall responsibility for ensuring proper internal controls, he submits an annual assurance letter to the Council of Ministers indicating maintenance of effective internal control framework is in place. This enhances the ministers' understanding of the state management and provide positive incentives for ministries to correct any deficiencies reported by internal control system.

THE CZECH INTERNAL CONTROL STRUCTURES

| REGULATIONS/STANDARDS | COMPETENCES |
|--|--|
| 320/2001 Financial Control In The Public Administration Law | Coll. management control and ICS system so called "public administration reviews" financial sources from abroad internal audit in the public sector |
| decree of the Ministry of Finance Num. 64/2002 Coll. on the execution of the Financial Control Law | methods and procedures linked with each part of the ICS system 5 types of annual reports |
| Guidelines of Internal Auditing in the Public Sector and reference to the IIA Professional Standards and the European implementing guidelines of IAS | 14 model documents serve instead "Audit Manual" (e.g. audit plan, risk assessment chart, system checklist, budget checklist, report, working papers) |
| Guidelines on Public Administration Reviews (carried out by the control authority of the public body at the subordinated organizations) | 18 model documents (e.g. commencement of the review, requirements, penalty fees and procedures, reports, working papers) |
| Code of Ethics 1. general "Public Administration 2. explicitly expressed commitment to adhere the IIE CoE | (CoE): CoE extremely stressed principles competency and due car objectivity and and imparialit avoiding of conflict interests |

INTERNAL CONTROL SYSTEM IN CROATIA

Financial management, control and internal auditing system in Republic of Croatia is in the competence of the Ministry of Finance as coordination body. It is regulated by the number of legislative and sub legislative regulations whereof the most significant are:

1. The Budget Law;
2. The Budget Execution Law;
3. The Regulation of the System of the Treasury Main Book and the Modes of Maintenance of the Unified Treasury Account;
4. The Rulebook on Budget Users' Internal Audit;
5. Development Strategy of PIFC in the Republic of Croatia.

Control and audit of the revenue, expenses, assets and liabilities on the government and on local level is carried out by different government bodies, each at its competences (particular departments and organizational units inside Ministry of Finance and to Government Offices).

Croatian State Audit Office as a supreme audit institution performs evaluation of reliability and efficacy of internal control within auditees and their impact on the information stated in the financial reports and evaluation of internal audit. State auditor's duty is also to determine what actions have been taken to rectify the faults and deficiencies noticed by the internal control and internal audit and, based on established facts, to propose to the management of the auditee the further corrective actions to be taken.

State Treasury– Central Treasury

Central Treasury is the central unit in organizational and informational meaning which approves resources, liquidate payment requests and carries out control on use of resources.

Department on Budget Supervision

Independent department in the organization of the State Treasury with the task to carry out budget supervision jobs due to assurance of legal and objective use of budget resources as also follow up and giving suggestion on the legal drafts and regulations which have impact on the execution of the state budget.

Budget Supervision, in that sense, is the control procedure of the legality, objectivity and timely use of budget resources that at the same time prescribes measures for elimination of ascertain irregularities and measures for their improvements. It contain accounting, financial, and other business documents of the budget and non budget user as also local (regional) self-government units and its users. Budget supervision is performed by the budget supervision inspectors, who's audit reports are delivered to the head of the audited entity, to departments for the preparation and execution of the state budget within the Ministry of Finance, and if necessary, to other authorized bodies and to the State Audit Office.

Department for Harmonization of Internal Audit and Financial Control (CHU)

This Department id consisted of two divisions:

1. Division for Methodology and Co-ordination of Internal Audit – shall co-ordinate the establishment of internal audit with budget users; determine and develop methodology and standards of the work of internal audit in the public sector in accordance with international standards and best European practice; prepare and pass the Internal Audit Manual; co-ordinate and participate in training issues; etc.
2. Division for Methodology and Co-ordination of Financial Management and Internal Control – shall determine and develop methodology of financial management and systems of internal controls in public sector in accordance with best European practice, which shell primarily pertain to independent functions of ex-ante and ex-post financial controls, functions of accounting and financial reporting and procedures for preparation, processing and storage of financial and other documents; shall prepare and develop procedures, implement training of personnel, etc.

Internal Audit

Internal audit is the budget user body that independently and objectively ascertain fulfillment of the tasks and functions of the budget users, give notice on irregularities and inconsistency with the legal and other regulations which fortify their dealings as also propose measures for elimination of ascertain irregularities and measures for the improvements of their dealing.

It is established by the head of the budget user.

Finance minister prescribes conditions to be fulfilled by the internal auditors, methodology of work as also mutual criteria.

Report with the activity results internal auditor submit to head of the budget user at least once

Semi-annual, as also to other government bodies authorized for control and audit in accordance with the particular regulations.

Tax Administration

The Tax Administration's inspection service (at Ministry of Finance) performs external supervision of taxpayers (supervision of the calculation, collection and execution due to collection of the obligatory contributions, thereof submit misdemeanor notices due to the violation of the tax regulations).

Custom Department

Department within the Ministry of Finance; organize internal control of public finances through supervision and audit of revenue which is collected by the Directorate.

Public Procurement Office and State Commission for Supervision of Public Procurement Procedures

Government bodies in charge of public procurement procedures and control.

Government Office for Internal Supervision

Established in 2002 with mandate to evaluate financial and material business transactions in Government departments and state administrative bodies on the request of Government. At the moment – in transition to the Government's Internal Audit Service.

State Property Office

The Office is expert department of the Government which performs property filing and maintenance tasks (real-estates, movables, rights and obligations) owned by the State.

Internal Control System in Cyprus

Internal Control System in Cyprus is based on relevant law, financial rules and regulations as well as financial instructions and circulars issued from time to time by the Ministry of Finance and the Treasury. ICS constantly evolves to take account of changes in the financial environment.

Budget Law – voted by Parliament annually and sets out the broad guidelines for financial control of public funds and financial dealings. The execution of the budget is monitored by the Ministry of Finance, as well as by line Ministries.

| | |
|---|---|
| Public Procurement Law | - Sets out detailed rules regarding public procurement. It aims at ensuring fair competition and efficiency in the award of public contracts in conditions of transparency. Until recently there was a Central Tender Board headed by the Accountant General. Following streamlining with EU Law the procedure has now be decentralised to ministry level. |
| Internal Audit | - In July 2003 an independent Internal Audit Service was set up (under the Internal Audit Act). The Service reports to the Council of Ministers through the Internal Audit Board. The Service has a mandate to perform internal audit in all government departments as it sees fit. The Act contains several provisions to safeguard the independence of the Service. |
| Financial Instructions and Stores Regulations | - they comprise detailed instructions and procedures for all day to day financial dealings of the government, and they form an important element of ICS. |

Internal Control System in Estonia

Legal basis for internal control and internal audit is set up in the Government of the Republic Act, relevant regulations of the Government and decrees of the Minister of Finance.

Government of the Republic Act includes Chapter 6¹ Internal Control and Internal Audit. Regulation of the Government of the Republic No 329, October 18, 2000 approved General Rules of Procedure of Internal Audit in Government Institutions and State Agencies within their Area of Government and Additional Requirements Established for Internal Auditors.

Ministry of Finance is appointed by the Government as the leading ministry in the area of internal control and internal audit in the government sector. It analyses and coordinates the organisation of implementation of internal control systems and internal audits in the government sector.

Financial Control Department of the Ministry of Finance (FCD) acts as the internal auditor of the Government. It:

1. monitors compliant and purposeful use of the state budget and external assistance funds;
2. coordinates and analyses the implementation of the internal control system and organisation of internal audit in government institutions and makes proposals for making them more effective.

FCD is focussing on counselling in methodology, auditing, reporting, evaluation of the organisation of internal audit, providing training for internal auditors. In May 2000 Best Practice Audit Manual for Public Sector Internal Auditors was introduced. It is updated every year. Sufficient training was organised with the assistance of experts from EU member states.

According to the law internal audit function was established in major government institutions from 1 January 2001. Each minister, county governor (15 in Estonia) and head of government agency had to ensure the establishment of internal control system; they are responsible for its accurate and purposeful implementation. They should ensure the implementation of internal audit and appoint the internal auditor or if necessary set up the relevant unit. Internal auditor and the head of the internal audit unit are directly accountable to the head of the institution.

At the moment about 200 internal auditors are working in government institutions. Reporting system is in place: FCD receives strategic plans, work schedules and quarterly reports. FCD devises a consolidated report, which is submitted to the Minister and the Government. The role of internal auditors in state accounting entities has been more clarified in the new legislation. For example, the State Budget Act stipulates, that an audit of the annual reports of ministries and county governments shall be conducted by the person responsible for the internal audit of the corresponding state accounting entity who shall assess the accuracy of the annual report and the legality of the transactions of the state accounting entity. The State Audit Office may, in the course of an audit of the annual report of the state, take into consideration the assessment made by the person responsible for the internal audit of the state accounting entity regarding the accuracy of the annual report and the legality of the transactions of the state accounting entity.

Internal control systems and internal audit function are evaluated by the State Audit Office during its audits. General assessment of the organisation of internal audit in public sector is given by the office in its annual overviews on the use and preservation of state assets. The State audit Office has proposed a number of measures necessary for improvements of public internal financial control system.

Since 2003 one of the tasks of the FCD is assessing the quality of work of internal auditors of ministries, county governments and State Chancellery. The audit of assessing the work of internal auditors in 2003 was carried out from May to July 2004 together with Teloitte&Touche auditors. The consolidated opinion of the quality of work of internal auditors was good (ranking is: very good, good, satisfactory, not satisfactory).

HUNGARY

The concept and elements of Public Internal Financial Control (PIFC)

The EU-conform legislative restructuring of the Hungarian PIFC system took place in the second half of 2003. According to the Policy Paper adopted in July, 2003, Act No XXXVIII of 1992 on Public Finances (PFA) was amended. According to Paragraph (1) Article 120: *"The main objective of public financial control is to ensure that public finances are managed in accordance with the principles of legality, regularity, economy, efficiency and effectiveness."*

PIFC consists of three major elements:

1. Financial management/control

The FM/C is the first level control within an organisation, the establishment, operation and development of which falls under the responsibility of the Head of PBO. The Head of PBO is responsible for issuing rules, elaborating and operating processes within the PBO that ensure the legality, regularity, economy, efficiency and effectiveness of the use of available resources. FM/C systems shall include:

- a) preparation of documents relating to any financial decisions (including documents of budgetary planning, commitments, contracts, disbursements, recoveries due to irregularities),
- b) ex ante/ex post financial control, approval/countersigning of financial decisions on the basis of legality and regularity,
- c) accounting of financial operations (proper book-keeping and reporting in accordance with rules of law in force).

The functional separation of tasks shall be ensured. Main task of the FM/C systems are to ensure that all financial activities and objectives of the PBO comply with the principles of legality, regularity and sound financial management; assets and liabilities are safeguarded against waste, abuse, mismanagement and other irregularities; adequate, timely and up-to-date information about the financial and other relating activities of the PBO is available; guidelines relating to the harmonisation and co-ordination of FM/C systems are implemented; available assets and liabilities are used in accordance with the principles of legality, regularity and sound financial management.

Further details on FM/C can be found in Gov. Decree 217/1998. (XII.30.).

2. Internal audit

According to Paragraph (1) Article 121/A: *"Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organisation's operations. The internal audit activity helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes."*

The regulation for the functionally independent internal audit has been elaborated in accordance with internationally accepted standards. The functional independence must be ensured regarding the elaboration of the annual audit plan, preparation and implementation of audits, selection of audit methods, elaboration of conclusions and recommendations, reporting; internal auditors must not be involved in any management function.

Further details on internal auditing can be found in Gov. Decree 193/2003. (XI.26.).

3. Central harmonization and coordination

According to Article 48 of the PFA, the Minister of Finance is responsible for the regulation, development, harmonisation and coordination of FM/C and internal auditing. The Central Harmonisation Unit established within the Ministry of Finance carries out this task. The CHU prepares legislation; elaborates, issues and regularly reviews methodological guidelines; furthermore monitors the implementation and assesses the quality of the internal audit performed through compliance tests.

A Consultative Inter-ministerial Committee for PIFC has been established in order to strengthen the functional independence of internal auditors, and to help the Minister of Finance in performing his tasks.

OVERVIEW

INTERNAL CONTROL SYSTEM IN LITHUANIA

Internal control system in Lithuania is regulated by the following laws:

- Law on State Treasury – defines content of the State Treasury, procedures for opening of Treasury account, pay into Treasury account and pay out from Treasury account, purpose, management and functions of State Treasury general system.
- Law on Budgeting – defines content of State budget and municipality budgets, legal basis for formation of revenues of the said budgets and for the use of appropriations, main provisions and procedures for drawing up, approval, implementation, evaluation and control of budgets, duties, rights and responsibilities of appropriations managers.
- Law on Budget Institutions – defines responsibility of managers of budget institutions for appropriate control of organisation in managing budget funding.
- Law on Accounting – defines accounting of assets, own capital, commitments, operations and events as well as organisation and handling of accounting.
- Law on Internal Control and Internal Audit – establishes a basic legal framework for internal control and internal audit in a public legal entity as well as responsibilities of its heads and internal auditors
- Law on Local Self-Government – denotes the right and actual power of the institutions of local government as well as competence of Municipality Council and Board and Municipality Controller.

The Ministry of Finance

Following the provisions of the Law on Internal Control and Internal Audit the Ministry of Finance:

- give a methodical guidance in financial control and internal audit matters, perform the assessment of internal audit services activities;
- prepare and provide the Government and the Budget and Financial Committee within the Parliament of the Republic of Lithuania with the annual report on the functioning of the internal audit services;
- co-ordinate internal auditors training, professional development and their certification system.

To implement the above functions Finance Control Methodology Department was established within the Ministry of Finance that will ensure centralised harmonisation of methodologies for finance management and control as well as internal audit: will prepare and amend legal acts and methodological recommendations relating to finance control and internal audit including internal audit of European Union financial support programmes or Structural Funds expenditure as well as will co-ordinate implementation of the said acts and recommendations.

Functional Independence of Internal Audit Service

Tasks of public sector institution's internal audit service:

- to assess whether a public legal entity conducts its activity in compliance with applicable legal normative acts;
- to advise the head of a public legal entity on the reduction of risk factors;
- to provide recommendations to the head of a public legal entity with the goal of improving the activities, management and internal control of the public legal entity;
- to assess strategic and/or other action plans, the implementation of the programmes of a public legal entity and the economic, efficient and effective use of state and municipal assets;
- to assess the administration and use by the public legal entity of funds received from EU and foreign institutions or other funds;

National Audit Office of the Republic of Lithuania

In compliance with the Law on the State Control the goals of a supreme government audit institution, accountable to the Parliament - the State Control:

- to supervise the lawfulness and effectiveness of management and use of the State property and carrying-out of the State budget;
- to ensure that government auditing conforms to the international standards accepted by the International Organisation of Supreme Audit Institutions INTOSAI and consolidates a positive role of the government auditing and its impact on the State and community.

In a manner prescribed by international treaties of the Republic of Lithuania and other legal acts, the State Control shall carry out audits of the European Union financial assistance allocated to the Republic of Lithuania.

Internal control systems and internal audit function within audited entities are evaluated by the State Control during its financial audits. An overall assessment of internal control system in the public sector is given by the State Control as special chapter in its annual conclusion on the account of the execution of the State budget.

Internal Control System in Latvia

Internal Control System in Latvia is regulated by:

- Internal Audit Law (adopted on October 31, 2002). The purpose of this Law is to ensure the evaluation of the functioning of the Internal Control Systems in Ministries and subordinate institutions, as well as in the programs and projects that are fully or partly financed by the state or by European Commission.
- Cabinet of Ministers' Regulation No 306, "Internal Audit Procedure in a State Institution" (adopted on June 3, 2003);
- Cabinet of Ministers' Regulation No 466, "Basic Requirements for Developing Internal Control Systems" (adopted on August 19, 2003), which regulates the basic requirements that institutions, subordinate to the Cabinet of Ministers and fully or partly financed from the State Budget should follow when developing Internal Control Systems.

In compliance with the Cabinet of Ministers' Regulation No 306, Ministries and other state institutions annually submit to the State Audit Office their Internal Audit Strategic Plans, short-term and long-term plans, as well as annual reports of the Internal Audit units. Ministry of Finance (MoF) submits to the State Audit Office an annual report on the functioning of the Internal Audit System in the government, which includes information about the fulfillment of the annual plan, essential conclusions, suggestions, and other important information.

The State Audit Office is represented at the Internal Audit Board, which was established with the aim to evaluate the development of Internal Audit in the government and to facilitate setting up a united internal audit policy and methodology in the Ministries.

A Financial Audit Manual was developed by the State Audit Office in 2003, and it states that during financial audits, amongst other things auditors check and evaluate the reliability of internal control systems. Financial Audit Planning Memorandum contains a chapter about Internal Audit with checklists to be used while evaluating the IA Systems.

In 2003 and 2004 the State Audit Office has had regular meetings with the heads of IA units of MoF and other government institutions. The main objective of the meetings was to discuss co-operation possibilities between internal and external auditors, co-ordination of audit plans, presenting audit results and audit programs.

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INTERNAL CONTROL SYSTEMS IN MALTA

Internal Control systems in Malta are the primary responsibility of the heads of Government Ministries and Departments. Top management in Ministries/Departments is to ensure that proper internal controls are in place, in line with good internal control practices as well as in consonance with directives that may be issued by Treasury (headed by the Accountant General) and by the Ministry responsible for finance (headed by a Permanent Secretary).

The Ministry of Finance is one of the line ministries within the Maltese Government. Objectives of the Ministry include:

- Efforts directed towards decreasing the Public Deficit by better control of Government Revenue and Expenditure;
- Right mechanism to ensure cost effectiveness and value for money in public expenditure;
- Developing benchmark reviews across the Public Sector;
- Ensuring the proper functioning of the Extended Decentralised System of fund Management (EDIS), which implies that ex-ante controls, hitherto exerted by the EU Commission would be eliminated but ex-post controls will still be retained.

The Treasury aims to ensure the maintenance of an efficient accounting and internal control system throughout the Public Service. In following this objective, the Treasury has the onus of supervising, regulating and recording all government financial transactions as determined by the Laws and Regulations administered by the department. The Accountant General (Head of Treasury) is responsible for:

- Checking that sound accounting policies and procedures are applied at all levels;
- Effecting payments to third parties in respect of approved projects; and
- Managing the Public Bank Account and accounting for the Consolidated Fund and EU funds.

The Public Account is the account at the **Central Bank of Malta** where all monies pertaining to the Government of Malta, as well as money held on behalf of third parties, are kept. The Central Bank is the bank where all funds advanced by EU to finance respective programmes/projects are deposited.

The computerized electronic accounting system across government (DAS - Departmental Accounting System) has in-built controls that ensure that internal controls function effectively and that reports pertaining to the accounting system are issued.

The Director of Contracts is responsible for the running of the Department of Contracts (which falls under the Ministry of Finance) and for the administration of the procurement procedures as laid down in the Financial Administration and Audit Act Public Service Procurement Regulations. The Director of Contracts has to ensure that tenders are issued and published and that contracts are awarded in strict conformity with the principles of free access, fair competition and transparency.

The Internal Audit and Investigations Directorate (IAID) is an independent agency operating under the responsibility of the Cabinet Office. It is functionally responsible to the Internal Audit and Investigations Board (IAID) that is chaired by the Secretary to Cabinet of Ministers. The role of the IAID is to provide assurance that proper controls and procedures in all government departments meet the pre-conditions set for the introduction of EDIS as well as the future implementation of the structural and cohesion funds. The IAID is also responsible for carrying out 'ex-post' performance auditing. It is the certifying body on internal control systems for EU purposes.

The IAID also functions as the national coordinator with those EU Commission services responsible for internal control and audit as well as the protection of EU financial interest, particularly against mismanagement and fraud. The IAID is also the national interlocutor for DG OLAF.

The National Audit Office is the external auditor of the Government of Malta and performs the external financial control function. The current legislative and organizational set-up of this Office is attributed to constitutional and legislative changes in state audit legislation that were undertaken in 1997, following the decision to set up the National Audit Office as an autonomous body independent from Government. Prior to the 1997 legislative changes, the National Audit Office was an Audit Department that was an integral part of Government.

In terms of the Constitution of Malta and the 'Auditor General and National Audit Office Act' the National Audit Office's mandate is to carry out financial and compliance audits of Government Ministries and Departments. The Office may also carry out financial and compliance audits of bodies receiving, administering or using public funds. It may also carry out Value for Money Audits and Investigations on finances, activities, programmes and other matters relating directly or indirectly to Government.

This Office is wholly independent from the Executive arm of Government and is responsible directly to Parliament. The Auditor General's reports are debated by the Public Accounts Committee (PAC).

Other Key Players in Internal Controls relating to EU Funds

In addition to the above key players, Malta's EU Accession process has also created additional key players that ensure proper transfer and management of EU funds flowing to/from Malta.

Presentation of IC and IA system in Romania

The Law on Internal Audit establishes the organization of Public Internal Audit as consisting of the Public Internal Audit Committee (PIAC), a Central Harmonization Unit for Public Internal Audit (CHU) and Internal Audit Units (IAU) within public entities.

The **Public Internal Audit Committee** has been established attached to the Central Harmonization Unit for Public Internal Audit and it is a consultative organism that acts to define the strategy and to enhance the public internal activity in public sector. The committee is made of following 11th members:

- the president of Financial Auditors Chamber.
- academic professors - expert in public internal audit
- specialists with high qualification in public internal audit field
- general director of CHU
- experts in other fields i.e. public accounting, jurisdiction, IT system

The **Central Harmonization Unit for Public Internal Audit** has been established in the Ministry of Public Finance. The head of CHU reports directly to the minister. This unit has a staff of 31 of which four are academic staff and 27 support staff. In achieving its objectives CHU have to cooperate with Romanian Court of Accounts. The main duties of CHU are to:

- elaborate, conduct and apply a unique strategy in public internal audit field and to monitor the activity on the national level
- improve the legal framework in this field
- implement the procedures and methodologies based on international standards, including the internal audit manual
- develop the methodology in assessing management risk
- develop the Ethic Code for internal auditors
- coordinate the selection and training staff in order to develop appropriate human resources and training policies for both the internal audit units and Central Harmonizing Unit

In accordance with the law, the senior management(either the head/director or the board of executives/directors) of an organizational entity with a budget above 100.000 EUR has the responsibility of establishing the organizational framework necessary for carrying out the activity of public audit. Since the 1999, **internal audit units (IAUs)** have been established in all ministries and the agencies.

IAUs perform a variety of tasks, ranging from traditional compliance audit and special investigations of violations of rules and regulations to more modern audits of systems based on risk assessments. Most IAUs in the line ministries have developed annual and three-year audit plans.

An important development when it comes to setting up of an internal control system, has been the development of the National Fund system for managing EU pre-accession funds on the decentralized basis including the formal accreditation of the National Fund unit of the Ministry of Public Finance and the SAPARD Agency. The experience of preparing a comprehensive set of written procedures and establishing an IAU in accordance with internationally accepted auditing standards was utilized by other parts of the administration. Funds to successfully complete the accreditation process have currently been made available from the Phare program.

The Romanian Government has taken a big step forward in implementing internal audit as a government-wide instrument that can facilitate better financial accountability.

DESCRIPTION OF ICS IN SLOVENIA

The public finance system of the Republic of Slovenia and within it the **internal control systems** were established by the Public Finance Act (PFA) adopted in September 1999 and amended in 2000 and 2002. The Ministry of Finance has the main role in internal control. The function of the internal control in the Ministry of Finance is based on their role as the controller of budget funds. The Ministry of Finance is responsible for controlling the budget funds also through the budget inspection function in the Budget Supervisory Service. One of the departments of the Budget Supervisory Service is the Budget Inspection Department, which supervises implementation of the Public Finance Act and regulations on management of central government budget funds.

The Public Accounting Service at the Ministry of Finance represents a central accounting service for almost all direct central government budget spending centres. The service carries out various types of controls. Accountants perform control over bookkeeping in accordance with the relevant regulations (whether all necessary regulations are in place, whether original invoices are attached, whether a correct expenditure account is indicated in the payment order, etc.) and the accounting control. In addition, many controls are also built-in within the computer program MFERAC which is a uniform program for all direct budget spending centres on the government level, irrespective whether the accounting is performed by the Ministry of Finance or by an independent accounting service of a direct budget spending centre.

Article 71 of the PFA provides that ministries and/or the local government bodies responsible for finance supervise the operations of legal entities - public institutions, public companies, funds and agencies. Furthermore, Article 14 of the Regulations on guidelines for the harmonised functioning of the public internal financial control set up detailed requirements, conditions and procedures for implementing control over public finances in public institutions and other budget users performing public services.

According to the amended PFA and the Regulations on guidelines for the harmonised functioning of the Public Internal Financial Control the Budget Supervisory Service at the Ministry of Finance is responsible for development, harmonisation and co-ordination of the Public Internal Financial Control. In line with the PFA, the Budget Supervisory Service at the Ministry of Finance supervises implementation of regulations and guidelines for financial management, control and internal audit by on-the-spot checks and based on reports of internal audit services. Internal Audit Services submit to the Ministry of Finance regular annual reports on performance of the service, including a summary of findings and recommendations, and special reports (red line reports) when an irregularity involving significant damage is detected or if there are reasonable grounds to believe that a criminal offence has been committed, and if the management does not respond to their recommendations.

Internal audit services are established in all ministries and in some major bodies within ministries. The budget spending centres with the budget which exceeds 500 million SIT must ensure regular annual internal auditing of their operations by their own Internal Audit Service, joint Internal Audit Service or by external provision of internal auditing (hiring a private audit company); in performing internal audit, the private company must comply with the Guidelines for internal audit of budget spending centres.

The Court of Audit of the Republic of Slovenia represents the external control over the budget and other public finance. The CARS assesses the ICS as a part of financial audits or as a separate pre-audit. The audit of the financial statements of the final account of the state budget for 2001 included review of ICS in 19 Ministries, 4 Government Offices and the National Assembly. The auditors assessed inherent risk and control risk and used the obtained results for defining the type, time scheduling and the scope of substantive testing for the Audit of the implementation of the state budget for 2001.

On the basis of testing the internal control systems, the auditors assessed that control environment supports internal control operation within 11 direct budget users (57,9 % of all audited direct budget users). For all other direct budget users the auditors assessed on the basis of testing the control environment that the inherent risk was high due to different factors. The most obvious factors were: demanding programmes undertaken by the budget users, transactions of high value, undefined and non-unified managerial structures, complex organisation of entities, replacement of management and insufficient accounting system.

After the review of existence and operation of the internal control, the auditors concluded that internal controls would not prevent possible misstatements in financial statements or in implementing the budget. The control risk was assessed as high, except in one ministry where compliance tests showed that internal controls were designed well and their operation was reliable. The audit procedures which followed in others entities did not rely upon internal controls.

ANNEX 4:

**EXAMPLES OF FINANCIAL CONTROL SYSTEMS IN EUROPEAN UNION,
SOME EU MEMBER STATES AND NON EUROPEAN COUNTRIES**

1. EUROPEAN UNION

4. Background

The fall of the European Commission (EC) – in a sense the “government” of the European Union - in early 1999 was 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 non-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 to the appointment of a new Commission, but also to an 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 be implemented. The description leaves intentionally 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.

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

The different analyses done of the function of the “old” system of financial management, control and audit of the finances gave several explanations to the failure of the system. The perhaps 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 giving a sense of a “watertight” control system, had in fact created a situation of “non-responsibility” amongst the managers at all levels appointed to carry through the policies, activities or operations of the EC. And, in addition, the old system was seen not to meet the requirements of a modern administration with its need for rapid decisions and possibility to handle millions of transactions. The system was slow and formalistic and did not answer or handle the question if 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 later that the new control system must be able to handle even these. The perspective of the control system must change its focus from merely taken action upon individual cases of mismanagement, irregularities, corruption or fraud to be 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 to be closed down. New control institutions are replacing them equipped with new competences, resources and sophisticated control/investigation tools. The legal framework on which the different parts of the control system rest, has or is well in the process to be 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.

6. 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 (here Directorate) (see no 1 in appendix) 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 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 proposing 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 Commission wide 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 Directorate 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 decide 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, issue instructions in the field of budgetary and financial management b) provides 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.

7. 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 forgery 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.

8. 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”.

9. 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 specialized 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.

Source: SIGMA

2. AUSTRIA

1. Drawing Up the Budget

1. The federal budget is adopted each year by Parliament ("Federal Finance Act"). The budget proper (i.e. the national financial estimates for the year ahead) is adopted as an annex to the Federal Finance Act. The Federal Finance Minister draws up a Finance Bill, which the federal Government then submits to Parliament together with the annexes, within a set time-limit. If the Parliament fails to adopt a budget for the coming year before the end of the current year, then the provisions in the federal Constitution on provisional budgets come into play.

2. It is important to know that the Federal Finance Act is not substantive legislation; it merely lays down the internal legal relationships between the various bodies involved in managing federal finances. It cannot be used as a basis for claims or commitments of third parties. The principle concerning the double legal conditionality of measures dealing with financial administration applies, i.e. federal resources cannot be spent without some basis both in federal financial law and, in particular, substantive law.

2. Internal Pre-Implementation Controls by the Finance Minister

3. Implementation of the budget is primarily the responsibility of the various spending departments. However, the Austrian Constitution gives the Finance Minister considerable power to intervene in implementation. Under Article 51a of the Constitution, the Finance Minister must ensure that "payments to honour commitments are made when due, within the limits on the availability of resources and in accordance with the principles of prudence, economy and effectiveness". The same Article empowers the Finance Minister to cut spending, with the Government's consent "if income and expenditure patterns require it or there is a significant change in general economic trends in the course of the year".

4. The reason that the Constitution empowers the Finance Minister to intervene in implementation is that he is responsible for managing the overall budget. The scope of his powers is determined primarily by the relevant provisions of the 1986 Federal Budget Act (particularly Sections 43 to 45). The Federal Finance Minister must, *de facto*, be involved in implementing any major projects. The amount which can be spent without having to obtain the Finance Minister's consent is laid down in the implementation decree attached to the annual Federal Finance Act, under "financial scope".

5. The Finance Minister must ensure that:

any project designed to enable the federal Government to fulfil its administrative duties is compatible with budget principles (prudence, economy and effectiveness), and the need for overall balance and financial solidarity between the federal Government, the *Länder* and the municipalities;

it is possible to cover all expenditures arising from implementation of the project, taking account of the forecast concerning the budget situation and the economy in general;

sufficient funds of the correct type are available to cover expenditure commitments, taking account of the relevant forecast and, in particular, existing commitments;

all commitments entered into meet a real need; and

payment deadlines are set in such way that payments can be made on time and in full.

6. The minister responsible for a given project and the Finance Minister must agree on a project before it is implemented. In certain cases, involving large amounts, the Finance Minister must be involved at the planning stage. If the minister responsible for the project and the Finance Minister fail to reach an agreement on the implementation of the project, either may put the matter to the Council of Ministers.

7. By virtue of its power to control budget implementation, the Budget Department of the Federal Finance Ministry is the most important pre-implementation control authority in Austria. This enables the Finance Minister to keep a check on the budget and the Government's finances, and he is both empowered and required to intervene in financial matters if there is a discrepancy between target figures and the out-turn.

3. Internal Financial Control by the Minister Responsible for the Area in Question

8. The ministers responsible for expenditure can use two bodies to carry out financial checks: the accounting department and the internal audit department in the ministry in question. The accounting department plays an important role in auditing the accounts as well as performing a number of other tasks. The Federal Budget Act (BHG) and the Federal Budget Directive or Ordinance (BHV), adopted in 1989, contain detailed provisions on the "internal auditing" to be carried out by the accounting departments as part of implementation of the budget (see particular Sections 90 to 92 of the Federal Budget Act). The internal audit includes the preliminary audit, budget-implementation audit and post-implementation audit.

9. The preliminary audit involves checking the sources for every individual payment claim and payment commitment, and the amounts. Everything is checked for legal and mathematical accuracy and for compatibility with the principles of prudence, economy and effectiveness. The preliminary audit should be as thorough as possible.

10. During the implementation audit, the orders are checked to ensure that their form and content comply with budget regulations and other provisions.

11. The post-implementation audit involves checking that the payments and clearing operations have been properly dealt with, that the relevant papers have been properly filed, that their form and content comply with the regulations and that valuables and other assets are available and recorded. After each post-implementation audit, an audit report is produced setting out the nature and scope of the audit and the main findings. While the preliminary audit should be very thorough, the post-implementation audit is more selective.

12. In addition to an accounting department, each ministry has an audit department, usually reporting directly to the minister. The legal basis for these departments is a Government decision adopted in 1981.

13. According to the "Guidelines for Internal Auditing in the Federal Administration", issued by the Federal Chancellor's Office, the most important tasks of the audit departments are as follows:

checking that the organisation of the department is compatible with prudence, economy and effectiveness;

putting forward rationalisation proposals and ideas for improving structures and procedures;

summarising the inspection and activity reports of the Court of Auditors;

helping with the drafting of organisational regulations and with important organisational measures;

advising on the drawing up of procurement programmes and financing plans;

advising on planning and implementation of major projects;

helping with awarding major contracts; and

ensuring that the public procurement regulations are observed.

14. As is clear from the list of their tasks, the audit departments play a largely ancillary role in the "system audit". With regard to individual cases, they usually carry out their checks after the event, i.e. after the administrative procedures in questions have been completed.

4. External Financial Control by the Austrian Court of Audit

15. See also the paper on experiences of the Austrian Court of Audit by Mr Wolfgang Wiklicky in SIGMA Paper No. 20 *Effects of European Union Accession—Part 2, External Audit*.

16. The Court of Audit is independent of the *Nationalrat* and the *Landtage* and is responsible for checking implementation measures carried out by the federal Government or the *Länder*. The legal basis is formed by the federal Constitution and the Court of Audit Act of 1948. The Court of Audit functions as a federal body or a *Land* body, depending on whether it is examining the federal Government's finances or one of the *Länder's*. The President is chosen by the Parliament for a period of twelve years. His rank is equivalent to that of members of the federal Government or members of the *Land* government in question.

17. The Court of Audit is responsible for controlling the finances of the federal Government, the *Länder*, communities (with more than 20 000 inhabitants), groups of communities and other bodies specified by legislation. With respect to the federal Government's finances, the Court of Audit's controls cover:

all financial transactions at federal Government level (income and expenditure, loans, moveable and fixed assets);

foundations, funds and organisations run by federal bodies for the federal Government; and

activities over which the federal Government exercises financial or organisation control.

18. As a rule, the Court of Audit exercises its powers on its own initiative. It checks the account for mathematical accuracy and for compliance with the law and with the principles of prudence, economy and effectiveness. The Court reports annually to the Parliament. It also produces special reports on the special audits it may have conducted (usually upon the Parliaments' request).

Source: SIGMA Paper No. 19: *Effects of European Union Accession; Part 1: Budgeting and Financial Control*

3. FRANCE

1. Introduction

19. Among all the countries of the adopted sample, France presents a specific characteristic: as a founding member of the EEC, it never had to adapt itself to pre-established Community rules, but it contributed to their gradual creation. So this study will not place particular emphasis on the adaptation efforts undertaken by the French administration, but will analyse, in a general way, the budgetary and financial links between France and the European Union from the perspective of the institutional and administrative organisation as well as the financial and accounting procedures.

20. This document is complemented by a second paper on audit and control matters that appears in SIGMA Paper No. 20 *Effects of European Union Accession—Part 2, External Audit*. Nevertheless, separating these papers is probably quite artificial because, considering French administrative practices and culture, the management of funds and their control are tightly linked.

21. The presentation of the French administrative and budgetary framework will be followed by a general indication on the impact of the European Budget on the French one. Then the management of internal resources and expenditures will be studied.

2. The Institutional Framework

22. The governmental institutional framework is studied first at the state level and then at the local government level.

2.1. The State

23. Governmental policy is implemented by central services of about twenty main ministries with, depending on political circumstances, some secondary ministries and Secretaries of State. Organised according to a quite strong hierarchical principle, these central administrations are divided into departments — from three or four to about fifteen per ministry — which are responsible for legislation and audit matters, but in principle have no responsibility in direct management.

24. In most of the main ministries, the responsibility for day-to-day operations are given to local offices spread out across the whole territory. At the level of the French local subdivision (called *département* in French) administered by a Prefect, the local services of each ministry are co-ordinated under the supervision of the Prefect (*Préfet*), a State civil servant directly appointed by the Government. For about twenty years, an increasing role in the co-ordination of the actions undertaken by the prefects has been given to the Regional Prefect (*Préfet de Région*). The Regional Prefect, who is also the Prefect of the main *département* within the same region, co-ordinates the action of four to six prefects.

25. The Ministry of Finance is generally grouped with the Ministry of the Economy. The Fiscal Legislation Department (*Service de la Législation Fiscale*) is responsible for the design of fiscal policy. Tax collection is shared between the Taxes Directorate General (*Direction Générale des Impôts*) with 80 000 agents dealing with direct taxation, and the European VAT, and the Customs and Excises Directorate General (*Direction Générale des Douanes et des Droits Indirects*) — with 19 000 agents dealing with customs taxation and the non-Community VAT. The state budget is prepared and managed by the Budget Directorate (*Direction du Budget*) with 250 agents, the accounting and financial implementation of which is provided by the Public Accounting Directorate (*Direction de la Comptabilité Publique*). This directorate with its 56 000 agents is also responsible for the accounting and the treasury of the local governments. The Treasury Directorate (*Direction du Trésor*) and Forecast Department (*Direction de la Prévision*) straddle the two ministries. The Treasury Directorate has particular responsibility for the public debt and external financial relations. The Forecast Directorate studies the main economic trends.

26. As all other ministries, the Ministry of Finance has local offices, particularly the Public Treasury (*Trésor Public*) network run locally by the Chief Treasurer and Paymaster (*Trésorier Payeur Général*) in each subdivision (*département*) administered by a prefect. These offices report on the Public Accounting Directorate (*Direction de la Comptabilité Publique*). They are the cashiers of all income and expenditure of the public authorities, including central government and local government money, which are managed in the same treasury account. There are also accountants for income and expenditure transactions of the state budget and local government budget. More recently they were asked to control the expenditure commitments, when the money comes from the state budget but the expenditure are local. Finally, they also collect part of the money for the financing of the public debt.

2.2. The Budgetary Organisation Of The State

27. The state budget is prepared by the Budget Directorate (*Direction du Budget*) under the supervision of the Ministry of Finance. The Budget Directorate has a fundamental role in the whole procedure of preparation and implementation. The parliamentary vote, which takes place on 31 December of each year at the latest, brings few modifications to the governmental proposal, particularly for the expenditure part.

28. After being controlled by the Constitutional Council (*Conseil Constitutionnel*, an independent body to which an appeal may be made to pronounce on the constitutionality of Government decisions), the budget is implemented by each ministry which appoints to that end central and local commitment officer (*ordonnateurs*). The local commitment officers are the territorial delegates of the central commitment officers. They are responsible for committing the expenditures of the ministries, i.e. recruitment and remuneration of civil servants, signature for public procurement, allocation of grants, etc., under the name and the responsibility of the corresponding ministry.

29. However, to become legally final and bind the State to a third party, the commitment must be stamped by a Financial Controller (*Contrôleur Financier*) named by the Ministry of Finance and working under the supervision of the Budget Directorate (*Direction du Budget*). When the expenditure is locally committed by the commitment officer of a territorial service of the State — often the Prefect — it is financially controlled by a collaborator of the Chief Treasurer and Paymaster (*Trésorier Payeur Général*) working under the supervision of the Budget Directorate.

30. Moreover, the commitment officer do not deal directly with the payment funds of the incurred expenditure. The expenditures are paid by the accountants of the Public Accounting Department (*Direction de la Comptabilité Publique*), i.e. the Chief Treasurer and Paymaster (*Trésorier Payeur Général*) at local level, as instructed by the commitment officer. Then the accountant has to pay, if the payment order is regularly established. Any irregular payment becomes the accountant's personal financial responsibility, so the accountants are requested to take out an insurance policy.

2.3. The Local Government

31. Since the early 1980s an important decentralisation movement transferred central powers and resources to the local government, which are spread across three levels:

25 regions (*régions*) created in the 1970s, which are responsible for the main infrastructure, vocational training and, partly, for university buildings.

100 *départements* created two centuries ago, which are responsible for social assistance, some infrastructure and, partly, secondary schools.

36 000 communes — with a tendency to try to regroup some of them — which are responsible for local equipment, urban transport, primary schools, some hospitals, and cultural and sport activities.

32. Each local community is administered by a council elected by the direct universal suffrage. Their budget is financed partly by local taxes and partly by global and automatic State transfers. This budget is voted by elected councils, without prejudice of regulatory control, and it is implemented by the local executive, i.e. the mayor of the commune.

33. However, the State financial departments supervises the implementation of local budgets. On the one hand, the local communities are required to deposit their funds in the unique account of the State Treasury (*Trésor de l'Etat*) which manages them on their behalf. In return, the State guarantees the local communities a regular supply of funds. On the other hand the cashier/accountant of each local community legally is a State civil servant of the Public Accounting Directorate (*Direction de la Comptabilité Publique*). Forty per cent of its 58 000 agents also work for the local communities without charge to the local communities.

34. Created in 1982, the 25 Audit Regional Chambers (*Chambres Régionales des Comptes*) — one per region — audit the local finances. The management of these Chambers is linked to the Audit Office (*Cour des Comptes*) to which they report. Their audit over accounting practices is complemented by a assessment on the relevant use of funds by local representatives. The state accounts at local level are not within the jurisdiction of the Audit Regional Chambers (*Chambres Régionales des Comptes*).

3. The Community Budget For French Public Finance

35. In 1996, the division of the French GDP — FF 8 000 billion — is as follows: 21 per cent State finances; 9 per cent local finances; and 22 per cent social finances.

36. For the same year, the total contribution of France to the Community Budget is FF 89 billion, which is fifteen times more than in 1981. Between 1981 and 1996, the contributions of the Community's Budget from the State income increased from 3.8 per cent to 6.3 per cent. Very high until 1988, the growth rhythm of the Community contributions slowed down during the last years, and even dropped in 1995. Concerning the 1995 gross payments, which are the latest available statistics, the French taxes break down as follows:

VAT resource: 62 per cent;

GNP resource: 21 per cent;

customs duties and agricultural deductions: 13 per cent;

sugar contributions: 3 per cent.

37. The Community expenditures for the benefit of France were ECU 9.9 billion in 1994, that is to say 16.5 per cent of the Community expenditures, because of the important financing obtained from the Common Agricultural Policy (24 per cent of the Community agricultural expenditure takes place in France). The situation for Structural Funds was not as good: France received only 9 per cent of the EAGGF-Guidance (EAGGF: European Agricultural Guidance and Guarantee Fund), ESF (European Social Fund) and ERDF (European Regional Development Funds) credits. The 1995 Community credits received by France break down as follows:

EAGGF-Guarantee: 83 per cent - 62 per cent for cereals and oilseeds and 21 per cent for animal production;

ESF: 6 per cent;

ERDF: 4 per cent; and

EAGGF-Guidance: 2.5 per cent.

38. Finally, even if these financial elements have to be handled very carefully, France is the fourth net contributor after Germany, United Kingdom and Netherlands, with a negative balance of ECU 1.7 billion in 1994. This represents ECU 46 per inhabitant.

2. The Community Budget Administration In France

39. Here are the relevant official bodies at the administrative level:

In Brussels, the Permanent Representation includes a budgetary unit of 3 people under the supervision of the Financial Adviser. This unit works in collaboration with Agricultural, Social and Regional Advisers, who are the other important members of the Permanent Representation. In principle, a Permanent Representation Member always accompanies the French government civil servants who attend the meetings of the different groups of the Council or the Committees of the Commission. All information between Paris and Brussels, in both directions, has to be made available at the Permanent Representation.

In Paris, the correspondent of the Permanent Representation is the Secretariat of the Interministerial Committee for European Affairs (*Secrétariat du Comité Interministériel pour les Questions Européennes*). In contact with the Prime Minister and often run by a member of his personal staff, the Secretariat of the Interministerial Committee for European Affairs employs about 150 agents coming from all ministries. A financial advisor, assisted by about six agents, co-ordinates all the budgetary, financial and fiscal dossiers.

40. For budgetary matters, the main ministerial departments are the following ones:

The Budget Directorate (*Direction du Budget*), which plays a decisive role in the areas of income and expenditure. It is assisted by the Forecast Directorate and the National Institute of Statistics and Economic Studies (*Institut National de la Statistique et des Etudes Economiques* — INSEE) for macro-economic aspects and for the determination of VAT and GNP resources.

The Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT), under the supervision of the Directorate of Public Accounting (*Direction de la Comptabilité Publique*), which runs the unique State account and therefore controls the daily management of movements of funds, in both directions, between Paris and Brussels.

The Directorate General of Customs and Indirect Duties (*Direction Générale des Douanes et des Droits Indirects* — DGDDI), for the traditional own resources.

The budget departments of the ministries responsible for expenditures relating to the negotiation and implementation of the European Budget, namely the Ministry of Agriculture and the Offices of Agricultural Intervention (*Offices d'Intervention Agricole*) controlled by it, the Ministry of Interior with the Delegation for Regional Planning and Action (*Délégation à l'Aménagement du Territoire et à l'Action Régionale* — DATAR) for the ERDF, and the Ministry of Social Affairs with the Delegation for Vocational Training (*Délégation à la Formation Professionnelle*) for the ESF.

41. All these official bodies have a particular role in negotiating of the Community Budget:

The Permanent Representation in Brussels and the Secretariat of the Interministerial Committee for European Affairs have a general co-ordination and information role.

The Budget Directorate, six agents at the European Office, runs the whole procedure.

The macro-economic framework and the internal resources are prepared by the Forecast Department (*Direction de la Prévision*) and, in a marginal way, by the Customs and Fiscal Services Department (*Direction des Douanes et des Services Fiscaux*).

The French amendments to the budget draft are prepared during several meetings at the Secretariat of the Interministerial Committee for European Affairs with the Budget Directorate (*Direction du Budget*) and each ministry concerned with these expenditures. In case of disagreement, the Prime Minister is asked to arbitrate.

42. During the whole progress of the transfer procedures between the Council and the Parliament, particularly in the Budgetary Committee (*Comité Budgétaire*), the Budget Directorate (*Direction du Budget*), jointly with the Financial Adviser of the Permanent Representation, defends French interests under the supervision of the Secretariat of the Interministerial Committee for European Affairs, which checks the interministerial nature of the French positions.

3. The Management Of "Own Resources"

43. There are two main categories of resources: the traditional own resources, and the VAT and GNP resources.

44. The traditional own resources: customs duties, agricultural levies, sugar contributions — except the sugar reserves contribution directly received by the Funds of Intervention and Regulation of the Sugar Market (*Fonds d'Intervention et de Régulation du Marché du Sucre* — FIRS) which pays an instalment in June and the balance in December — and monetary compensatory amounts

are collected by the Customs and Excises DG (*Direction Générale des Douanes et des Droits Indirects* — DGDDI). This organisation employs 19 000 agents, but the collection of the Community income represents only a small part of its activity. Following the receipt of funds by its own accountants, it transfers them to the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT) via the Chiefs Treasurers and Paymasters (*Trésoriers-Payeurs Généraux*) and deposits them into the central account of the Commission in FF.

These transfers are made the first working day after the 19th of the second month following their notification, after deduction of the 10 per cent collection costs which are credited to the general state budget. In some cases, the Commission can request in advance the payment of some transfers.

45. The VAT and GNP resources are estimated and planned within the framework of the Community budgetary procedure. In the Own Resources Committee, the French delegation is mainly composed of a mixed Budget/Forecast team. Depending on the procedure results, the Budget Department (*Direction du Budget*) issues the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT) on the first working day of each month a payment order to the central account of the Commission corresponding to one twelfth of the budgetary taxes voted for VAT and GNP. In some cases, the Commission can request some anticipated payments.

46. The central account of the Commission can also be credited with other sums coming from the French budget, for example European Development Fund contribution or transfer representing the reimbursement of sums rejected by the Commission within clearance procedures.

47. At internal budgetary level, the proper resources of the Community are technically processed as deductions from the national budget income, in the same way as deductions from national income made on behalf of the local government. Criticised by the French Audit Office, this procedure was recently formally modified: an article of French budget law, generally agreed by a vote in December of the year preceding the corresponding financial period, indicates the provisional total amount of deductions from receipts made on behalf of the European Budget during the following year. Brought in for purely political reasons, the vote on this article has no legal effect.

4. The Management Of Expenditures

48. More complicated than income management, expenditure management is different for each main category of the Community expenditures.

49. For the EAGGF-Guarantee, the main role is played by the eleven approved Agricultural Intervention Offices (*Offices d'Intervention Agricole*), that is to say one per each product category: National Interprofessional Office for Cereals (*Office National Interprofessionnel des Céréales* — ONIC), National Interprofessional Office for Milk and Dairy Products (*Office National Interprofessionnel du Lait et des Produits Laitiers* — ONILAIT), etc. Organised with similar structures, these Offices are State public organisations, managed by boards of directors including representatives of the corresponding agricultural occupations and civil servants representing the Ministry of Agriculture and the Ministry of Finance. The director of each office is named by the Government. Most of the staff come from the Ministry of Agriculture and its operational expenditure is paid through a subsidy from the same ministry. The accountant, who is personally financially responsible, is a finance civil servant, jointly appointed by the Ministry of Finance and the Ministry of Agriculture. The main decisions, particularly regarding accounts and budgets, must be approved by the same ministries. State Controllers, named by the Ministry of Finance, control the main commitments and supervise the financial activities of the Office.

50. A co-ordinating agency, the Central Agency of Guidance Organisations in the Agricultural Sector (*Agence Centrale des Organismes d'Intervention dans le Secteur Agricole* — ACOFA), is shared by all the Offices. It has three functions:

common management of the treasury, which allows the Agency to borrow funds for pre-financing Community transfers, in accordance with the Community regulations;

expenditure control and reporting; and

management of common services, such as computer services, purchasing and payments.

51. These Offices deal with 95 per cent of the EAGGF-Guarantee payments. For expenditures implemented on behalf on the Commission, the role of the Offices is extensive. First, during European Budget preparation and negotiations, they provide the Ministry of Agriculture and the Ministry of Budget with projections and planning information concerning the needs for the next financial period. During the implementation of the Budget, they pass their treasury requests every month to the Commission, via the Ministry of Budget, according to a schedule — most often monthly — which is peculiar to each kind of agricultural production and assistance. After the requests have been examined in Brussels by the relevant management committee, the Commission pays the necessary funds via a transfer order sent to the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT) from its central account held within this Agency. If necessary, the Commission has to draw on available funds held elsewhere to credit its account at the Central Accounting Agency of the Treasury. The Offices then distribute assistance grants to entitled beneficiaries after examination of the request dossiers. They also participate in audits and sometimes in clearance procedures.

52. Nevertheless, some expenditures are paid directly by the Ministry of Agriculture, particularly the grant for the "suckling cow". These dossiers are examined by the Local Agricultural Departments (*Directions Départementales de l'Agriculture*), which are the territorial departments of the Ministry of Agriculture, one per subdivision administered by the Prefect. In this case, before the expenditure is paid and after the funds are put at the disposal of the French state through a transfer order sent by the Commission to the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT), a budgetary credit of an equivalent amount must be registered in the budget of the Ministry of Agriculture. It is the procedure of "*fonds de concours*" which — during the current year and by the means of a parliamentary vote — allows an increase in the budget by an amount which is equivalent to the

taxes received by a third party. Included in the national budget, the expenditure are then implemented according to the French procedures:

commitment by the commitment officer: the Local Agricultural Department (*Direction Départementale de l'Agriculture*), in the name and on behalf of the Minister;

payment by the accountant: the Chief Treasurer and Paymaster (*Trésorier-Payeur Général*); and

audit by the Audit Office according to the conditions of common law.

53. However, as the revised Common Agricultural Policy favours direct assistance to the person over indirect assistance to the products, the scheme explained above was substantially modified. For direct assistance allocated according to the area for cereals or oilseeds and the number of animals raised for slaughter, the assistance dossiers are prepared by the Local Agricultural Departments (*Directions Départementales de l'Agriculture*) which, because of their work in the field, have a better knowledge of the farms. These dossiers are then transmitted to the Offices which make the payment.

54. The reform of the Common Agricultural Policy disrupted the working methods of the relevant administrations, which had to process hundreds of thousands of complex individual dossiers within a few months instead of the few thousand dossiers they were accustomed to.

55. For the Structural Funds — EAGGF-Guidance, ERDF, ESF and FIIG— the procedure is quite different from the one explained above. However, its similar scheme is based on the very important role given to the Region Prefect (*Préfet de Région*) or more exactly to his main deputy in charge of economic affairs: the Secretary-General for Regional Affairs (*Secrétaire Général pour les Affaires Régionales*— SGAR).

56. Credits are scheduled within a regional co-ordination committee composed of the Secretary-General for Regional Affairs (*Secrétaire Général pour les Affaires Régionales* - SGAR) and the top civil servants of the local government. When allocation decisions have been made by the Commission — DG VI, V or XVI depending on the cases — the funds are transferred by the Commission to the French budget by a payment order to the Commission's central account at the Central Accounting Agency of the Treasury (*Agence Comptable Centrale du Trésor* — ACCT), and credited to the budget of the concerned Ministry for assistance funds. The expenditure is then paid by the relevant territorial services: the local commitment officer is in charge of the commitment, and the Chief Treasurer in charge of the payment. The whole process is monitored by a committee made up of the co-ordinating committee mentioned above and a Commission representative.

Source: SIGMA Paper No. 19: Effects of European Union Accession; Part 1: Budgeting and Financial Control

4. NETHERLANDS

FINANCIAL CONTROL AND AUDIT IN THE NETHERLANDS

1. Financial control and auditing within the ministries

On account of the provisions of the Government Accounts Act the responsibility for a sound and verifiable financial management within the ministries, lies with the ministers - each in respect of the budget(s) in his or her charge. With regard to financial control, *ex-ante* internal controls (operational in character), have to be distinguished from *ex-post* audits (evaluative in character). Operational controls are incorporated into the budget implementation process. Evaluative audits are carried out by the internal audit departments of the various ministries.

Every ministry in the Netherlands has an internal audit department, which is required to fulfil the legal task to examine whether the principles of sound financial management have been applied and to verify whether the annual accounts are reliable and the underlying transactions have been realised legitimately.² Audit findings have to be set out in reports, addressed to the minister concerned and to be sent in copy to the Minister of Finance and the Court of Audit. The summary annual report (that has to be presented by March 15 at the latest) includes, along with the main audit findings, an audit certificate on whether the financial statements give a true and fair view and whether the commitments, expenses and revenues accounted for are established in conformity with the relevant budget provisions, regulations and other acts in force. The audit certificate the internal audit department issues is qualitative in character. The Parliament of the Netherlands can request to receive the reports submitted by the internal audit departments; in certain circumstances the minister will submit these reports of his own accord to Parliament.

An important feature of the general audit approach of the internal audit departments is that it is implemented in a uniform way, as far as such is possible. With respect to this, the Minister of Finance has a co-ordinating and supporting role in the domain of the internal audit departments' activities. The Government Audit Policy Directorate, part of the Directorate-General of the Budget of the Ministry of Finance, is assigned to implement these co-ordinating and supporting activities. Within this scope, once a month the Inter-Departmental Council of Directors of the Internal Audit Departments (IODAD) consults on audit policy issues. The Director of the Government Audit Policy Directorate is the chairman of this Council.

Aiming at streamlining State government auditing the Inter-Departmental Council has issued an Audit Manual which describes the scope of the audit opinions to be issued and states the materiality (significance) criteria to be used.³ The materiality limits are established by the Netherlands' Cabinet. The objective of the Audit Manual is to set out the basis for a uniform approach to the audit activities of all the internal audit departments. The Audit Manual describes a uniform approach which has been agreed upon with the Netherlands' Court of Audit. The internal audit departments are obliged to apply the rules laid down in the common Audit Manual.

To ensure an objective opinion and reporting, the position of the internal audit department within the organisation of the ministry must be as independent as possible (high position immediately under the Secretary General, and reporting directly to the minister).⁴ This means that the internal audit department stands functionally apart from its auditee. To avoid any possible conflict of interests, an internal audit department never performs any managing or controlling activity. Moreover, the legal status of the internal audit departments' employees as civil servants guarantees that they are able to exercise adequately their duties in accordance with the relevant requirements.

The director of an internal audit department must be a certified auditor.⁵ Being given a general appointment for the State at large, he or she does not have a direct employment contract or employment relationship with the minister concerned. The assignment to the post of director of an internal audit department needs prior consent of the Minister of Finance.⁶

² According to art. 66, first par., of the Government Accounts Act 2001, the task of the internal audit departments includes:

- the financial information in the annual report of the ministry;
- the realisation process of information in the annual report on the policies pursued and the processes managed;
- the balance sheet items;
- financial management and management of equipment, including the accounts kept for these.

The audit certificate of the internal audit department has to cover the reliability of the financial information in the annual report and the balance sheet of the ministry, the compliance with the reporting requirements, and the legality/regularity of the underlying transactions (art. 66, fifth par., Government Accounts Act 2001).

³ The internal audit departments use a materiality of 1% (the margin of error considered to be acceptable for an unqualified audit opinion) and an audit risk of 5% (level of confidence). Both are upper limits and are determined in advance. The materiality margin of 1% relates to the sum of errors against the reliability of the accounts (fair and true view) and errors against the legality and regularity of the underlying transactions.

⁴ Art. 2, second par., of the Decree on the task and position of the internal audit departments.

⁵ Art. 2, first par., of the Decree on the task and position of the internal audit departments. However, in advance of a revised Decree, there are now a few directors who are not certified auditors. This fits into the broadening of the tasks of the internal audit departments, not performing only financial audits, but also operational and other audits. If the director is not a certified auditor himself, one of his deputies must be a certified auditor and shall have direct reporting relations to the minister.

⁶ Art. 68, second par., of the Government Accounts Act 2001.

The rules of professional practice established by the Netherlands' institute of registered auditors oblige every auditor to be objected to a *peer review*. Furthermore the regulations regarding professional conduct and code of ethics governing the work of registered (certified) auditors in the Netherlands and the audit guidelines guarantee their independence, expertise, objectivity, impartiality and integrity. The auditors can be summoned to appear before the disciplinary committee of the Netherlands' institute of registered auditors, that can impose disciplinary punishments. Finally, an important element in the system of checks and balances guaranteeing the functional independence of the internal audit departments, is that they are actively supervised and monitored by the Ministry of Finance and thoroughly reviewed by the Netherlands' Court of Audit.

The task and position of the internal audit departments are elaborated in a special decree, issued under the authority of the Minister of Finance. This decree gives the Minister of Finance the power to issue further guidance and to settle more detailed rules regarding the role, task and responsibility of the internal audit departments.

2. *The audit of third-party data*

An aspect of particular importance is the policy of each ministry on checking the reliability of so called 'third-party data'. For a lot of payments and receipts the calculation of individual amounts is largely based on data and figures provided by third parties, i.e. persons or organisations which receive or have to pay these amounts. Adequate control over data supplied by third parties (students, social welfare beneficiaries, etc.) is often an important prerequisite for guaranteeing the legitimacy of payments and receipts. By giving wrong or incomplete data, the third party can misuse or make improper use of a regulation. Therefore, before a payment or receipt, the policy department must check the correctness and the completeness of data and figures provided by the third party. Performing these checks is part of the responsibility of the policy department. The policy department should develop and implement an adequate control policy. The internal audit department examines whether the design and the operating effectiveness of this control policy meet the standards.

While implementing an adequate control policy regarding third-party data, however, there will be a risk regarding the legitimacy of the payments or receipts concerned, as it is impossible to check all third-party data. This remaining uncertainty can be considered as inherent to the financial management and control and to the financial statements to be drawn up. If (a) this uncertainty is adequately disclosed in the explanatory memorandum of the annual accounts, and (b) the internal audit department assesses the control policy as being sufficient in the applicable circumstances and possibilities, this uncertainty plays no role in the final audit opinion. The Audit Manual only prescribes that the auditor in this case must use a so-called *emphasis of matter* in his audit certificate.

3. *Role and position of the Netherlands' Court of Audit*

The Netherlands' Court of Audit, without prejudice to its own right to make inspections, bases its opinion to a large extent on the results of the audits carried out by the internal audit departments. Therefore, the audit of the Court can be characterised more as a systems-based (analytical) audit than as a data-oriented (substantive) audit. The fact that the Court can do this, is to a large extent thanks to the results of the comprehensive improvement programme of the eighties. To have a well-founded basis for relying upon the work of these departments, the Court of Audit has to determine the quality of the work performed by these departments. The Court of Audit's assessment specifically relates to the question whether the audit work, the findings resulting from it and the final audit opinion are established in a sufficiently independent way.

The Netherlands' Court of Audit has to approve the comprehensive financial statements of the State government. The Court lays down its conclusions regarding the financial management and the annual accounts of each ministry in separate reports, addressed to Parliament. In these reports the Court presents a quantitative conclusion. The Court reports to Parliament on the third Wednesday in May (accountability day, the equivalent of third Tuesday in September, when the budget for next year is presented to Parliament).

Given the results of its compliance audits, the findings of the Court of Audit can include an objection regarding the financial management or an objection regarding the financial statements. Although this distinction is not quite the same as the distinction between formal and material/substantial errors the European Court of Auditors makes, there are some similarities in these classifications. In the Netherlands, legality or regularity errors with a direct, measurable effect on the amounts given in the financial statements give rise to an objection against the financial statements, whereas legality or regularity errors consisting of infringements of the regulatory mechanisms without a direct, measurable adverse financial effect, are considered as objectives against financial management.

4. *Concluding remark*

In this brief description the main aspects of the Netherlands' control and audit system have been outlined. More specifically, an explanatory description has been given with regard to the position, role and function of the internal audit departments of the ministries, the Government Audit Policy Directorate of the Ministry of Finance (co-ordinating and supporting task⁷) and the Court of Audit (external

⁷ For the sake of completeness, it should be pointed out that the Government Audit Policy Directorate also has a supervisory and monitoring task in respect of each ministry as regards budget implementation, the accounts kept to that end and the audit process involved.

auditor). The existence of these three audit bodies reflects the various responsibilities in the structure of the Netherlands' State: the ministerial responsibility of the individual ministers, the overall co-ordinating and supervisory responsibility of the Minister of Finance, and, finally, the external audit responsibility of the Court of Audit towards the Parliament and the public.

5. PORTUGAL

1. Chapter Summary

57. This country paper intends to draw an overall picture of the impact that joining the EU has had on the Portuguese financial control and budgeting system. Major changes are stressed, with an emphasis on concrete and operational difficulties faced and on the solutions adopted to solve them.

58. The effects of Portuguese accession to the EU on budgeting and financial control were felt even before acceding. Some lessons for the future can be pointed out regarding our experience.

59. It is fundamental to provide, at least a year before acceding, a comprehensive training programme dealing with general Community organisations and procedures for officials appointed to carry out tasks relating to these matters. Technical assistance from the European Commission must be fully benefited from.

60. Simultaneously, regulatory obligations regarding budgeting and financial control must be carefully studied. Preliminary planning and a time-table for managing the implementation of new obligations in order to adapt the national budgeting and control system to EC requirements are also very important.

61. Joining the EU certainly shall demand adaptations on the part of national administrations to respond appropriately to the European regulatory framework. However, there are no ideal models to be followed. This is an important lesson to note.

62. Accession can reveal the necessity for specialised structures in some areas, namely in agricultural and Structural Funds, such as the paying agencies related to the EAGGF–Guarantee section or a specialised agency for ESF, for instance.

63. In some cases, it can be prudent to use the natural vocation and experience of already existing public departments to carry out the new obligations in this area.

64. A central unit in the finance ministry is fundamental to provide internal (to and from other ministries and agencies) and external (to and from Commission and Permanent Representation in Brussels) exchange of relevant information and to monitor the budgeting process.

65. A good co-ordination of internal audit and financial control appears to be a very important contribution to support a well-functioning system and to facilitate the contact with the Commission's Financial Control Unit (DG XX).

66. The reforms underway leading to a Community-oriented financial control system may have fundamental implications for the existing national organisation for financial control or internal audit. However, the creation of new and potentially costly administrative structures must be carefully evaluated.

5. National System

2.1. Legal Framework For Budgeting And Financial Control

67. According to the Portuguese Constitution, the national budget must assume the form of a law and is prepared, organised, voted and executed in compliance with the budget law. This law contains principles and rules that are mainly the same as those found in the Financial Regulations of the EU.

68. A proposed budget is prepared by the Government, under the co-ordination of the Ministry of Finance, involving all line ministries.

69. In drafting the budget proposal, the Government must give priority to its legal or contractual obligations and to its investment and development policies. To prepare this budget proposal, a central role has been committed to the Directorate General for Budget in the Ministry of Finance.

70. Once the Government has its budget proposal ready, the Parliament discusses and votes the Budget Law initiating its control function as prescribed in the Constitution.

71. The Directorate General for Budget is also responsible for the control of budget execution in all government departments and for preparing the State General Accounts to be submitted to the Parliament and to be audited by the Court of Auditors.

2.2. Organisational Structure For Financial Control

72. The Portuguese finance control system adopts a model that distinguishes different types or levels of intervention. External and internal types of control are distinguished.

73. External control has a political level, with the national Parliament; and a jurisdictional level, with the Court of Auditors. The Court of Auditors, as a supreme audit institution, is responsible for the external audit.
74. The horizontal level of internal control is fulfilled by the Inspectorate General for Finance (IGF).
75. The IGF depends directly on the Finance Minister and is responsible for financial control of all public expenditure and revenue. Its intervention covers all relevant items of the national budget and departments of public administration, including public enterprises, municipalities and grants and subsidies to private entities.
76. Finally, there are internal audit bodies in the various ministries in charge of sectoral level of control.
77. All these bodies have the competence to control public expenditure and revenues in the national or community budgets.

Source: SIGMA Paper No. 19: Effects of European Union Accession; Part 1: Budgeting and Financial Control

6. CANADA

1. 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.

2. 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 precede the budget formulation by the Ministry of Finance.

Individual departments prepare their spending plans based on advance information provided by the Department 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.

The individual departmental estimates are reviewed by estimates committees of the House of Commons. 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 estimates request and submit a report back to the House. This is then consolidated with all other committee reports on the estimates 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.

3. 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 for a given purpose, called Votes. 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.

4. 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 his operations, hears his requests for additional funds. Public Accounts committee meetings, like the majority of Parliamentary estimates committees, are conducted in public. Their interest 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.

3. 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. He is a senior Cabinet Minister, serving at the pleasure of the Prime Minister. The Minister 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.

4. 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, which serves as the basis for the financial management and control in government and in state-owned enterprises owned or controlled by the government.

5. 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 authority to operate their departments, spend funds in accordance with the instruments of delegation and their respective financial and other limits, and are accountable to their minister and through he minister to Parliament 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 utilized. 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 the approval of a level of management who 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.

6. Addendum

The financial control system is the process that operationalizes the budget insofar as the allocation of resources to government are 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 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 subject of extensive consultations between the governments involved.

Source: SIGMA Paper No. 19: Effects of European Union Accession; Part 1: Budgeting and Financial Control

7. 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 heads of departments (ministries) and agencies are appointed by the President, subject to the approval of the Senate, 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 departments 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. All laws must be enacted by Congress. 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, centralized police forces, leading to the creation of numerous specialized 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. But such exceptions are selective, not general. The national security exception, for example, does not prevent publication of detailed financial reports by the Defense 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 authorized by a court order, which typically requires strong evidence of criminal activity.

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 authorized 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 authorized, approved, executed, recorded and reported. The overall standards for these controls are promulgated by OMB (with related accounting requirements promulgated by TD), 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 organizations. 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 organizations.

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 centered in the US Attorneys, who are 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.
- Tax fraud is investigated by agents of the Internal Revenue Service (IRS).
- 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 Naturalization Service investigates illegal immigration, including the organized 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 (and there are others) all pursue economic crimes within their specific areas of responsibility. Despite the organizational 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 cooperate, sharing information and lending expertise. The cooperation is far from perfect, but the needed flexibility has been demonstrated on many occasions, such as in pursuing some 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 \$10,000. The transaction itself is not necessarily illegal, but the failure to report it is a criminal offense. 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 cooperate in other areas. The FBI and IRS often work together against organized crime, where other crimes may be couple with tax fraud. The same occurs with the FBI, DEA and IRS on major drug cases. Other specialized agencies may be involved in complex cases where the criminal activity extends to mail fraud, banks, the securities markets or trans-border activities.

The decentralized approach responds to US aversion to centralized law enforcement and facilitates the development of specialized expertise, while permitting joint efforts when appropriate.

Source: SIGMA

ANNEX 5:

**A PRACTICAL FRAMEWORK FOR KEY ELEMENTS OF PUBLIC INTERNAL FINANCIAL CONTROL
(PIFC)**

A PRACTICAL FRAMEWORK FOR KEY ELEMENTS OF PUBLIC INTERNAL FINANCIAL CONTROL (PIFC)

The setting-up and implementation of an effective Public Internal Financial Control (PIFC) system demands commitment to effective management, personal integrity and professionalism amongst top leadership on all levels. The key practical elements of such a system can be described as follows:

1. The system should be based on the rule of law

- A clear and comprehensive legal set-up, preferably using an overall framework law and individual implementing acts *e.g.* IA and FC.
- A systematic approach for financial management and control.
- An operational separation between law/regulations and standards/guidelines/manuals to ensure efficiency and flexibility.

2. Sound financial management systems should be in place

A good general control environment and structure.

The budget managers should have good preconditions and clear responsibilities for the management, control and implementation of the budget. Effective and efficient revenue collection should be a priority.

A strong central ministry responsible for all financial matters and policy.

Lines of accountability must be clear and transparent inside individual entities and between different levels of the state administration. The responsibilities of managers should be well set-out.

Clearly defined internal control responsibilities. Centrally set standards for risk management, accounting, financial reporting, internal audit, and financial systems, and a means to enforce these standards.

3. Effective control activities and procedures should be implemented

The standards should be based on international standards acceptable to the EU.

Effective, coherent systems and procedures should exist for *ex ante* and ongoing controls (wherever situated), including investment appraisal and procurement procedures and checks. These should be based on an effective assessment and appreciation of risk.

Clear, complete, comprehensive and transparent public annual reporting of all public sector.

4. Effective internal audit functions should be in place at relevant levels

5. Mechanisms for the fight against fraud and corruption should exist

6. A strong external oversight by parliament and an effective public sector external audit.

Source: SIGMA (Detailed Report of the Peers on the SIGMA Peer Assistance to the PIFC System in the Slovak Republic; October 2002 – February 2003).

ANNEX 6:

CENTRAL HARMONIZATION UNITS: ROLE AND FUNCTION

**Article for the Draft report
on Internal Control Systems in Candidate Countries**

**by the PIFC expert Group
(Sub-group of the Working Group on Audit Manuals)
under the co-operation between
Supreme Audit Institutions of Candidate Countries and the
European Court of Auditors**

March 11th, 2004

CHU: its role and function

Introduction

As an integral part of the EU fostered PIFC concept, the Central Harmonization Unit or CHU stands for a central government organization responsible for developing and promoting internal control and -audit methodologies on the basis of internationally accepted standards and best practices and to co-ordinating the implementation in all the administrative bodies of the government the new legislation on managerial accountability (financial management and control-systems) and internal audit. Usually, this responsibility is given to the Ministry of Finance, although other solutions are possible. CHUs have been established in conformity with the criteria set out in the EU accession negotiation Chapter 28 on Financial Control. These criteria relate not only to the EU acquis for the new Member States' management and control of EU funds, but equally to best practice for the national control and audit systems applicable to the national budgetary funds, both on revenue as on expenditure.

The first steps

Once a country has decided to upgrade its public control and audit systems by introducing modern, internationally accepted standards, then the best option is to make a central institution responsible for raising the awareness of all shareholders (i.e. all management, control and audit levels) towards the new concepts to be introduced. Ideally, such a central organization would therefore start by developing a network for an adequate exchange of relevant information between its participants. At the same time such institution should define and explain to all stakeholders the advantages and challenges that are inherent to the introduction of PIFC. This networking and policy-making (including developing a written strategic vision paper known as "PIFC Policy Paper") should provide for a steadily widening platform of understanding and involvement in the process, which is a condition for the success of the enterprise.

Self-assessment

In a second stage, based on a commonly agreed self-assessment of the **present** financial management and control systems and its weaknesses as compared to modern international standards⁸, the CHU should take responsibility for drafting framework or primary legislation to provide the government with a legal basis to introduce the various elements of PIFC. Such self-assessment process in the context of accession into the EU this is often supported by outside support, e.g. a SIGMA⁹ peer review. This self-assessment may sometimes be a cumbersome exercise which needs to be carefully monitored and coached because traditional administrative values may be at stake. The results of such self-assessment of the current administrative capacities are then to be brought to the attention of the highest administrative levels for discussion and agreement on the recommendations.

Introducing the new laws and regulations

Development and implementation of primary and secondary law is to follow next. On the basis of these laws, a start should be made with tertiary regulations like manuals for Financial Management and Control (FMC) and Internal Audit (IA)-systems, for templates like the Internal Audit Charter and the Code of Ethics, but also on directives relating to risk management and other methodologies, templates for audit trails, audit reporting, etc. all to be used and refined by the relevant services inside line ministries and other budget agencies.

⁸ For example: the Institute of Internal Auditors Attribute and Performance Standards, and Code of Ethics for Internal audit. <http://www.theiia.org/>

⁹ SIGMA is a joint initiative of the OECD and the EU, principally funded by the EU.

From development to monitoring: compliance audit

Once these tasks have been performed in good order, the role of the CHU will gradually change from PIFC development into PIFC monitoring. It will be the task of the CHU to make compliance and quality assurance checks on whether its recommendations are being properly carried out and find out how to overcome any bottlenecks in the implementation of the adopted policies. This "compliance audit" together with the results of analyzing the annual audit reports from each of the budgetary income or spending centers will facilitate the reporting role of the CHU to the Ministry of Finance on the progress of PIFC throughout the public sector. A good vertical and horizontal networking facilitated by the CHU between the professions of financial managers and controllers and internal auditors, will certainly contribute to the quality and impact of such reporting. The networking itself would be carried out by e.g. regularly organized meetings within the profession, the use of a website and/or of a regular magazine to disseminate the latest information and discussions on common issues raised.


CHU as centre of excellence

The above mentioned tasks explain why CHUs are called the "engines of propagation" of the PIFC principles. This involves learning from, sharing and consolidating experience in implementing the adopted legislation and standards. Many government institutions wish and need to be continuously informed and updated about the PIFC developments. They also may want to receive training on the further implementation of these new developments. They address their questions to the CHUs, who have thus become "centers of excellence". As a consequence, a CHU is facing extra responsibilities for improving government governance¹⁰. One of the basic objectives of the CHU is to improve the quality of the staff responsible for financial control and internal audit and thereby enhancing the successful implementation of the PIFC systems. In this respect the CHU is the co-ordinator or supervisor of the establishment of sustainable training facilities for the professions at stake. Close co-ordination and co-operation with the State Audit Office, professional private organizations (like the local IIA) and academic circles will facilitate this task.

A CHU is so fundamental condition to the successful introduction and development of PIFC that in reality the concept has become part of PIFC itself: indeed PIFC is being defined as having three pillars: managerial accountability (FMC-systems), functionally independent internal audit (IA-systems) and a central harmonization for methodologies and standards (CHU).

Some lessons from the past

The establishment of CHUs in candidate countries has not always been an easy matter. In most countries they grew out of specialized services in the Ministry of Finance and had to struggle for taking the lead and for acknowledgement as leader by other ministries and budget agencies. In other countries the absence of strong commitment by the hierarchy and/or resistance by established traditional inspection forces proved to be blocking factors for the proper development of the CHU functions. In many cases, this situation led to a waste of effort and precious time to develop the PIFC-systems. There are some lessons to be learned in this respect. A CHU should from the outset be established under the inspiring leadership of a person that has proven qualities in management, knowledge of modern control and internal audit systems, easy access to western professional literature and appointed in such a way that continuity of the project can be safeguarded. This means independent of political changes in the government. Since visibility is an important issue, the CHU should have the same status as the Internal Auditor of the institution, which is directly reporting to the highest level of the hierarchy. What the internal auditor of the Ministry is to the Minister of Finance, should apply to the CHU Director on the PIFC systems of the entire public sector. This is of obvious interest to the Minister of Finance. The CHU Director should be regarded as the General Internal Auditor of the public internal audit function. In this capacity, the CHU director should be able to resolve conflicts of interest between the internal auditor and its hierarchy on issues of professional integrity and even to provide an opinion (or visa) on the nomination and dismissal of financial control or internal audit staff.

Often, the question arises whether there should be one CHU or two, dealing separately with the issues of harmonization and co-ordination of Financial Management and Control systems and of the Internal Audit systems. It is thought that in the beginning there could be a preference for establishing only one CHU, dealing with both aspects through separated sub-units. This has the advantage that the harmonization of PIFC is in one hand. In the longer run  however, the establishment of two different CHUs might be a better option: one for FMC-systems e.g. in the Treasury of the Ministry of Finance (closer to proper budget management and control) and another for IA-systems focusing on internal audit only. This would have the advantage that the development of both sub-systems is subject to a split of responsibilities, taking away from the CHU for Internal Audit the responsibility for developing the FMC-systems, which after all is a matter for management, thus avoiding possible conflicts of interest. This issue should normally be discussed and solved at the level of drafting the PIFC Policy Paper, taking into account the special characteristics of

¹⁰ The responsibility of managing and controlling the state budget

already existing organizations in each country.

CHU networking

CHUs have been established in about all the acceding and candidate countries (13), more or less in accordance with the above-mentioned general functions depending on national conditions and characteristics. Whereas adequate internal networking should be the highest priority for the optimal performance of a CHU, external networking is of equal importance. This external networking not only relates to co-operation with the State Audit Office, the private internal audit organizations, professional audit and accountancy bodies, and relevant academic niches inside the country, but also to international contacts. Since CHUs are recently established institutions, there is much benefit in learning from each other about common problems relating to the introduction and implementation of PIFC. This has been recognized by the Commission and in June 2003 a first workshop was organized to bring together all existing CHUs in accession and candidate countries. This workshop took place in LEUVEN, Belgium.

The conclusions of this workshop reflect the overall common concerns as expressed by the majority of the CHU representatives. Six main areas of concern could be distinguished:

1. The low degree of awareness by management levels about the rationale for PIFC principles and an unsatisfactory level of hierarchical support for the work of the CHUs;
2. The highest priority should be given to raising the quality of Internal Audit. Failing to achieve this was thought to be a determining factor for the deterioration of the role and status of the functionally independent internal auditors;
3. The networking role of the CHU and its visibility (organizational location and impact on ministries and budget agencies) needs strengthening and with it improved salary systems and other compensation schemes in line e.g. with the external audit function.
4. Co-ordination with the Supreme Audit Institutions should improve considerably in order to establish a common approach to general audit rules and methodologies and to the training of control and audit officials. Suggestions were made for administrative co-operation agreements while fully taking into account each other's roles and independence;
5. CHUs should know best the training criteria for financial controllers and internal auditors; they have therefore a key role to play on the description of training requirements and in the organization of training, which should be primarily focusing towards practical control and audit skills;
6. Finally, the CHUs expressed their wish to have their voices be heard in the international control and audit arena through the establishment of a permanent discussion forum. As CHUs are steadily changing the emphasis of their work from law drafting to implementation, it would be necessary to further define the future roles and tasks of the CHUs.

CHUs have only just begun; they are new and under development and thus subject to quite a number of challenges. In the acceding countries they may well benefit from further administrative reform support under the EU Transition Facility (2004-2006) and from SIGMA. I hope that this article contributed to supporting the plight of CHUs to develop into strong vehicles for supporting the central role of the Ministries of Finance: ensuring sound financial management and control of the national budgetary resources.

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ANNEX 7:

CONCLUSIONS OF THE WORKSHOPS IN SOFIA, BRATISLAVA, AND GDANSK

ANNEX 7.1.: CONCLUSIONS FROM SOFIA WORKSHOP ON AUDIT MANUALS, AUDIT STANDARDS AND POLICIES

Based on the issues discussed, the outputs of the group exercises and the concluding remarks of the co-chairs of the workshop, the following are some of the *general conclusions* that were drawn from the workshop in Sofia:

- It is apparent that it is still an issue of discussion among Member State and Candidate SAI practitioners concerning what is required from SAIs concerning the adoption and implementation of public sector external auditing standards;
- Adopting standards and applying (international) standards rigorously is difficult, but greatly increases the credibility and professionalism of, and thus strengthens, the SAI. Standards are something required by the EU and there has been a lot of progress in this area. The way forward is to obtain practical experiences and solutions.
- A problem sometimes facing the staff being responsible for developing audit methodology for SAIs is in the lack of support from top management and the political level;
- Clearer understanding of key concepts are needed of: 1) Detailed Auditing Standards; and 2) Audit Policies regulating the action of the SAI and the way it audits;
- The Workshop considered that missing from available Standards are appropriate and comprehensive standards concerning:
 - Judicial process (in the case of Court structures);
 - Detailed and specific procedures for public sector "clients" (e.g. contradiction procedures);
 - Comprehensive Performance audit standards;
 - Legality/compliance audit;
 - Detailed IT audit and Computer Assisted Auditing Techniques Standards;
 - More detailed Audit Sampling Standards.

For most of these last detailed areas the EU Implementing Guidelines (EUIG) for the INTOSAI Standards provide more detailed, relevant guidance, although the EUIG also could benefit from updating and extension on certain aspects. Active consideration needs to be given as to how the EUIG can be further developed and made even more relevant and useful.

To provide for a current overview of developments in the participating SAIs (e.g with a view to establishing useful and relevant bilateral contacts with other SAIs), SIGMA will collect and currently update information from SAIs concerning implementation of audit manuals, vision and mission statements, PIFC audit guidelines, quality assurance guidelines and other developments recommended by the working group. A table summarising this information for all SAIs will be available for distribution to the Presidents' Meeting.

ANNEX 7.2.: CONCLUSIONS FROM BRATISLAVA WORKSHOP ON AUDITING PUBLIC INTERNAL CONTROL SYSTEMS (PIFC)

PIFC systems are at present reviewed in all candidate countries due to the negotiation process with the European Union. Although there was no written *acquis communautaire* at the beginning of the negotiation process on what such a system should look like, a model was developed by the EU Commission to be applied to the management of pre-accession funds, which was followed by all candidate countries. Although the implementation of the model was slightly different in each candidate country, the degree of harmonisation of PIFC systems between candidate countries is greater than in present EU Member States.

The participants of the workshop considered *the following features as the most important for a functioning PIFC system*:

- Clear management responsibilities
- Creation of an effective Internal Audit function
- Competent staff and adequate staff training programme
- Clear legal framework defining the PIFC
- Positive attitude of the management towards PIFC
- Adequate reporting system and effective use of it
- Reliable and secure IT Management Information Systems (MIS)
- Sound accounting practices and application of relevant international accounting standards
- Controls need to be cost effective and based on risk assessment
- Cost effectiveness of PIFC

When auditing or looking at these PIFC systems SAIs play an important role. To this end, SAIs should establish good contacts with the internal audit departments of the government and assess, whether these units are able to provide assurance that the PIFC system in place is reliable.

Consequently, an audit of PIFC systems should always include an assessment of the control environment in the audited institution, in particular in the areas of the management support for the PIFC system in place and the position of the Internal Audit Unit. International standards and guidelines like the INTOSAI standards on Internal Control, which are at present in the process of being updated, or the COSO¹¹ standards, represent valuable material for defining the general internal control standards. The recent publication from INTOSAI: "Internal Control: Providing a Foundation for Accountability in Government - an introduction to internal control for managers in government organisations" (http://www.intosai.org/3_INT_Ae.pdf) was considered to be a good tool to explain the responsibilities of Internal Control to the audited institutions and this should be circulated to financial managers.

In order *to promote more effective PIFC systems* SAIs could do the following:

- Discuss observations and recommendations with the auditee;
- Report observations and recommendations to the Parliament;
- Follow-up earlier recommendations to assess corrective actions taken;
- Ensure auditees are aware of risk management techniques
- Make observations and recommendations concerning new legislation;
- Establish good business relations with IA and support work of IA
- Seeking media attention.

However, when auditing PIFC systems and when making recommendations for its improvement, particularly during the early stages of the development of such systems, SAIs should pay attention to the fact that they do not become too involved in the decision making process, and that they maintain an adequate level of independence regarding future audits of the systems.

¹¹ Committee of Sponsoring Organizations of the Treadway Commission in 1992

ANNEX 7.3.: CONCLUSIONS FROM GDANSK WORKSHOP ON QUALITY CONTROL

Quality Control Systems

The quality of the audit work of SAIs is an important subject that concern all SAIs and that lays the basis for the reputation SAIs will have. Therefore it is essential that SAIs dispose of an adequate quality control system that ensures the application of agreed quality standards. International standards (INTOSAI, IFAC) differentiate between quality control systems on institutional level and for individual audits.

The organisation of the SAI (eg Court/Office) will have a bearing on the quality systems adopted. Some SAIs who made presentations during the workshop had different quality control systems for financial audits and VFM/performance audits reflecting the different needs and approaches required by these types of audit.

Quality Control on institutional level

The quality control system on institutional level includes all measures that are not directly linked to a specific audit. It includes for example:

- the definition of quality requirements;
- the assessment of skills of auditors and what is needed in terms of skills and training;
- the assessment of skills of managers and what is needed in terms of skills and training;
- a training programme according to the needs identified;
- the definition of quality control procedures;
- an ex-post Quality Assurance System.

Quality Control for individual audits

Quality control procedures for individual audits should exist in all phases of the audit, i.e. during planning, execution and reporting. Some of the most important quality control measures identified by the participants for the different phases are:

Planning:

- Standardised planning documents;
- Identification of risk areas;
- Assignment of personnel;
- Independent Review of the planning document

Execution:

- Direction, supervision and review (2 stage approach) by team leader and Head of Division etc based on audit evidence to ensure the implementation of the audit according to the plan;
- Clear responsibilities in the audit team;
- Collection of sufficient and reliable evidence;
- Proper documentation of findings;
- Communication between members of the audit team to ensure clear understanding of the audit objectives and procedures and to ensure its consistent implementation;
- Standardised working papers for standardise audit tasks and to ensure completeness;

Reporting:

- Communication between members of the audit team to ensure consistent conclusions and recommendations;
- Standardised structure of the report with guidance on structure and form;
- Discussion of the audit report with the auditee;
- Review by management not involved in the audit process
- Review by independent experts;

Quality Assurance

Quality assurance is understood as a function that reviews the audit after completion of the final report. It can be organised in different ways like for example internally as well as externally by peers, standard setting bodies or the

auditee itself.

The review system should be independent and be reported to higher management. A general report should be sent annually to the staff of the SAI.

Consequences of « bad quality » reports

The main consequences for SAIs who do not ensure a high quality of their report are the loss of reputation and in the ultimate case also a legal liability for material damages resulting from wrong statements.

The loss of reputation has then also wider consequences and may result in a reduced impact of recommendations in general and finally in bad financial management by the auditee with the final consequence of increased risk of fraud. In particular cases wrong recommendations might lead to wrong political decisions and might cause major damages to the social environment of the country.

Poor quality of reports might also have an impact on the resources of SAIs either through the cutting of the budget by the Parliament or through the decrease of motivation and more difficult recruitment of qualified staff.

ANNEX 8:

INTERNAL CONTROL – CATEGORIES AND PRACTICE

INTERNAL CONTROL – CATEGORIES AND PRACTICE

Introduction

In European public sector circles great attention is paid to control. It is often placed into categories such as “ongoing”, *ex ante*, *ex post* etc. To the uninitiated, this placement can all seem a little mysterious, not to say mystifying. In the modern risk-based world of business, both in the public and private sectors, internal control is seen as a total concept with a common language throughout the world. Control is not limited to certain phases of activity but, rather, is present throughout the operation and functioning of an organisation. Every function is subject to internal control and can no longer be seen in isolation from other parts of the organisation. Concentrating solely on certain phases of work, *e.g. ex ante* and using these rather historic terms, is not necessarily the most effective or transparent of ways of working. This paper attempts to bring together some thoughts and guidance on internal control as it is practised generally.

Importance of Control

Every activity within an organisation works on two levels within two systems. One is the operating system, which is designed to accomplish stated objectives like processing 200 payments per day without error and within EU requirements. The other is the control system, which is overlaid on the operating system. It is made up of procedures, rules, and instructions that are designed to make sure that the operating system’s objectives will be met. Control enhances the probability that management’s wishes will be met. Control is especially important in large organisations where managers are unable to personally oversee everything for which they will be held accountable.

Benefits of Control

Controls need not be exclusively restrictive. Modern management philosophy regards control as an aid rather than a constriction. It is a means of helping people meet their goals. Controls become the means of auto-control and not only protect the organisation but also the employee. Further, by establishing an appropriate system of control managers can provide assurances to their stakeholders as to the acceptable conduct of their business.

Types of Control

Controls may be divided into different types. For example:

Preventative - designed to prevent the occurrence of inefficiencies, errors or irregularities. These cannot guarantee that the controlled factor will not occur but reduce the chance of it occurring. Examples include division of duties and authorisation controls.

Detective - designed to detect and correct errors, inefficiencies or irregularities. They may not give absolute assurance since they operate after an event has occurred or an output has been produced but they should reduce the risk of undesirable consequences as they enable remedial action to be taken. Detective controls are most effective when they form part of a feedback loop in which their results are monitored and used to improve procedures or preventive controls. Examples include post payment check, stock verification and bank reconciliations.

Directive - designed to cause or encourage events necessary to the achievement of objectives. Examples include clear definition of policies, the setting of targets and adequate training and staffing. In practice, the above categories may not be clearly distinguished and a single control may operate to cover two or more functions. Supervision for example, covers all three categories.

Internal Control Standards

Operating standards may be key elements in the control process as they establish the kind of performance expected. These standards can come from various sources such as:

- Mandated standards.
- Industry standards.
- Cost accounting standards.
- EU standards/guidelines.
- Historical standards.
- Best-estimate standards.

Apart from these there is a body of standards to which the control systems themselves should conform. These are

General

Reasonable assurance - that the objective will be achieved.
Supportive attitude - by managers and employees.
Integrity and competence - of those involved in the system.
Control objectives - for each activity.
Monitoring controls - managers to continually monitor output.

Detailed

Documentation-adequate documentation readily available.
Prompt and proper recording of transactions and events.
Authorisation and execution of transactions and events-by properly designated persons.
Separation of duties.
Supervision.
Access to and accountability for resources/and records – to be limited to authorised individuals.

General characteristics of controls

| | |
|---------------------------|--|
| Timely | Detect problems early enough to limit costly exposures. |
| Economic | Provide "reasonable" assurance of achieving intended results at a minimum cost and with fewest |
| undesirable side effects. | |
| Accountable | Help people demonstrate their accountability for assigned tasks. |
| Well-placed | Positioned where they are most effective. |
| Flexible | Will accommodate changes to procedures without themselves needing to be changed. |
| Identify cause | Identify not only the problem but also the cause. |
| Appropriate | Meet management's needs. |

Problems with Controls

- Over-emphasis on controls can make them an end in themselves rather than the means towards the end.
- Can become obsolete.
- People generally resist controls.

Means of Achieving Control

Some of the means by which managers can control functions in an organisation are:

Organisation

Organisation as a means of control, is an approved intentional structuring of roles assigned to people within the organisation so that the organisation can achieve its objectives efficiently and economically.

Policies

Stated principles that require guides or restricts actions.

Procedures

Means employed to carry out activities in line with prescribed policies.

Personnel

People employed should be qualified to do their jobs. The best form of control over the performance of individuals is supervision. Hence, high standards of supervision should be established.

Accounting

Accounting is the indispensable means of financial control over activities and resources. It furnishes a framework that can be fitted to assignments of responsibility. Moreover, it is the financial scorekeeper of the organisation. The problem lies in which scores to keep!

Budgeting

A budget is a statement of expected results expressed in numerical terms. As a control it sets a standard for input of resources and what should be achieved as output and outcome.

Reporting

In most organisations management functions and makes decisions on the basis of reports it receives. Therefore, reports should be timely, accurate, meaningful and economical.

Controls in Practice

Planning

- The setting of aims, objectives and targets.
- Forecasts of activity.
- Specification of desired levels of control.
- Setting standards of performance.
- Definition of outputs of a system and criteria for measuring them.
- Anticipation of contingencies and the action to take in response.

Organisation

- Clear and documented definition of the responsibilities of individuals and groups for resources, activities, objectives and targets.
- Establishing clear reporting lines.
- Establishing the best split of work between different groups in the organisation.
- Establishing the most effective spans of command.
- Establishing the most effective means of communication throughout the organisation.
- Separating duties to avoid conflicts of interest.
- Avoiding undue reliance on any one individual.
- Giving managers the necessary authority to do their jobs effectively.
- Organisation charts and manuals.

Accounting

- The organisation must keep adequate financial and other information to allow it to produce accounts in the form prescribed.
- Accounting that fits the needs of the organisation and allows managers to make rational decisions.
- Based on lines of responsibility.
- Financial reports of results which parallel the organisational units which carry out operations.
- Accounting which allows controllable costs to be identified.

Monitoring of Performance

- Quality control built into systems.
- Clear management information requirements.
- Performance measures and indicators.

Authorisation

- Clear definition of the authorisation requirements for activities and transactions.
- Allocation of authority to appropriate individuals or groups.
- Separation of responsibility for authorisation from activities which could lead to a conflict of interest.
- Checks that relevant activities and transactions have been properly authorised.

Budgeting

- Matching of resources and costs to responsibility for objectives and outputs.
- Realistic but sufficiently tight to encourage economical use of resources.
- Closely linked to planning to ensure proposed expenditure is necessary.
- Subsidiary budgets should tie into the overall budget.

Segregation of Duties

- Preparation, authorisation and despatch of payments to be done by different people.
- More than one person to be involved in a transaction that can lead to an actual gain or benefit (fraud).

Staffing

- Identification and continuing review of numbers, grades, experience and expertise levels.
- Recruiting staff to meet the needs.
- Monitoring performance.
- Adequate training.
- Employees investigated for honesty and reliability.

- Effective recruitment practices.

Completeness and Accuracy

- Transactions should be recorded as close to their origin as possible.
- Transactions checked at appropriate times.
- Checks by staff independent of those performing the activities.
- Sequence checks on pre-numbered documents.
- Comparison of one set of documents or accounting records with another *e.g.* orders and goods received notes.
- Control totals.
- Re-performance checks by management on a sample basis.

Policies

- Clearly stated in writing.
- Systematically communicated to all employees.
- Must conform with applicable laws and regulations.
- Periodically reviewed.

Written Guidance/Procedures

- Operations manuals.
- Financial guidance and regulations covering income, expenditure, cash, banking, general accounting, contracts and related matters.
- Staff handbook.
- Purchasing code of practice.
- Code of personal conduct with guidance on gifts and hospitality.
- Computer standards on the use of computer hardware and software.

Systems Development

- Authorisation of project/change.
- Project management.
- Stage reporting.
- Quality assurance.
- Testing.

- Post-implementation review.

Physical

- Access controls such as passwords, identity cards, guards, computer logging.
- Stocktaking, security inspections.
- Secure custody of assets and records.

Supervision

Staff observed, checked and helped by their line managers.

Compliance Checks

Control teams carrying out regular compliance checks.

Output Inspection

Reviewing reconciliations, working papers, reports, physical products, and achievements against a defined standard.

Documentation

- Good standards laid down.
- Auditable, able to be reviewed by audit management.

Inter-Relationships of Controls

Controls should not be viewed singly because they inter-relate, either in a hierarchy or in the consecutive flow of operations. A hierarchy may be represented by controls at various levels within a system, or be imposed by a higher level system (e.g. budgetary control). In the consecutive flow of operations, controls at one stage of processing may act to achieve similar objectives to others at different stages. Weaknesses in one control may therefore be compensated for by other controls. Appraisal of the adequacy of internal controls should therefore be made in relation to the objectives of control in the system as a whole.

Corporate/Organisational Control

So far we have looked at control primarily in terms of individual or groups of controls to cover certain conditions. Corporate governance, and its requirements that good internal control should exist in an organisation, has led to organisations taking a wider view of the whole control framework for which they are responsible. This has resulted in a move to providing an overall assessment of an organisation's control activities with the aim of giving an assurance as to the effectiveness of its internal control systems. A number of frameworks have been established and adapted according to the individual characteristics of an organisation. Perhaps the one which has attracted the greatest following is the COSO framework of controls developed by a Committee of Sponsoring Organisations in the USA.

This framework is built around five main control areas:

- Control environment.
- Identification of risks and priorities for control.
- Financial strategy and management.
- Control activities.
- Monitoring and corrective action.

This grouping provides a combination of "soft" controls such as establishing an environment in which control can survive and flourish alongside stricter more traditional types of "hard" controls over accounting and financial

transactions. The main issues to be considered would be along the following lines.

Control Environment

- A commitment by ministers, directors, management and staff to competence and integrity.
- The communication of ethical values and control consciousness to managers and employees.
- An appropriate organisational structure within which business can be planned, executed controlled and monitored to achieve the organisation's objectives.
- Appropriate delegation of authority which has regard to acceptable levels of risk.
- A professional approach to financial reporting that complies with accounting practice.

Identification of Risk and Priorities for Control

- Identification of key organisational risks in a timely manner.
- Consideration of the likelihood of risks occurring and the significance of the likely impact on the organisation.
- Establishment of priorities for the allocation of resources available for control and the setting of clear control objectives.

Financial Strategy and Management

- Performance indicators that allow management to monitor the key business and financial activities and risks, and the progress towards objectives, and to identify developments that require intervention.
- Information systems that provide on-going identification and capture of relevant, reliable and up to date financial and operational information from internal and external sources.
- Systems that communicate relevant information to the right people at the right time in a way that identifies variance from plans and allows a prompt response.

Control Activities

- Procedures to ensure complete and accurate accounting for claims and financial transactions.
- Appropriate authorisation limits for claims and transactions.
- Procedures to ensure the reliability of data processing and information reports generated.
- Controls that limit exposure to loss of assets/records or to fraud and the risk of disallowance.
- Procedures to ensure compliance with laws and regulations that have significant operational and financial implications.

Monitoring and corrective action

- A monitoring process that provides reasonable assurance to directors and managers that there are appropriate control procedures in place for all significant business activities and that these procedures are being followed.
- Identification of change in the business and its environment that may require changes to internal control systems.
- Formal procedures for reporting weaknesses and for ensuring appropriate corrective action.
- The provision of adequate support for public statements on internal control.

Suitability of control(s)

In terms of assessing the suitability of systems of internal control, there are some danger signs that should be looked for that might lower the efficiency of the control environment:

Ability of senior managers to over-ride accepted controls Particularly a problem where staff are intimidated or feel unable to challenge senior managers who choose to bypass a standard control.

Lack of staff and vacant posts Authorisation, internal check segregation and supervision suffer when there aren't enough staff to carry out the procedures

Poor control culture Depends on managers and staff being committed to doing the job properly.

Staff collusion Virtually all systems can be by-passed if dishonest staff choose to conclude. This is the nightmare scenario for control!

Reliance on a single performance indicator The temptation is to concentrate on the one issue to the detriment of achieving good overall practice.

Reliance on memory Lack of formal procedures leads to certain experienced individuals becoming indispensable – a classic breeding ground for fraud.

Retrospective recording of transactions Bureaucracy can be given as a cause for delay justifying the non or late completion of necessary documentation.

Uncontrolled delegation of tasks Delegation can be abused to the point that no one knows who is responsible for what.

Controls in computer based systems

This is a specialised area in its own right covering security, installation and application controls. Guidelines for computer security have been produced by the European Commission and give a useful overview of best practice.

Source: SIGMA

ANNEX 9:

CO-OPERATION OF INTERNAL AND EXTERNAL AUDITORS IN PRACTICE

CO-OPERATION OF INTERNAL AND EXTERNAL AUDITORS IN PRACTICE

Internal Control

Measuring and evaluating effectiveness of the system of internal control is the primary objective of internal audit. External auditors are required to make a preliminary assessment of the adequacy of the accounting system and the control environment as a basis for the preparation of the financial statements and the design of audit procedures. Exchange of information about internal control is therefore important. When internal audit can provide positive assurance that internal control is adequate, external audit can use that information in determining the extent of its audit procedures.

Reporting and Financial Statements

Parts of internal audit work can help external audit when reporting on financial statements. In addition to internal audit's opinion on control, any relevant specific testing work undertaken will be of use. There may also be opportunities to conduct joint testing work which can serve the purposes of both internal and external audit.

Compliance with Laws and Regulations

Internal auditors will invariably consider controls over compliance with laws and regulations as part of their compliance and systems based audit work. This will be of use to external auditors who may have to give a view on the regularity of transactions and whether or not activities have been carried out in accordance with laws and regulations passed by the country's parliament.

Fraud and Corruption

Internal and external audit both have an interest in the prevention and detection of fraud. External audit should consider the work of internal audit when assessing the risks of fraud in the context of the financial statements.

Developing Systems and Major New Initiatives

Internal auditors may review the development of new systems. This work will be particularly important to external audit when new accounting systems are reviewed.

Testing Programmes

The interrogation of computerised systems for testing purposes can be expensive both in the preparation of the testing techniques and in the running of the testing programmes on computer systems. When there is an overlap in testing plans, co-operation can allow more economic approaches to meet the needs of both parties.

Audit of Regional Organisations

If the audited organisation has regional/functions or offices there is obvious scope for co-ordinating the planning of visits. Chances to work in joint teams or for one party to carry out work on the other's behalf is more economical and limits disruption.

Audits by European Commission Officials

The EC auditors will often choose to derive much of their assurance that European funds have been dispersed in line with regulations, by examining the work of both internal and external auditors. The two parties can usefully liaise to provide essential background information, assurances on the basis of work carried out or indicate a willingness to put resource into areas where the Commission auditors consider there is a need for further activity.

Conclusion

Effective co-operation between internal and external audit leads to a range of benefits for both sides, and also for the organisation being audited. Whilst their respective roles are different, co-operation helps both parties achieve their objectives and also helps them provide a more effective, efficient and economical service to the organisation they work for and ultimately to parliament and the public.

Source: SIGMA

ANNEX 10:

MANAGEMENT OF RISKS

SIGMA Short paper - MANAGEMENT OF RISK

The running of any organisation is primarily concerned with achieving its objectives. Whatever the purpose of the organisation, whether it be government or private sector, it will face all manner of risks. The job of management is to respond to these risks so as to maximise the likelihood of the organisation doing what it is set-up for.

Risk can be defined as "an outcome or event which could have a material effect on the objectives of an organisation".

The primary causes of risk are closely inter-related:

The random nature of events.

Imperfect or incomplete knowledge and information.

Lack of control and/or control weaknesses in the organisation.

There is a continuous 'cycle' to the risk management process:

Identify the risks and define a framework within which risk is to be identified.

Evaluate the risks.

Assess risk appetite.

Identify suitable responses to risks.

Gain assurance about the effectiveness of the responses.

Embed and review.

A strategic approach to risk management depends on identifying risks against key organisational objectives. Two of the most common approaches to identifying risk are:

- To commission a risk review.
- Risk self-assessment.

An alternative but unsystematic approach is to rely on intuition. This may be the most pragmatic in getting risk management off the ground. It simply involves management identifying risks using their "gut feelings".

Essential to the process is that the organisation has a well defined hierarchy of objectives starting with high level, strategic objectives, and working down to lower level, day to day objectives (*e.g.* objective for payroll, purchasing etc.) against which risks can be identified.

Categories of risk (not comprehensive) with examples.

Organisations will probably be able to identify other categories of risk applicable to their work. Issues can arise which can be an external source of risk to an organisation or can occur as an effect of an organisation's own activity or lack of it. Some examples:

| | |
|------------------------|---|
| External Risks | |
| Infrastructure | Infrastructure failure prevents normal functioning <i>e.g.</i> overload of e-mail system, computer networks, power supply systems, Transport systems for bringing staff to work may go on strike. |
| Economic | Interest rates, exchange rates, inflation may adversely affect plans. |
| Legal and regulatory | Laws and regulations may limit scope to act as desired. Inappropriate constraint through regulation may be imposed. |
| Environmental | Pollution, fuel consumption may have a damaging effect on the environment. The constraints of the environment in which the organisation is located may limit possible action. |
| Political | Change of government may require change of objectives. Organisation's actions may attract a political response/reaction. |
| Market | Developments with competitors and suppliers of goods adversely affect plans. |
| "Act of God" | Ability to act as desired affected by fire, flood etc. Contingency plans against disasters prove inadequate |
| Financial Risks | |
| Budgetary | Availability of resources insufficient to carry out desirable actions. Inability to control or direct resources |
| Fraud or theft | Loss of assets. Resources not available to carry out desirable preventative actions. |
| Insurable | Insurance not obtainable at acceptable cost. Failure to insure. |
| Capital investment | Inappropriate investment decisions being made. |
| Liability | The organisation is adversely affected by others actions, leading to the organisation gaining a right to seek damages. The reverse can apply. |
| Activity Risks | |
| Policy | Inappropriate policies being pursued. Policies based on inadequate or inaccurate information. |
| Operational | Unachievable/impractical objectives. Objectives inadequately achieved. |
| Information | Inadequacy of information for decision making leads to decisions being made without sufficient knowledge. |

| | |
|------------------------------|---|
| Reputation | Development of poor public reputation and consequent effects. Ethical reputation, for example, may limit scope to act as desired. |
| Transferable | Risks which could be transferred are retained or are transferred at the wrong price. |
| Technological | Need to improve/replace technology technology to remain effective. Failure of technology disables the organisation's operations. |
| Project | Projects developed without the risks being properly assessed. Projects failing to deliver in time budget or functionality. |
| Innovation | Exploitation of opportunities for innovation missed. Using new approaches without properly assessing risks. |
| Human Resources Risks | |
| Personnel | Lack of sufficient staff with appropriate skills limits ability to operate effectively, or at all. Poor morale affects staff. |
| Health and safety | People unable to perform their responsibilities due to neglect of well being of employees. |

Assign ownership of risks

Risk management is most effective when a senior official is allocated ownership. The risk owners can be formed into a Risk Management Committee. Risk management is most effective when a senior official is allocated ownership of particular risks, normally those within his area of responsibility. The risk owners can be formed into a Risk Management Committee that would identify the areas of greatest risk to the organisation, and decide how to respond to those risks. A re-evaluation of risk would take place at regular intervals and the Committee would also have a monitoring role to determine how risks are being managed.

Evaluate

Some types of risk lend themselves to a numerical diagnosis, particularly financial risk. For other risks, for example reputation risk, a much more subjective view is all that is possible. It will be necessary, however, to develop some framework for categorising risks into, e.g. high/medium/low.

Assess Appetite for Risk

Decisions about response to risk have to be taken in conjunction with the identification of the amount of risk that can be tolerated.

Response to Risk

Mitigation/control strategies

- Avoid the risk by suggesting alternative strategies.
- Eliminate the cause(s) of the risk.
- Reduce the likelihood of the risk occurring.
- Reduce the direct consequences of the risk.
- Minimise its impact in business terms.
- Transfer the risk (insurance).
- Instigate further investigation to gather further information before a final decision is made.
- Accept the risk as unavoidable.

Flowing from this the organisation should draw up a corporate risk register. The register should contain details of the risks. For each risk the register will show:

- Importance.
- Proposed action to deal with the risk.
- Responsible officer.
- Whether there are controls in place to achieve the organisation's objectives.
- If the controls are inadequate, what the organisation is doing about it.

Gain Assurance that Risk is being Properly Managed

It is vital that assurance is obtained as to the effectiveness of management actions. This can be provided by management periodically reporting on the work they have done to keep risk and control procedures appropriate and up to date. Internal Audit can also provide assurances about management's risk and control mechanisms.

Embed and review

The risk environment doesn't stand still and it is important that the risk process is regularly re-visited to have an assurance that the risk profile for the organisation continues to be valid.

Useful steps for implementing the risk management process:

A memo from the "boss" to all members of management and staff to "kick off" the process.

Circulation of a risk management policy document.

Workshops at different levels on risk management.

Re-allocation of some of the training budget specifically to risk training.

Dissemination of key business objectives and significant risks.

Clear policy communicated on how significant risks are to be managed.

Rather than developing separate risk reporting systems it is better if possible to build early warning mechanisms into existing management information systems. Cumbersome databases can be a major distraction from the key point which is that each person in the organisation becomes more focussed on meeting the business objectives and in managing the significant risks which relate to the task which he or she performs.

The message is that risk management is not simply a process to be gone through to satisfy external parties. It is a highly practical management tool and should be a fundamental part of planning and decision making. Therefore top management should work to embed risk management within every process and to ensure all staff understand the value of risk management. Anyone wishing to go further on this topic may wish to refer to the UK Treasury's booklet: The management of risk – a strategic overview, the so-called "orange book" on risk management. (http://www.hmtreasury.gov.uk/Documents/Public_Spending_and_Services/risk/pss_risk_managerisk.cfm) Or look into the newly issued standards on risk management prepared in the UK. (<http://www.theirm.org/pdf/standard.pdf>)

ANNEX 11:

THE EXECUTIVE SUMMARY OF INTEGRATED COSO FRAMEWORK OF INTERNAL CONTROL

THE EXECUTIVE SUMMARY OF INTEGRATED COSO FRAMEWORK OF INTERNAL CONTROL

Senior executives have long sought ways to better control the enterprises they run. Internal controls are put in place to keep the company on course toward profitability goals and achievement of its mission, and to minimize surprises along the way. They enable management to deal with rapidly changing economic and competitive environments, shifting customer demands and priorities, and restructuring for future growth. Internal controls promote efficiency, reduce risk of asset loss, and help ensure the reliability of financial statements and compliance with laws and regulations.

Because internal control serves many important purposes, there are increasing calls for better internal control systems and report cards on them. Internal control is looked upon more and more as a solution to a variety of potential problems.

What Internal Control Is

Internal control means different things to different people. This causes confusion among businesspeople, legislators, regulators and others. Resulting miscommunication and different expectations cause problems within an enterprise. Problems are compounded when the term, if not clearly defined, is written into law, regulation or rule.

This report deals with the needs and expectations of management and others. It defines and describes internal control to:

- Establish a common definition serving the needs of different parties.
- Provide a standard against which business and other entities--large or small, in the public or private sector, for profit or not--can assess their control systems and determine how to improve them.

Internal control is broadly defined as a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories:

- Effectiveness and efficiency of operations.
- Reliability of financial reporting.
- Compliance with applicable laws and regulations.

The first category addresses an entity's basic business objectives, including performance and profitability goals and safeguarding of resources. The second relates to the preparation of reliable published financial statements, including interim and condensed financial statements and selected financial data derived from such statements, such as earnings releases, reported publicly. The third deals with complying with those laws and regulations to which the entity is subject. These distinct but overlapping categories address different needs and allow a directed focus to meet the separate needs.

Internal control systems operate at different levels of effectiveness. Internal control can be judged effective in each of the three categories, respectively, if the board of directors and management have reasonable assurance that:

- They understand the extent to which the entity's operations objectives are being achieved.
- Published financial statements are being prepared reliably.
- Applicable laws and regulations are being complied with.

While internal control is a process, its effectiveness is a state or condition of the process at one or more points in time.

Internal control consists of five interrelated components. These are derived from the way management runs a business, and are integrated with the management process. Although the components apply to all entities, small and mid-size companies may implement them differently than large ones. Its controls may be less formal and less structured, yet a small company can still have effective internal control. The components are:

Control Environment

--The control environment sets the tone of an organization, influencing the control consciousness of its people. It is the foundation for all other components of internal control, providing discipline and structure. Control environment factors include the integrity, ethical values and competence of the entity's people; management's philosophy and operating style; the way management assigns authority and responsibility, and organizes and develops its people; and the attention and direction provided by the board of directors.

Risk Assessment

--Every entity faces a variety of risks from external and internal sources that must be assessed. A precondition to risk assessment is establishment of objectives, linked at different levels and internally consistent. Risk assessment is the identification and analysis of relevant risks to achievement of the objectives, forming a basis for determining how the risks should be managed. Because economic, industry, regulatory and operating conditions will continue to change, mechanisms are needed to identify and deal with the special risks associated with change.

Control Activities

--Control activities are the policies and procedures that help ensure management directives are carried out. They help ensure that necessary actions are taken to address risks to achievement of the entity's objectives. Control activities occur throughout the organization, at all levels and in all functions. They include a range of activities as diverse as approvals, authorizations, verifications, reconciliations, reviews of operating performance, security of assets and segregation of duties.

Information and Communication

--Pertinent information must be identified, captured and communicated in a form and timeframe that enable people to carry out their responsibilities. Information systems produce reports, containing operational, financial and compliance-related information, that make it possible to run and control the business. They deal not only with internally generated data, but also information about external events, activities and conditions necessary to informed business decision-making and external reporting. Effective communication also must occur in a broader sense, flowing down, across and up the organization. All personnel must receive a clear message from top management that control responsibilities must be taken seriously. They must understand their own role in the internal control system, as well as how individual activities relate to the work of others. They must have a means of communicating significant information upstream. There also needs to be effective communication with external parties, such as customers, suppliers, regulators and shareholders.

Monitoring

--Internal control systems need to be monitored--a process that assesses the quality of the system's performance over time. This is accomplished through ongoing monitoring activities, separate evaluations or a combination of the two. Ongoing monitoring occurs in the course of operations. It includes regular management and supervisory activities, and other actions personnel take in performing their duties. The scope and frequency of separate evaluations will depend primarily on an assessment of risks and the effectiveness of ongoing monitoring procedures. Internal control deficiencies should be reported upstream, with serious matters reported to top management and the board.

There is synergy and linkage among these components, forming an integrated system that reacts dynamically to changing conditions. The internal control system is intertwined with the entity's operating activities and exists for fundamental business reasons. Internal control is most effective when controls are built into the entity's infrastructure and are a part of the essence of the enterprise. "Built in" controls support quality and empowerment initiatives, avoid unnecessary costs and enable quick response to changing conditions.

There is a direct relationship between the three categories of objectives, which are what an entity strives to achieve, and components, which represent what is needed to achieve the objectives. All components are relevant to each objectives category. When looking at any one category--the effectiveness and efficiency of operations, for instance--all five components must be present and functioning effectively to conclude that internal control over operations is effective.

The internal control definition--with its underlying fundamental concepts of a process, effected by people, providing reasonable assurance--together with the categorization of objectives and the components and criteria for effectiveness, and the associated discussions, constitute this internal control framework.

What Internal Control Can Do

Internal control can help an entity achieve its performance and profitability targets, and prevent loss of resources. It can help ensure reliable financial reporting. And it can help ensure that the enterprise complies with laws and regulations, avoiding damage to its reputation and other consequences. In sum, it can help an entity get to where it wants to go, and avoid pitfalls and surprises along the way.

What Internal Control Cannot Do

Unfortunately, some people have greater, and unrealistic, expectations. They look for absolutes, believing that:

- Internal control can ensure an entity's success--that is, it will ensure achievement of basic business objectives or will, at the least, ensure survival.

Even effective internal control can only help an entity achieve these objectives. It can provide management information about the entity's progress, or lack of it, toward their achievement. But internal control cannot change an inherently poor manager into a good one. And, shifts in government policy or programs, competitors' actions or economic conditions can be beyond management's control. Internal control cannot ensure success, or even survival.

- Internal control can ensure the reliability of financial reporting and compliance with laws and regulations.

This belief is also unwarranted. An internal control system, no matter how well conceived and operated, can provide only reasonable--not absolute--assurance to management and the board regarding achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the collusion of two or more people, and management has the ability to override the system. Another limiting factor is that the design of an internal control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs.

Thus, while internal control can help an entity achieve its objectives, it is not a panacea.

Roles and Responsibilities

Everyone in an organization has responsibility for internal control.

Management

--The chief executive officer is ultimately responsible and should assume "ownership" of the system. More than any other individual, the chief executive sets the "tone at the top" that affects integrity and ethics and other factors of a positive control environment. In a large company, the chief executive fulfills this duty by providing leadership and direction to senior managers and reviewing the way they're controlling the business. Senior managers, in turn, assign responsibility for establishment of more specific internal control policies and procedures to personnel responsible for the unit's functions. In a smaller entity, the influence of the chief executive, often an owner-manager, is usually more direct. In any event, in a cascading responsibility, a manager is effectively a chief executive of his or her sphere of responsibility. Of particular significance are financial officers and their staffs, whose control activities cut across, as well as up and down, the operating and other units of an enterprise.

Board of Directors

--Management is accountable to the board of directors, which provides governance, guidance and oversight. Effective board members are objective, capable and inquisitive. They also have a knowledge of the entity's activities and environment, and commit the time necessary to fulfill their board responsibilities. Management may be in a position to override controls and ignore or stifle communications from subordinates, enabling a dishonest management which intentionally misrepresents results to cover its tracks. A strong, active board, particularly when coupled with effective upward communications channels and capable financial, legal and internal audit functions, is often best able to identify and correct such a problem.

Internal Auditors

--Internal auditors play an important role in evaluating the effectiveness of control systems, and contribute to ongoing effectiveness. Because of organizational position and authority in an entity, an internal audit function often plays a significant monitoring role.

Other Personnel

--Internal control is, to some degree, the responsibility of everyone in an organization and therefore should be an explicit or implicit part of everyone's job description. Virtually all employees produce information used in the internal control system or take other actions needed to effect control. Also, all personnel should be responsible for communicating upward problems in operations, noncompliance with the code of conduct, or other policy violations or illegal actions.

A number of external parties often contribute to achievement of an entity's objectives. External auditors, bringing an independent and objective view, contribute directly through the financial statement audit and indirectly by providing information useful to management and the board in carrying out their responsibilities. Others providing information to the entity useful in effecting internal control are legislators and regulators, customers and others transacting business with the enterprise, financial analysts, bond raters and the news media. External parties, however, are not responsible for, nor are they a part of, the entity's internal control system.

Senior Management

--Most senior executives who contributed to this study believe they are basically "in control" of their organizations. Many said, however, that there are areas of their company--a division, a department or a control component that cuts across activities--where controls are in early stages of development or otherwise need to be strengthened. They do not like surprises. This study suggests that the chief executive initiate a self-assessment of the control system. Using this framework, a CEO, together with key operating and financial executives, can focus attention where needed. Under one approach, the chief executive could proceed by bringing together business unit heads and key functional staff to discuss an initial assessment of control. Directives would be provided for those individuals to discuss this report's concepts with their lead personnel, provide oversight of the initial assessment process in their areas of responsibility and report back findings. Another approach might involve an initial review of corporate and business unit policies and internal audit programs. Whatever its form, an initial self-assessment should determine whether there is a need for, and how to proceed with, a broader, more in-depth evaluation. It should also ensure that ongoing monitoring processes are in place. Time spent in evaluating internal control represents an investment, but one with a high return.

Board Members

--Members of the board of directors should discuss with senior management the state of the entity's internal control system and provide oversight as needed. They should seek input from the internal and external auditors.

Other Personnel

--Managers and other personnel should consider how their control responsibilities are being conducted in light of this framework, and discuss with more senior personnel ideas for strengthening control. Internal auditors should consider the breadth of their focus on the internal control system, and may wish to compare their evaluation materials to the evaluation tools.

Legislators and Regulators

--Government officials who write or enforce laws recognize that there can be misconceptions and different expectations about virtually any issue. Expectations for internal control vary widely in two respects. First, they differ regarding what control systems can accomplish. As noted, some observers believe internal control systems will, or should, prevent economic loss, or at least prevent companies from going out of business. Second, even when there is agreement about what internal control systems can and can't do, and about the validity of the "reasonable assurance" concept, there can be disparate views of what that concept means and how it will be applied. Corporate executives have expressed concern regarding how regulators might construe public reports asserting "reasonable assurance" in hindsight after an alleged control failure has occurred. Before legislation or regulation dealing with management reporting on internal control is acted upon, there should be agreement on a common internal control framework, including limitations of internal control. This framework should be helpful in reaching such agreement.

Professional Organizations

--Rule-making and other professional organizations providing guidance on financial management, auditing and related topics should consider their standards and guidance in light of this framework. To the extent diversity in concept and terminology is eliminated, all parties will benefit.

Educators

--This framework should be the subject of academic research and analysis, to see where future enhancements can be made. With the presumption that this report becomes accepted as a common ground for understanding, its concepts and terms should find their way into university curricula.

We believe this report offers a number of benefits. With this foundation for mutual understanding, all parties will be able to speak a common language and communicate more effectively. Business executives will be positioned to assess control systems against a standard, and strengthen the systems and move their enterprises toward established goals. Future research can be leveraged off an established base. Legislators and regulators will be able to gain an increased understanding of internal control, its benefits and limitations. With all parties utilizing a common internal control framework, these benefits will be realized.

Source: www.coso.org

ANNEX 12:

MODERN ARRANGEMENTS FOR INTERNAL AUDIT

SIGMA SHORT PAPER ON MODERN ARRANGEMENTS FOR INTERNAL AUDIT (IA)

Introduction

The Institute of Internal Auditors defines internal audit as an:

Independent, objective, assurance and consulting activity designed to add value and improve an organisation's operations. It helps an organisation accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control and governance processes.

This is a definition that recognises the increasingly widening and important role which internal audit has to play in any organisation. The elements of independence and objectivity are vital in giving an assurance on the state of internal control in transition countries and have always been an essential feature of any effective internal audit activity. The definition in addition focuses for the first time on an organisation's corporate governance and risk management processes.

Thus internal audit is positioned quite clearly in the forefront of ensuring transition countries develop and implement sound practices and processes for the custody of EU and national funds, a position totally underpinned by the European Commission's support and expectations of the benefits an effective internal audit service can bring to transition countries.

Where is IA generally in countries seeking accession?

Most candidate countries have little or no tradition of modern internal auditing as it is widely practised throughout many parts of the world. Instead there is the tradition of a "government control office" or "control activity" based on the practice of the pre-independence regime. These units investigate complaints received about staff from members of the public and may also investigate allegations of irregularity or fraud before turning the cases over to the fiscal or criminal police. There is thus a very large element of "the policeman" associated with this type of activity, something not uncommon with the role and perception of internal audit in other parts of the world in its earlier "pioneering" days.

In each transition country, it is likely that there will be different levels of capability. Currently those units in the SAPARD and ISPA agencies, together with the internal audit units of the National Fund, associated and supplying the agencies with EU money, will have had to meet criteria for internal audit as a condition of accreditation of the agency. They will have received considerable external support in achieving this position and will probably be the leaders in the field in their particular country.

Following that will be pockets of very good practice in individual ministries but generally the picture throughout the public sector will be one of being very much in the developmental stage with internal audit units struggling to create a different environment from the traditional "control" culture.

Where IA needs to get to?

This is most definitely not the case for modern internal audit globally. Internal audit these days is generally recognised as being positioned to promote good practice and act in a positive pro-active way without the negative connotations associated with a "control" or "checker" type of approach. The best internal audit units have a very positive role to play in the running of an organisation and their value in helping to keep the organisation out of trouble is being increasingly recognised by management and staff alike.

Nowhere could the need for good internal audit be more evident than for transition countries in preparing for and after achieving accession to the European Union. The European Commission auditors have clear views of the standard of organisational stewardship they demand from countries receiving EU funds. These are heavily biased towards sound internal control and good governance. Who could be better than well-trained and professional internal auditors to provide guidance and advice in these circumstances? Existing member states and the Commission have long recognised the role internal audit can and should play. It is essential that new countries coming into the Union are equally committed.

Need to adopt and execute internationally accepted standards for internal audit

At the forefront of the drive to provide effective internal audit throughout the EU is the recognition that internal audit must recognise and follow standards for internal audit which are laid down and practised globally. These are in two parts and cover:

Attribute Standards

Purpose Authority and Responsibility.

Independence and Objectivity.

Proficiency and Due Professional Care.

Quality Assurance and Improvement Programme.

Performance Standards

- Managing the Internal Audit Activity
- Nature of Work.
- Engagement Planning.
- Performing the Engagement.
- Communicating results.
- Monitoring Progress.
- Management's Acceptance of Risks.

Need to move from traditional emphasis on "control" to modern internal auditing

Historically, internal auditing has focused on financial systems and financial controls within an organisation and it is certainly true within transition countries that what would be classed as "internal auditing". This is auditing inside the organisation, comes from the offices of controllers by people generally trained more in line with external auditing work-business continuity;

The focus of internal auditing has shifted, and is continuing to shift, quite dramatically. This is also closely associated with the greater understanding and relative importance being placed on internal control, good stewardship and corporate governance.

Some of the key changes that have taken place are:

Historic role

Policemen
Financial focus
Focus on hard controls
Focus on tangible assets
Compliance based
Functional focus
Self-sufficient
Reactive

Modern role

Partners in the organisation
Business focus
Focus on soft controls
Focus on intangible assets
Risk based
Process focus
Sharers of best practice
Proactive

OVERALL OBJECTIVES FOR IA-INTERNAL CONTROL

What does Internal Audit do?

Ultimately, management is responsible for managing risk and establishing an effective control framework. Internal audit can assist management in this and can also provide advice to management on what it needs to do to establish appropriate policies, systems of control, and procedures necessary to manage risk effectively and efficiently.

The scope of work of any internal audit function will invariably need to be agreed with management but nevertheless the following list, drawn in part from the IIA Standards, is a commonly pursued range of work for internal auditors:

Understanding the key business risks and reviewing the adequacy and effectiveness of the processes in place to manage the risks.

Reviewing the controls which ensure the reliability and integrity of management information and the means used to identify, measure, classify and report such information.

Reviewing the processes and systems established by management to ensure adherence with those policies, plans, procedures, laws and regulations which could have an impact on operations and determine whether the organisation is in compliance.

Reviewing the means of safeguarding assets (including both tangible and intangible assets such as people and information).

Appraising the economy, efficiency and effectiveness with which resources are employed.

Reviewing operations and projects to establish whether results are consistent with established objectives and whether the projects are being carried out as planned.

Monitoring corrective action plans to ensure they are implemented effectively and promptly.

What is key to the success and contribution of internal audit is that it must focus on the critical risks to the organisation and review the adequacy of the underlying activities to manage those risks. This will add value to the organisation and strengthen its ability to deal with the issues and risks facing it.

The understanding and evaluation of the risks will generally come together in to an Audit Needs Assessment which identifies those aspects of the organisation which should form part of the overall strategic and annual plans for Internal Audit. From these plans comes the day-to-day work of Internal Audit.

Structure-viable critical mass

At present the establishment of internal audit in ministries is minimal. There is little by way of meaningful capacity to provide internal audit services. In effect there are many one-man audit units, each of which has to provide an effective service:

Over a whole range of tasks.

Generally provide information to the MoF.

Carry out certain laid down pieces of work.

It may be in the early stages of the development of internal audit units, but not in the longer term, that benefit could be gained if resources were centralised. This would also have the effect of:

- Creating a critical mass of auditors which would enable a wide range of skills to be acquired.
- Ensuring the service could continue in the absence or in the event of the departure of individual officers.
- Enabling a structure for the unit to be created which could provide a career progression for auditors.
- Ensuring experience is built up and passed on so as to enable a better quality and more effective end product.

The thin spread/dissipation of resources which exists at present, whilst possibly understandable in the overriding need to provide internal audit functions, is not necessarily the most effective use of scarce resources.

Need for independence

The internal auditor should be responsible to the minister or the Secretary-General of a ministry or agency, giving technical advice on the efficient management of resources without becoming involved in political questions. It is important to be clear about the nature of the internal auditor's independence. It should not be compared with the independence of the external auditor (*e.g.* the supreme audit institution) who reports directly to the parliament or budgetary authority and whose independence is normally reinforced by the tenure and security of his appointment and safeguards against unjustified dismissal. The internal auditor is responsible to the head of the ministry and is part of the staff of the ministry or agency.

The Institute of Internal Auditors requires that the head of internal audit should have organisational independence and "should report to a level within the organisation that allows the internal audit activity to fulfil its responsibilities".

The IIA also lays down that "The internal audit activity should be free from interference in determining the scope of internal auditing, performing work and communicating results". Since the internal auditor is not completely independent of the ministry or organisation in which he functions it is essential that the internal audit function achieves an appropriate status and weight in the organisation.

Relationship with management and the organisation

One of the most vital roles internal audit can play is in the support and assurance it can give to the head of any organisation. With an honest, objective approach coupled with operational independence, internal audit is well placed to tell the minister what is really happening in the ministry and not what officials would like the minister to know. When so much of good governance is dependent upon the minister having a realistic idea of what is involved in certain courses of action, or having unbiased facts on a particular case or situation, then the internal auditor can really prove his value.

In order to establish awareness of, and gain support for, good governance, internal control and risk issues, it is good practice to establish regular contact with the minister/state secretary.

Pillars on which IA should be constructed:

These can be summed up as the four P's:

Pre-requisites – things such as:

HIA independence.
Effective audit committee.
ANA.
Strategic plans.
Annual and assignment plans.
Audit charter.

Pay and conditions

- Adequate salary levels.
- Career structure for internal auditors.
- Working conditions which take account of the specific needs of internal auditors such as confidentiality.
- Security etc.

Professionalism

- Working to internationally accepted standards.
- Professional training and qualifications.
- Membership of IIA.
- Attitude of mind.

Practices

- Good planning.
- Risk analysis.
- Documentation/manuals.
- Quality assurance.
- Effective reporting.
- Good communication skills.
- Systems/risk based approach.
- Performance indicators.
- Follow-up systems.
- Internal/external audit communication.

The Need for Internal Audit

Over the last 10 to 15 years in areas where internal audit has had solid foundations, there has been a change to internal auditors becoming advisers to management, helping them to deal with risk and to establish an effective framework of internal control. This has been a concerted move from internal financial control to internal control through to risk management activities.

This more modern role for internal audit assists management at all levels to carry out their duties and meet their responsibilities more effectively. It also helps to ensure:

- The business of an organisation is conducted in an orderly and efficient manner.
- Assets are protected.
- Accuracy of records.
- Minimisation of opportunities for fraud.

This is the role that for transitional countries is largely aspirational in their early days in joining the EU but which must be the goal.

Benefits of Internal Audit

An effective internal organisation can give the following benefits to an organisation:

- Assurance regarding the adequacy and effectiveness of the organisational control framework in the context of the organisation's critical business risks.
- Identification of major control weaknesses and recommendations to reduce risk exposure.
- Advice on and facilitation of best practice in risk management and internal control.
- Value for money performance reviews looking at economy efficiency and effectiveness.
- Education of line management and their staff in elements of risk management and control.
- Advice on the most appropriate controls to be implemented in projects and new systems.
- The potential deterrence of fraud and other illegal activities across the organisation.
- An early warning of potential problem areas.

Making internal audit effective

Internal audit needs to be set up and managed in the best way to ensure that it assists in the achievement of organisational objectives and that it operates in an effective manner within the organisation. Internal audit can be most effective if the following are in place:

The objectives of internal audit are agreed at the highest level in the organisation and are clearly understood across all levels of management and staff. This may be partially achieved by the production and circulation of an internal charter or terms of reference but there will also need to be a continuing and concerted educational process to ensure the message is properly spread.

The scope of internal audit work should cover the entire organisation, not simply the financial aspects or those systems or processes which management decides are appropriate for audit review.

Internal audit must have totally unrestricted access across the entire organisation, endorsed by the Minister or other head of an organisation.

The head of internal audit must have a direct reporting line to the minister/ head of the organisation and where one exists, the Chair of the Audit Committee.

Internal audit must be, and must be seen to be, completely independent from the day to day operations of the organisation.

Internal audit should not undertake non-audit work, but where it is absolutely essential, it is understood that they are not operating as Internal Audit.

The results of internal audit work must be effectively communicated and be seen to be acted upon.

Options for providing an Internal Audit service

Several options exist for providing an internal audit service.

The conventional arrangement is to have an internal team which is directly employed by the organisation. Size and cost of providing the service are among the determining factors when considering in-house provision. The in-house team may be reinforced by contractors who can provide specialist skills and additional resources as appropriate.

Alternatively the whole service can be contracted out.

Smaller organisations should consider the use of consortia to take advantage of the flexibility this arrangement can produce. Additional skills or expertise can be brought in on a short or long term basis.

In some countries it is possible that there will be a central strong function, perhaps under the Ministry of Finance, which could be used to provide an internal audit service whilst the in-house facility is being developed. It is also possible that this additional expertise could be called on when an area demands specific expertise, as in some IT Audit situations.

Is the internal audit function adding value?

Although we have spoken in a previous section of the ways of making internal audit effective, the other side of the coin is that Internal Audit needs to demonstrate the value it adds to an organisation. The questions you may wish to ask in determining whether or not your internal audit unit is delivering the value that you both want and need might include:

Does the internal audit plan focus on the achievement of the organisation's objectives?

Does internal audit provide you with adequate assurance on the state of risk and control within your organisation?

Does your internal audit function have the correct blend of skills, knowledge and experience of your business?

Is internal audit invited to become involved in all major projects that the organisation sets up?

Is Internal Audit responsive to changes in the business and does it offer constructive advice in relation to those changes?

Is there a constant demand for internal audit staff to move into line management positions within the organisation?

Does internal audit enjoy good and strong relationships at the most senior levels within the organisation?

The Institute of Internal Auditors also recommends that each internal audit function should have an independent peer review on a regular basis. Such a review will also inform you of the value added by your internal audit function and will enable comparison with best practices from other organisations.

It is also important to develop a set of performance measures for your internal audit function.

The internal/external audit relationship

Although internal and external auditors have different end result objectives and, to some degree, different reporting lines, their work is complementary.

External auditors have a wide experience of a number of different organisations and related systems and controls whilst internal auditors have an unparalleled knowledge of their own organisation and an understanding that outsiders are never ever likely to have.

Both sets of auditors should be striving to work for the public good to ensure that systems and controls are strong, to ensure that fraud does not happen, or where it does, that it is picked up at the earliest opportunity and that lessons are learnt and immediately put into practice.

Many of the recent corporate governance initiatives should virtually "force" auditors to focus on clarifying what controls need to exist within an organisation and defining the most efficient way for senior management to satisfy themselves that controls are working effectively. The following issues will certainly need to be addressed as part of this process:

How should an organisation define its control standards?

How can line management be motivated to take on their responsibilities for managing risk and internal controls?

What is the right split of responsibilities between internal and external audit work?

How can the value of the work be maximised?

Where there has been an internal audit function, historically external auditors have used it to carry out a range of its own work. This is not a course to be recommended or continued.

- The aims and purposes of the two are different although complementary.
- It is not in an organisation's interest to have an internal audit function that spends considerable time carrying out external audit work.
- Many organisations use internal audit as a training ground for future.
- Organisation managers.

The two sets of auditors need to communicate on a regular basis. Frequent communication will lead to:

- More effective working for both parties.
- Lack of duplication of work.
- Stronger reports leading to better implementation of recommendations and a stronger control environment.

What internal audit is not responsible for:

- It cannot ensure the success of the organisation.
- It cannot ensure the survival of the organisation.
- It cannot ensure the effectiveness of internal control.
- It cannot ensure the reliability of financial reporting and accounts.
- It cannot ensure the absence of fraud or other irregularities or that they are detected.

All of the above remain, as they always have been, clearly the responsibility of management.

ANNEX 13:

INTOSAI INTERNAL CONTROL GUIDE FOR MANAGERS

Internal Control: Providing a Foundation for Accountability in Government

An introduction to internal control for managers in governmental organizations International Organization of Supreme Audit Institutions 1

Overview

"Internal control is a management tool used to provide reasonable assurance that management objectives are being achieved."

Guidelines for Internal Control Standards, INTOSAI

Managers are responsible for establishing an effective control environment in their organizations. This is part of their stewardship responsibility over the use of government resources. Indeed, the tone managers set through their actions, policies, and communications can result in a culture of either positive or lax control. Planning, implementing, supervising, and monitoring are fundamental components of internal control. You may go about these activities routinely, without thinking of them as part of a broad control environment that helps to ensure accountability. But they are.

Internal control, or management control, helps to provide reasonable assurance that the organization

- adheres to laws, regulations, and management directives;
- promotes orderly, economical, efficient, and effective operations and achieves planned outcomes;
- safeguards resources against fraud, waste, abuse, and mismanagement;
- provides quality products and services consistent with the organization's mission; and
- develops and maintains reliable financial and management information and fairly discloses that data through timely reporting.

Therefore, it is essential that all managers in an organization understand the importance of establishing and maintaining effective internal control.

For this reason, the Internal Control Standards Committee of the International Organization of Supreme Audit Institutions (INTOSAI) has prepared this booklet to

- provide an overall framework for establishing and maintaining effective internal controls,
- describe internal control roles and responsibilities for government managers and auditors,
- describe common internal control practices,
- provide a simple checklist to help you begin thinking about whether your organization has taken appropriate steps to ensure effective internal control, and
- provide a list of references for further information.

2

Framework for Establishing and Maintaining Effective Internal Control

Managers' Internal Control Roles and Responsibilities

- Create a positive control environment by
 - setting a positive ethical tone,
 - providing guidance for proper behavior,
 - removing temptations for unethical behavior,
 - providing discipline when appropriate,
 - preparing a written code of conduct for employees.
- Ensure that personnel have and maintain a level of competence to perform their duties.
- Clearly define key areas of authority and responsibility.
- Establish appropriate lines of reporting.
- Establish management control policies and procedures that are based on management's analysis of risk.
- Use training, management communications, and day-to-day actions of managers at all levels to reinforce the importance of management control.
- Monitor the organization's control operations through annual assessments and reports to topmanagement.

Auditors' Roles and Responsibilities

- Maintain independence in fact and appearance.
- Ensure professional competence of audit staff.
- Advise management on areas at risk.
- Establish auditing strategic plans and goals.
- Perform audits of operations.
- Evaluate information technology systems.
- Recommend ways to improve operations and strengthen controls.
- Follow up to ensure recommendations are fully and effectively implemented.
- Coordinate audit activities with external auditors.
- Implement an audit quality assurance system.

Periodically evaluate effectiveness of internal control practices

Continually monitor operation of internal control practices throughout the organization and modify them as appropriate

Common Internal Control Practices

- Transactions are promptly recorded to maintain their relevance and value to management in controlling operations and making decisions.
- Internal control practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body.
- An organization's workforce is effectively trained and managed so as to achieve results.
- Performance indicators are developed and monitored.
- Key duties and responsibilities are divided among people to reduce the risk of error or fraud. That is, duties are segregated.
- Managers compare actual performance to planned or expected results and analyze differences.
- Information processing is controlled, such as through edit checks of data entered.
- Physical control is established to secure and safeguard all vulnerable assets.
- Access to resources and records is limited to authorized individuals. Accountability for their custody and use is assigned and maintained.
- Transactions and other significant events are authorized and executed only by persons acting within the scope of their authority.
- Internal control and all transactions and other significant events are clearly documented and the documentation is readily available for examination.

3

Managers

Managers should realize that a strong internal control structure is fundamental to control of an organization and its purpose, operations, and resources.

Responsibility for providing an adequate and effective internal control structure rests with an organization's management. The head of each governmental organization must ensure that a proper internal control structure is instituted, reviewed, and updated to keep it effective. A positive and supportive attitude on the part of all managers is critical. All managers must be individuals of personal and professional integrity. They are to maintain a level of competence that allows them to understand the importance of developing, implementing, and maintaining effective internal controls.

Management establishes an independent audit function as a key part of the internal control structure. Management should establish objectives for the audit function and place no restrictions on auditors in meeting them. To ensure independence, the head of this audit unit should report directly to the manager heading the agency. Management should also select an experienced, well-qualified person to lead the unit and provide sufficient resources and a competent staff to carry out audit operations. In this regard, managers work constructively with auditors to identify risks and design mitigating controls, and they give auditors responsibility for periodically evaluating internal control operations to identify weaknesses and recommend corrective measures.

4

Auditors

Management often establishes an audit unit as part of its internal control and self-assessment framework.

Auditors are a part of a governmental organization's internal control framework, but they are not responsible for implementing specific internal control procedures in an audited organization. That is properly management's job.

The auditors' role is to audit an organization's internal control policies, practices, and procedures to assure that controls are adequate to achieve the organization's mission. Although auditors may be part of the organization they audit, it is important and necessary that the auditors' independence be maintained.

For its part, management can demonstrate its support by emphasizing the value of independent and objective auditing. Management should also identify areas for improving performance quality and respond to information developed through audits.

An external audit unit may also play a role in auditing a governmental entity's internal control.

Most governmental entities are also audited by an external audit function. This external auditor is often appointed by, and reports to, the oversight body to which an entity is responsible. This external auditor may examine and suggest improvements to a governmental entity's internal control.

5

Internal Control

Simply defined, internal control is the process by which an organization governs its activities to effectively and efficiently accomplish its mission.

Internal control should not be looked upon as separate, specialized systems within a governmental organization. Rather, internal control should be recognized as an integral part of each system that management uses to guide its operations.

Establishing effective internal control involves an assessment of the risks the agency faces from both external and internal sources. A precondition to risk assessment is the establishment of clear, consistent entity objectives, which are the goals or purposes to be achieved. Risk assessment is the identification and analysis of relevant risk associated with achieving the objectives. Internal control practices (such as procedures, processes, physical arrangement, organizational structure, and assignment of responsibility and authority) should then be designed and implemented to achieve the goals.

Also, information should be recorded and communicated in writing to management and others within the entity who need it and within a time frame that enables them to carry out their internal control and other responsibilities. Internal control monitoring should assess the quality of performance over time and ensure that the findings of audits and other reviews are promptly resolved.

6

Checklist for Managers

In establishing your framework, have you

- q Assessed the risks the organization faces?
- q Identified control objectives to manage the risks?
- q Established control policies and procedures to achieve the control objectives?
- q Created a positive control environment?
- q Maintained and demonstrated personal and professional integrity and ethical values?
- q Maintained and demonstrated a level of skill necessary to help ensure effective and efficient performance?
- q Maintained and demonstrated an understanding of internal controls sufficient to effectively discharge responsibilities?

For implementing internal control, have you

- q Adopted effective internal control throughout the organization?
- q Based the organization's internal control on sound internal control standards?
- q Included in the organization's internal control structure appropriate and cost-effective control practices?
- q Prescribed control practices through management directives, plans, and policies?
- q Established a means of continually monitoring the operation of the organization's internal control practices?

Concerning the audit function, have you

- q Shown an understanding of the difference between internal control and audit?
- q Recognized that an audit function is integral to your organization's internal control?
- q Established an audit function?
- q Ensured the audit organization's independence?
- q Given the audit organization responsibility for evaluating the effectiveness of the audited organization's internal control practices?
- q Established a system to monitor the organization's progress in implementing internal and external auditor recommendations?

7

References for Further Information

The International Organization of Supreme Audit Institutions has issued the following documents.

_ *Guidelines for Internal Control Standards*

_ *Guidelines for Reporting on the Effectiveness of Internal Controls: SAI Experiences in Implementing and Evaluating Internal Controls*

These publications can be found at (<http://www.intosai.org>).

Various professional accounting organizations can provide internal control information.

The American Accounting Association

(<http://www.aaa-edu.org>)

The American Institute of Certified Public Accountants

(<http://www.aicpa.org/index.htm>)

The Canadian Institute of Chartered Accountants

(<http://www.cica.ca>)

The Chartered Institute of Public Finance and Accountancy

(<http://www.cipfa.org.uk>)

The Committee of Sponsoring Organizations of the Treadway Commission (COSO)

(<http://www.coso.org>)

The Institute of Chartered Accountants in England & Wales

(<http://www.icaew.co.uk>)

The Institute of Internal Auditors

(<http://www.theiia.org>)

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ANNEX 14:

EXAMPLE OF INTERNAL AUDIT TRAINING MODULES DEVELOPED IN LITHUANIA

Example of internal audit training modules being developed in Lithuania

Internal Audit Concept and Legal Regulation

Objectives:

Understand the significance and aims of internal audit.

Train and perform internal audit and evaluate the system of internal audit.

Learn to plan and organise internal audit as well as to document it correctly.

Introduce the theory of internal controls based on the COSO study, policy and performance of internal audit in the specific Member States of the European Union.

Main Topics

- The theory of internal controls, based on the COSO study.
- Necessity of audit.
- System of internal audit, concepts, postulates, tasks and functions.
- Audit classification.
- Audit planning and strategy.
- Auditor's working documents
- Submission of audit results.
- System of control for internal audit.
- Risks of internal audit.
- Audit programmes.
- Audit arrangement.
- Internal audit system in Lithuania and its interactions.
- Arrangement of work of internal audit bodies.
- Internal audit process in Ministries, public enterprises and other institutions.
- Policy and performance of internal audit in the specific Member States of the European Union.

Module 2

Internal Audit in Public Institutions

Objectives

- Get acquainted with legal instruments for internal audit and the latest international standards for internal audit.
- Get acquainted with audit classification according to functional indication and scope.

Main Topics

- Internal control system.
- Audit for errors and fraud.
- Regulatory documents on internal audit analysis and application.
- Management audit.
- Operational audit.
- IT audit.
- Financial audit.
- Practical class assignments on financial audit.
- Methods of teaching.
- Lecture.
- Discussion.
- Work in groups.
- Individual tasks.
- Situation analysis.
- Tests.
- Exercises.

Each module takes 40 academic hours, successful completion, of which enables the students to get certification for their efforts. The modules are in the process of development and the recommendations, developed under Twinning programme "Internal Financial Control", are taken into account for the training programme of Lithuanian public sector internal auditors for 2002-2005. The training package and training arrangements are professionally organised and cater to the perceived needs of its students, concentrating on an understanding of the concepts and regulations governing internal audit; internal audit of public institutions; internal audit according to sectors; and an internal audit focus on administrative capacities, strategic planning and psychological activities. The Training Centre of the MoF, together with the Ministry of Finance and Lithuanian Institute of Public Administration, the university professors and the members of the association established the Certifying Commission. After the completion of the required training programme, the internal auditors from the public sector are awarded with the certificate. If the internal auditor from the public sector is not satisfied with the results of the examination and assessment of knowledge, he may appeal for an assessment repeatedly.

INTERNAL CONTROL SYSTEMS IN CANDIDATE COUNTRIES

VOLUME III

QUESTIONNAIRE / COUNTRY REPLIES

Prepared by the PIFC Expert Group
- Working Group on Audit Manuals -

March 2004¹

¹ Updated: November 2004

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I. QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

The intention of the Questionnaire is to gather information to support the WG on Audit Manuals in considering the topic of common interest of all members of the Group, through following objectives:

- Providing an effective update on the state of the development in external auditing of ICS in candidate countries;
 - Initiating discussion on how to get acquainted with and harmonizing of the IC/IA methods established within the EU and meeting the EU requirements;
 - Promoting the exchange of knowledge and experiences among SAIs with intention to ensure appropriate, timely and effective ICSs.
-

Country: _____

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

A. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes
 - Only for IC
 - No
 - If so, how are IC and IA defined?
-

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes
 - No
 - Which organisation is responsible for developing and promulgating definition of IC/IA?
-

- Which organisation is responsible for implementing IC/IA in the state?
-

B. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - Yes
 - No
 - Which authority is in charge of issue standards and provides technical advice for ICS?
-

- Is ICS in your country based on the relevant professional standards?
 - Yes
 - No
- Is this responsibility based on:
 - Constitution
 - Law
 - Regulations
 - Other: _____
- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - Yes
 - No
- Does your SAI participate in development and promulgation of IC standards?
 - Yes
 - No
- Does a Code of Professional Ethics for internal auditors exist in your country?
 - Yes
 - No

C. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - o Yes
 - o No
- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - o Yes
 - o No
- Regardless of legal obligation, are IA units established in line ministries?
 - o Yes, in all of them
 - o Yes, In most of them
 - o Yes, but only in some
 - o No
 - o SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - o Yes, in all of them
 - o Yes, In most of them
 - o Yes, but only in some
 - o No
 - o SAI don't have this information
- Do the IA units have a mandate to carry out :
 - o Management audit
 - o Financial audit
 - o Performance audit
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - o Yes
 - o Yes, but not the EU funds
 - o No
- To whom do the IA units report on their work in line ministries?

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - o Yes
 - o No

PART II: ROLE OF SAI IN ASSESMENT OF ICS

A. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - o Yes
 - o No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - o Yes
 - o No
- If so, which bodies/agencies? _____
- If your SAI implement audits of ICS, do you:
 - o look at the ICS during the regular audits?
 - o perform specific audits for the assessment of ICS?
- What number of the staff employed in your SAI is involved in audits of ICS?
Number of staff: _____ (Percentage: _____)
- Does a special department exist?
 - o Yes
 - o No
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - o Yes
 - o Yes, but as an integral part of the general Audit Manual

- o No
- If so, do they meet INTOSAI and EU requirements?
 - o Yes
 - o No

B. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - o Yes
 - o No
- Has any joint action been taken to avoid duplication of work?
 - o Yes
 - o No
- If so, what kind of action?

- Does your SAI assist in establishment of IA units?
 - o Yes
 - o No
- If so, in which way:
 - o By secondment of its staff
 - o Through help in education of their staff within the SAI?
 - o Through help in education by lectures or seminars in IA units?
 - o By organising joint training in working methodology with IA units in public sector?
 - If so:
 - What kind of training?

 - How often?

 - Is there follow-up of the results of this training?
 - o Yes
 - o No
 - Did your SAI find such cooperation helpful in its work?
 - o Yes
 - o No
 - O By lending them equipment and materials for education?
 - O In other ways:

C. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

| | |
|--------------------|------------|
| <u>Management:</u> | <u>IA:</u> |
| Yes | Yes |
| No | No |
- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - o Yes
 - o No
- From your experience, does management have a positive and encouraging attitude relating to ICs?
 - o In all of the cases
 - o In most of the cases
 - o In some cases
 - o Almost never
 - o Never
- Does management in auditees support cooperation between SAI and IA units?
 - o Always
 - o Mostly
 - o Rarely
 - o Almost never

- o Never
- Does management follow recommendations concerning ICS given by SAI?
 - o Always
 - o Mostly
 - o Rarely
 - o Almost never
 - o Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - o Yes
 - o No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - o Yes
 - o No
- If so, do you have some specific experiences?

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
 - o Yes
 - o No
- If so, what kind of problems/barriers are the most frequent?
 - o lack of mandate,
 - o weak communication,
 - o overlapping of work,
 - o lack of qualified staff in IC and IA units,
 - o access to reports and documents,
 - o lack of relevant guides and procedures for audit ICS,
 - o lack of understanding of ICSs by the staff in SAI,
 - o various definitions of IC and IA in public sector,
 - o others, namely: _____
- What action have you taken to deal with the problems?

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - o Yes
 - o No
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - o Yes
 - o No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - o Yes
 - o No

- Has your SAI been appointed as the certifying body for pre-accession funds?
 - o Yes
 - o No
 - How many audits of EU funds has your SAI performed so far?
-

- What type of audit has your SAI perform?
 - o Legality
 - o Performance
 - o Special investigations
 - o Other
 - What was the subject of the audits?
 - o Administrative preparedness of ministries to receive EU funds?
 - o Management of received EU funds?
 - o Both
 - o Other topics
 - o
 - To whom were this reports addressed?
 - o Auditee
 - o Ministry of finance
 - o Parliament
 - o EU
 - o Other
 - Which funds have been audited?
 - o SAPARD
 - o ISPA
 - o PHARE
 - o CARDS
 - o Other
 - Do you have a mandate to audit the final beneficiary?
 - o Yes
 - o No
 - Has there been follow-up on those audits?
 - o Yes
 - o No
 - If yes, what kind of?
-

- Have those audits been published?
 - o Yes
 - o No
 - Is there a separate unit organized for carrying out audits of EU funds?
 - o Yes
 - o No
 - o In the process
 - How many staff are engaged in auditing EU funds?
-

- How many auditors are trained to audit EU funds?
-

- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - o Yes
 - o No
- Is (or was) your SAI beneficiary of TWINNING projects?
 - o Yes
 - o No
- If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - o Yes
 - o No
- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - o Yes

- o No
- If so, can you indicate the main sources used for the preparation of this Audit Manual?

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - o Yes
 - o No
- Has training been organised to assist with the implementation of the Audit Manual?
 - o Yes
 - o No
- Have there been pilot audit(s) on management of EU funds?
 - o Yes
 - o No
- Have they been assisted by SAIs of EU member states?
 - o Yes
 - o No
- If so, did those audits
 - o provide useful input for preparation of Audit Manuals on EU issues?
 - o provide the required experience in the implementation of certain audit methodologies and techniques?
 - o Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - o Yes
 - o No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - o Yes
 - o No
- If so, should they be based on good practice and experience?
 - o Yes
 - o No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - o Yes
 - o No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?
- Do you think that this issue should be further developed?
 - o Yes
 - o No
- If so, do you think that:
 - o the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - o Strategic Committee should be established
 - o Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - o Yes
 - o No
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - o Yes
 - o No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - o exchange of experiences at the meetings of the Group
 - o easier cooperation with other SAIs on the particular field
 - o the wider access to the information on the same issue in SAIs of EU
 - o development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements

others, namely: _____

- Are you interested in preparing country paper on this topic for the next meeting of LOs?

- Yes
- No

- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

On behalf of Head of SAI: _____

II. COUNTRY REPLIES

ALBANIA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **ALBANIA**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

D. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes
 - Only for IC
 - No
- If so, how are IC and IA defined?

Internal Audit: *Internal audit is an objective, independent assurance activity for management, designed to increase value and to improve a public entity's operations. By applying a systematic and disciplined approach it helps entity to evaluate and improve the effectiveness of the risk management, controls and governance.*

Internal Control: *is the organisation, policies and procedures used to help ensure that Government programs achieve their intended results, that the resources used to deliver these programs are consistent with the aims and objectives of the organization, that the programs are protected from fraud, waste and mismanagement, and that reliable and timely information is obtained, maintained, reported and used for decision-making.*

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes
 - No
- Which organisation is responsible for developing and promulgating definition of IC/IA?

N/A

- Which organisation is responsible for implementing IC/IA in the state?

General Directorate of Internal Audit, in the Ministry of Finance

E. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - Yes
 - No
- Which authority is in charge of issue standards and provides technical advice for ICS?

Recently in our country is approved the Law on Internal Audit in Public Sector, so it is not yet clear defined the authority in charge of issue standards for ICS. In the other hand the SAI has adapted and adopted a set of standards, regulations and good international practices that soon will be at the disposal of executive bodies. In the future the SAI will take more active role to provide with technical advise for ICS.

- Is ICS in your country based on the relevant professional standards?
 - Yes
 - No
- Is this responsibility based on:
 - Constitution
 - Law
 - Regulations
 - Other: _____

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 Yes
 No
- Does your SAI participate in development and promulgation of IC standards?
 Yes
 No
- Does a Code of Professional Ethics for internal auditors exist in your country?
 Yes
 No

F. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 Yes
 No
- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 Yes
 No
- Regardless of legal obligation, are IA units established in line ministries?
 Yes, in all of them
 Yes, In most of them
 Yes, but only in some
 No
 SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 Yes, in all of them
 Yes, In most of them
 Yes, but only in some
 No
 SAI don't have this information
- Do the IA units have a mandate to carry out :
 Management audit
 Financial audit
 Performance audit
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 Yes
 Yes, but not the EU funds
 No
- To whom do the IA units report on their work in line ministries?

They report to the management of the Ministry (mainly to the Minister)

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 Yes
 No

PART II: ROLE OF SAI IN ASSESMENT OF ICS

D. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 Yes
 No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 Yes
 No
- If so, which bodies/agencies? *General Directorate of Internal Audit in Ministry of Finance may control/assess ICS, but it is not responsible by law on control/assessment of ICS.*

- If your SAI implement audits of ICS, do you:
 - o look at the ICS during the regular audits?
 - perform specific audits for the assessment of ICS?
- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: 15 (Percentage: 10 %)
- Does a special department exist?
 - Yes, a audit section inside a department
 - o No
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - Yes
 - o Yes, but as an integral part of the general Audit Manual
 - o No
- If so, do they meet INTOSAI and EU requirements?
 - Yes
 - o No

E. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - Yes
 - o No
- Has any joint action been taken to avoid duplication of work?
 - Yes
 - o No
- If so, what kind of action?

With the General Directorate of Internal Audit in the Ministry of Finance, it is co-ordinated the annual audit programme and during the period there are realised frequently contacts with this directorate for specific cases to avoid duplication.

-
- Does your SAI assist in establishment of IA units?
 - Yes
 - o No
 - If so, in which way:
 - By secondment of its staff
 - Through help in education of their staff within the SAI?
 - Through help in education by lectures or seminars in IA units?
 - o By organising joint training in working methodology with IA units in public sector?

If so:

 - What kind of training? _____
 - How often? _____
 - Is there follow-up of the results of this training?
 - o Yes
 - o No
 - Did your SAI find such cooperation helpful in its work?
 - o Yes
 - o No

By lending them equipment and materials for education?

o In other ways: _____

F. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

Management:

Yes
o No

IA:

Yes
o No

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (either in the audit report conclusions or as pointed out in the annual reports)?
 - Yes
 - No
- From your experience, does management have a positive and encouraging attitude relating to ICS?
 - In all of the cases
 - In most of the cases
 - In some cases
 - Almost never
 - Never
- Does management in auditees support cooperation between SAI and IA units?
 - Always
 - Mostly
 - Rarely
 - Almost never
 - Never
- Does management follow recommendations concerning ICS given by SAI?
 - Always
 - Mostly
 - Rarely
 - Almost never
 - Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - Yes
 - No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - Yes
 - No
- If so, do you have some specific experiences?

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
 - Yes
 - No
- If so, what kind of problems/barriers are the most frequent?
 - lack of mandate,
 - weak communication,
 - overlapping of work,
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: _____
- What action have you taken to deal with the problems?

Currently we are working to develop some relevant guides on auditing ICS.

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - Yes
 - No
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

As mentioned above we are working to develop guides on ICS that will be disseminated to executive bodies. After that the SAI will organise training seminar on ICS auditing, etc.

-
- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?

No

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - Yes
 - No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - No
- Has your SAI been appointed as the certifying body for pre-accession funds?
 - Yes
 - No
- How many audits of EU funds has your SAI performed so far?

Usually we audit the investments with foreign funds that mostly are co-financed (WB, EBRD, EU, etc.), few of these audits are only with EU funds. Recently it is established a section within an Audit Department concerning investment with foreign funds. As the matter of course in the future this audit section will be more focused on EU funds auditing.

- What type of audit has your SAI perform?
 - Legality
 - Performance
 - Special investigations
 - Other
- What was the subject of the audits?
 - Administrative preparedness of ministries to receive EU funds?
 - Management of received EU funds?
 - Both
 - Other topics
 -
- To whom were this reports addressed?
 - Auditee
 - Ministry of finance
 - Parliament
 - EU
 - Other
- Which funds have been audited?
 - SAPARD
 - ISPA
 - PHARE
 - CARDS
 - Other
- Do you have a mandate to audit the final beneficiary?
 - Yes
 - As I described above we have not a clear mandate to audit EU funds at all, so the audit of final beneficiary is not clear as well. However we have not had obstacles to audit EU funds so far.*
 - No
- Has there been follow-up on those audits?
 - Yes
 - No

- If yes, what kind of?

During next audit there are examined by SAI the following up of recommendations suggested to the auditee.

- Have those audits been published?
 - Yes, partially
 - No
- Is there a separate unit organized for carrying out audits of EU funds?
 - Yes
 - No
 - In the process
- How many staff are engaged in auditing EU funds? - *three auditors*

-
- How many auditors are trained to audit EU funds? - *three auditors*

-
- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - No
 - Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes, *it is foreseen for the future*
 - No
 - If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes
 - No
 - If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - No
 - If so, can you indicate the main sources used for the preparation of this Audit Manual?

-
- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - No
 - Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - No
 - Have there been pilot audit(s) on management of EU funds?
 - Yes
 - No
 - Have they been assisted by SAIs of EU member states?
 - Yes
 - No
 - If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)?
 - Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No
 - Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes
 - No
 - If so, should they be based on good practice and experience?
 - Yes
 - No

- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - absolutely, Yes*
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?

Yes
- Do you think that this issue should be further developed?
 - Yes
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established
 - Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group
 - easier cooperation with other SAIs on the particular field
 - the wider access to the information on the same issue in SAIs of EU
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 - others, namely: _____
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - No
- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

On behalf of Head of SAI: Completed by Sali AGAJ
 Head Audit Methodology
 SAI - Albania

Tirana, 08 April 2003

BULGARIA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **BULGARIA**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

G. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes ✓
 - Only for IC
 - No

- If so, how are IC and IA defined?

The definitions are detailed in the Public Internal Financial Control Act (PIFC Act).

“**Internal control**” includes financial management and control systems, internal audit performed by the Public Internal Financial Control Agency (PIFCA) authorities and preventive control.

“**Internal audit**” is the audit performed by the executive power independently of the audited entities.

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes
 - No ✓

- Which organisation is responsible for developing and promulgating definition of IC/IA?

The Public Internal Financial Control Agency (hereinafter referred to as the **Agency**)

- Which organisation is responsible for implementing IC/IA in the state?

The Agency

H. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - Yes
 - No ✓ (such standards are currently being developed)

- Which authority is in charge of issue standards and provides technical advice for ICS?

The Agency

- Is ICS in your country based on the relevant professional standards?
 - Yes ✓
 - No

- Is this responsibility based on:

- Constitution
- Law ✓ (The PIFC Act)
- Regulations
- Other: _____

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - Yes ✓
 - No

- Does your SAI participate in development and promulgation of IC standards?
 - Yes
 - No ✓

- Does a Code of Professional Ethics for internal auditors exist in your country?
 - Yes ✓
 - No

I. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - Yes ✓
 - No

- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - Yes
 - No ✓

- Regardless of legal obligation, are IA units established in line ministries?
 - Yes, in all of them
 - Yes, In most of them
 - Yes, but only in some ✓
 - No
 - SAI don't have this information

- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - Yes, in all of them
 - Yes, In most of them
 - Yes, but only in some ✓
 - No
 - SAI don't have this information

- Do the IA units have a mandate to carry out:
 - Management audit - No
 - Financial audit – No
 - Performance audit - No

- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - Yes
 - Yes, but not the EU funds
 - No ✓ (not internal audit units within individual ministries but the Agency has full legal mandate to carry out audits of all relevant funds, including EU funds)

- To whom do the IA units report on their work in line ministries?

The results of audits performed in line ministries are summarised in an annual report, which is submitted to the Ministry of Finance. In the case where the audits have been assigned by the Minister of Finance the results of audits carried out are reported to him/her.

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - Yes
 - No ✓ (Auditing guides and manuals are developed by the Agency)

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

G. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - Yes ✓
 - No

- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - Yes ✓
 - No

- If so, which bodies/agencies? **The Agency**

- If your SAI implement audits of ICS, do you:
 - look at the ICS during the regular audits? **Yes**
 - perform specific audits for the assessment of ICS? **Yes**

- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: **322** (Percentage: **87 percent**)

- Does a special department exist?
 - Yes
 - No ✓

- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - o Yes
 - o Yes, but as an integral part of the general Audit Manual ✓
 - o No
- If so, do they meet INTOSAI and EU requirements?
 - o Yes ✓
 - o No

H. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - o Yes ✓
 - o No
- Has any joint action been taken to avoid duplication of work?
 - o Yes ✓
 - o No
- If so, what kind of action?

Meetings between the two institutions (SAI and the Agency) for the coordination of audit-related activities.
A Cooperation and Assistance Agreement between the National Audit Office and the Agency for Public Internal Financial Control signed on 3rd July 2002.

- Does your SAI assist in establishment of IA units?
 - o Yes ✓
 - o No
- If so, in which way:
 - o By secondment of its staff
 - o Through help in education of their staff within the SAI?
 - o Through help in education by lectures or seminars in IA units? ✓
 - o By organising joint training in working methodology with IA units in public sector? ✓

If so:

 - What kind of training?
 - The organisation of joint seminars

 - How often?
 - As per the schedule contained in the SAI Training Plan

 - Is there follow-up of the results of this training?
 - o Yes ✓
 - o No
 - Did your SAI find such cooperation helpful in its work?
 - o Yes ✓
 - o No

O By lending them equipment and materials for education? ✓
 O In other ways: _____

I. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

| | |
|--------------------|------------|
| <u>Management:</u> | <u>IA:</u> |
| Yes ✓ | Yes ✓ |
| No | No |
- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - o Yes ✓
 - o No
- From your experience, does management have a positive and encouraging attitude relating to ICS?
 - o In all of the cases
 - o In most of the cases ✓
 - o In some cases

- Almost never
 - Never
- Does management in auditees support cooperation between SAI and IA units?
- Always
 - Mostly ✓
 - Rarely
 - Almost never
 - Never
- Does management follow recommendations concerning ICS given by SAI?
- Always
 - Mostly ✓
 - Rarely
 - Almost never
 - Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
- Yes ✓
 - No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
- Yes ✓
 - No
- If so, do you have some specific experiences?
Based on the audit results SAI makes proposals relating to the improvement of internal control systems of the auditees. In case of non-compliance SAI notifies the responsible bodies as prescribed by law.
-

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
- Yes ✓
 - No

- If so, what kind of problems/barriers are the most frequent?
- lack of mandate,
 - weak communication,
 - overlapping of work ✓
 - lack of qualified staff in IC and IA units ✓
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: _____

- What action have you taken to deal with the problems?
SAI issues recommendations aimed at eliminating the problems/barriers identified.
-

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
- Yes ✓
 - No

- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?
Training course and seminars are organised and guidelines on the audit of internal control systems are developed.
-

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?
Meetings are organised with the heads of various ministries and internal control units.
-

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?
Yes. The position has been submitted to the Parliament and the Minister of Finance.
-

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - o Yes ✓
 - o No
 - Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - o Yes
 - o No ✓
 - Has your SAI been appointed as the certifying body for pre-accession funds?
 - o Yes
 - o No ✓ (But SAI has mandate to audit all EC funds and programmes as well as audit certification activities as related to such programmes).
 - How many audits of EU funds has your SAI performed so far?
30 (thirty)
-

- What type of audit has your SAI perform?
 - o Legality ✓
 - o Performance ✓
 - o Special investigations ✓
 - o Other
- What was the subject of the audits?
 - o Administrative preparedness of ministries to receive EU funds?
 - o Management of received EU funds?
 - o Both ✓
 - o Other topics
 - o
- To whom were this reports addressed?
 - o Auditee ✓
 - o Ministry of finance ✓
 - o Parliament
 - o EU ✓
 - o Other ✓ (The European Court of Audit)
- Which funds have been audited?
 - o SAPARD
 - o ISPA ✓
 - o PHARE ✓
 - o CARDS
 - o Other
- Do you have a mandate to audit the final beneficiary?
 - o Yes ✓
 - o No
- Has there been follow-up on those audits?
 - o Yes ✓
 - o No
- If yes, what kind of?

Follow-up action, i.e. reports on the implementation of the recommendations of the audit report.

- Have those audits been published?
 - o Yes ✓
 - o No
- Is there a separate unit organized for carrying out audits of EU funds?
 - o Yes ✓ (A department has been established within the SAI specifically for the purpose of auditing EU funds)
 - o No
 - o No In the process
- How many staff are engaged in auditing EU funds?
14 (fourteen) auditors

- How many auditors are trained to audit EU funds?
25 (twenty-five), including auditors from regional offices

- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - No ✓ (Procurement within EU-funded programmes is audited in compliance with EU audit rules and regulations)
 - Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes ✓
 - No
 - If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes ✓
 - No
 - If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - No
 - If so, can you indicate the main sources used for the preparation of this Audit Manual?

Not applicable
-

- INTOSAI Auditing Standards;
 - European Guidelines on the implementation of INTOSAI Auditing Standards;
 - The reports of the INTOSAI Working group on Auditing Manuals;
 - Various materials developed by SIGMA, the UK NAO and the Court of Auditors of the Netherlands;
-

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - No ✓
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes ✓ (Seminars have been held in order to provide training on the developed and adopted chapters of the Audit Manual)
 - No
- Have there been pilot audit(s) on management of EU funds?
 - Yes ✓
 - No
- Have they been assisted by SAIs of EU member states?
 - Yes
 - No ✓ (But SAI has assisted ECA auditors in audits of EU funds)
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)? ✓
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No ✓
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes ✓
 - No
- If so, should they be based on good practice and experience?
 - Yes ✓
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes ✓
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)? **Yes**
- Do you think that this issue should be further developed?

- Yes ✓
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM? **No**
 - Strategic Committee should be established
 - Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No ✓
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes ✓
 - No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group ✓
 - easier cooperation with other SAIs on the particular field ✓
 - the wider access to the information on the same issue in SAIs of EU ✓
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements ✓
 - others, namely: _____
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes ✓
 - No
- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

On behalf of Head of SAI: **Dr. Georgi Nikolov**
 President
 National Audit Office of the Republic of Bulgaria (sgd.)

CROATIA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **CROATIA**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

J. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes.
 - Only for IC
 - No

- If so, how are IC and IA defined?

Internal Audit is the budget user's unit that independently and objectively determines fulfilment of tasks and activities of budget user, gives a warning on irregularities and non-compliance with laws and regulation that determines user's activity, and recommends measures for their removal and for improvement of budget user's work.

Public internal financial control describes the overall, consolidated system established for controlling, auditing and reporting on the use of national budgetary and EU means.

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes
 - No

- Which organisation is responsible for developing and promulgating definition of IC/IA?

Ministry of Finance

- Which organisation is responsible for implementing IC/IA in the state?

Ministry of Finance and Heads of public administration bodies

K. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - Yes
 - No

- Which authority is in charge of issue standards and provides technical advice for ICS?

Ministry of Finance

- Is ICS in your country based on the relevant professional standards?
 - Yes
 - No

- Is this responsibility based on:
 - Constitution
 - Law
 - Regulations
 - Other: _____

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - Yes
 - No

- Does your SAI participate in development and promulgation of IC standards?
 - Yes
 - No

- Does a Code of Professional Ethics for internal auditors exist in your country?

- Yes
- No

L. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - Yes
 - No
- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - Yes, if they are users of the state budget funds.
 - No
- Regardless of legal obligation, are IA units established in line ministries?
 - Yes, in all of them
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - Yes, in all of them
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Do the IA units have a mandate to carry out :
 - Management audit
 - Financial audit
 - Performance audit
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - Yes
 - Yes, but not the EU funds
 - No
- To whom do the IA units report on their work in line ministries?
To the head of organisation and to other state bodies in charge of control and audit if prescribed by special regulations.
- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - Yes
 - No

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

J. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - Yes
 - No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - Yes
 - No
- If so, which bodies/agencies?

Departments within the Ministry of Finance, Office for Internal Supervision at Government.

- If your SAI implement audits of ICS, do you:
 - look at the ICS during the regular audits?
 - perform specific audits for the assessment of ICS?
- What number of the staff employed in your SAI is involved in audits of ICS?
 Number of staff: ___all___ (Percentage: __100%___)
- Does a special department exist?

- Yes
 - No
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - Yes
 - Yes, but as an integral part of the general Audit Manual
 - No
 - If so, do they meet INTOSAI and EU requirements?
 - Yes
 - No

K. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - Yes
 - No
- Has any joint action been taken to avoid duplication of work?
 - Yes
 - No
- If so, what kind of action?

Audit planning meetings _____
- Does your SAI assist in establishment of IA units?
 - Yes
 - No
- If so, in which way:
 - By secondment of its staff
 - Through help in education of their staff within the SAI?
 - Through help in education by lectures or seminars in IA units?
 - By organising joint training in working methodology with IA units in public sector?
 - If so:
 - What kind of training?

Seminar organised by Association of Internal Auditors and State Audit Office _____
 - How often?

Annually _____
 - Is there follow-up of the results of this training?
 - Yes
 - No
 - Did your SAI find such cooperation helpful in its work?
 - Yes
 - No
 - By lending them equipment and materials for education?
 - In other ways: **By providing recommendations for improvement of IAU's work** _____

L. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

| | |
|--------------------|------------|
| <u>Management:</u> | <u>IA:</u> |
| Yes | Yes |
| No | No |
- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - Yes
 - No
- From your experience, does management have a positive and encouraging attitude relating to ICS?
 - In all of the cases
 - In most of the cases
 - In some cases
 - Almost never
 - Never
- Does management in auditees support cooperation between SAI and IA units?

- Always
 - Mostly
 - Rarely
 - Almost never
 - Never
- Does management follow recommendations concerning ICS given by SAI?
- Always
 - Mostly
 - Rarely
 - Almost never
 - Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
- Yes
 - No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
- Yes
 - No
- If so, do you have some specific experiences?
Pointing out as the general conclusion in the Annual Report _____
- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
- Yes
 - No
- If so, what kind of problems/barriers are the most frequent?
- lack of mandate,
 - weak communication,
 - overlapping of work,
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: _____
- What action have you taken to deal with the problems?
SAO organized relevant seminars for internal auditors; advised MoF in creating relevant, laws, regulations and polices _____

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
- Yes
 - No
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?
Meetings with Ministry of Finance; preparing for pilot audit of ICSs; continuation of giving recommendations for improvement _____
- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?
Yes, as a part of basic analyses made for the purpose of development of SAO's Strategic Development Plan _____

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence,

preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - Yes
 - No
 - Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - No
 - Has your SAI been appointed as the certifying body for pre-accession funds?
 - Yes
 - No
 - How many audits of EU funds has your SAI performed so far?
-
-

- What type of audit has your SAI perform? **N/A**
 - Legality
 - Performance
 - Special investigations
 - Other
 - What was the subject of the audits? **N/A**
 - Administrative preparedness of ministries to receive EU funds?
 - Management of received EU funds?
 - Both
 - Other topics
 -
 - To whom were this reports addressed? **N/A**
 - Auditee
 - Ministry of finance
 - Parliament
 - EU
 - Other
 - Which funds have been audited? **N/A**
 - SAPARD
 - ISPA
 - PHARE
 - CARDS
 - Other
 - Do you have a mandate to audit the final beneficiary?
 - Yes
 - No
 - Has there been follow-up on those audits? **N/A**
 - Yes
 - No
 - If yes, what kind of?
-
-
-

- Have those audits been published? **N/A**
 - Yes
 - No
 - Is there a separate unit organized for carrying out audits of EU funds?
 - Yes
 - No
 - In the process
 - How many staff are engaged in auditing EU funds?
-
-

- How many auditors are trained to audit EU funds?
-
-
- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - No

- Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes
 - No
 - If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes
 - No
 - If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - No
 - If so, can you indicate the main sources used for the preparation of this Audit Manual?
-

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - No
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - No
- Have there been pilot audit(s) on management of EU funds?
 - Yes
 - No

(Will be)
- Have they been assisted by SAIs of EU member states?
 - Yes
 - No
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes
 - No
- If so, should they be based on good practice and experience?
 - Yes
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?

Yes

- Do you think that this issue should be further developed?
 - Yes
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established
 - Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group**
 - easier cooperation with other SAIs on the particular field**
 - the wider access to the information on the same issue in SAIs of EU
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements**
 - others, namely: _____

 - Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - No

 - Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

-

On behalf of Head of SAI: ____Ljerka Linzbauer, Assistant Auditor General; Lidija Pernar, Assistant Auditor General ____

CYPRUS

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country : CYPRUS

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

M. DEFINITION

- Is there a legal definition of IC and IA in your country?

- Yes
 - Only for IC
 - No

- If so, how are IC and IA defined?

Though no legal definitions exist, INTOSAI's definition of IC is followed by the SAI and other organisations (line ministries / departments, local government etc.)

IA defined in Internal Audit Act as an independent and objective exercise of a consultative nature designed to add value and help to improve the operations of the auditee. It assists the auditee to achieve its objectives through a systematic, disciplined approach to evaluate and upgrade the effectiveness of risk management, internal control and management systems and procedures.

- Has (or is) the SAI been involved in developing the definition of IC/IA?

- No
 - Yes

- Which organisation is responsible for developing and promulgating definition of IC/IA?

Internal Audit Service is responsible for developing IC

- Which organisation is responsible for implementing IC/IA in the state?

Ministry of Finance, Line Ministries, Government Departments, Municipalities etc. Implementation of IC / IA falls on the management of the above entities.

N. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?

- No
 - Yes

- Which authority is in charge of issue standards and provides technical advice for ICS?

Technical advise for internal control issues is provided by the Audit Office through the recurring financial audit. It is also provided by the Internal Audit Service through the review and evaluation of financial controls and procedures.

- Is ICS in your country based on the relevant professional standards?

- Yes
 - No

- Is this responsibility based on:

- Constitution
- Law
- Regulations
- Other: **Professional Ethics, best audit practice**

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?

- Yes
 - No

Government regulations assist the development of I.C.S in the public sector.

- Does your SAI participate in development and promulgation of IC standards?

- Yes
 - No

Through its recommendations the SAI assists in the development of standards.

- Does a Code of Professional Ethics for internal auditors exist in your country?

- Yes
 - No

They follow the international Professional Ethics of the Institute of Internal Auditors

O. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - Yes
 - No

However, I.A. is centrally performed by the Internal Audit Service.
- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - Yes
 - No

But, I.A. is generally executed by the Internal Audit Service.
- Regardless of legal obligation, are IA units established in line ministries?
 - Yes, in all of them
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - Yes, in all of them
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Do the IA units have a mandate to carry out :
 - Management audit
 - Financial audit
 - Performance audit
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - Yes
 - Yes, but not the EU funds
 - No
- To whom do the IA units report on their work in line ministries?

Where Internal Audit Units exist, they report to the Director General of the Ministry.

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - Yes
 - No

PART II: ROLE OF SAI IN ASSESMENT OF ICS

M. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - Yes
 - No

Audit of ICS by the SAI is a routine procedure in all audits carried out.

- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - Yes
 - No
- If so, which bodies/agencies? **Internal Audit Service**
- If your SAI implement audits of ICS, do you:
 - look at the ICS during the regular audits?
 - perform specific audits for the assessment of ICS?
- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: **All** _____ (Percentage: _____)
- Does a special department exist?
 - Yes

No

All audit staff of the SAI are involved in the assessment of ICS.

- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - Yes
 - Yes, but as an integral part of the general Audit Manual
 - No
- If so, do they meet INTOSAI and EU requirements?
 - Yes
 - No

All audits performed by the SAI meet INTOSAI Audit Standards and E.U. requirements.

N. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - Yes
 - No

SAI has access to IA plans and IA work done is taken into account by the SAI when planning the audit.

- Has any joint action been taken to avoid duplication of work?
 - Yes
 - No

- If so, what kind of action?

Audit Planning Meetings. access to audit date, IA reports and findings etc.

- Does your SAI assist in establishment of IA units?
 - Yes
 - No

- If so, in which way:

- By secondment of its staff
- Through help in education of their staff within the SAI?
- Through help in education by lectures or seminars in IA units? **When needed and upon request.**
- By organising joint training in working methodology with IA units in public sector?

If so:

- What kind of training?

- How often?

- Is there follow-up of the results of this training?

Yes
 No

- Did your SAI find such cooperation helpful in its work?

Yes
 No

O By lending them equipment and materials for education?

O In other ways: _____

O. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

Management:

Yes

No

IA:

Yes **Their views on the issues are taken into account if logical and reasonable.**

No

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (either in the audit report conclusions or as pointed out in the annual reports)?

Yes
 No

Weaknesses are reported in a weakness letter and if material are included in the Annual Report.

- From your experience, does management have a positive and encouraging attitude relating to ICs?
 - In all of the cases
 - In most of the cases **Especially if their applicability is possible.**
 - In some cases
 - Almost never
 - Never

- Does management in auditees support cooperation between SAI and IA units?
 - Always
 - Mostly
 - Rarely
 - Almost never
 - Never

Generally auditees support the cooperation between the SAI and its units

- Does management follow recommendations concerning ICS given by SAI?
 - Always
 - Mostly **Almost in all cases**
 - Rarely
 - Almost never
 - Never

- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - Yes **Through follow up work and repeating annual audits.**
 - No

- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - Yes
 - No

- If so, do you have some specific experiences?

Management Letter is sent to auditee in all cases where IC weaknesses are observed.

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
 - Yes
 - No

Cooperation in almost all cases is at a very good level.

- If so, what kind of problems/barriers are the most frequent?
 - lack of mandate,
 - weak communication,
 - overlapping of work,
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: _____

- What action have you taken to deal with the problems?

Management Letter, Audit Meetings _____

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - Yes
 - No

No changes are required.

- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

More intensive ICS Reviews during the audit.

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?

Self-assessment on development of ICS in auditees is a continuous process in the Cyprus SAI

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - Yes **SAI has indirect mandate as EU funds are expended through the national budget.**
 - No

- Has your SAI been involved formally in the accreditation of the SAPARD Agency? **N/A**
 - Yes
 - No

Not applicable. Cyprus is not receiving any SAPARD Funds.

- Has your SAI been appointed as the certifying body for pre-accession funds? **N/A**
 - Yes
 - No

SAI indirectly involved as certifying body for Socrates, Leonardo and Youth Programs only. Report prepared by the SAI is forwarded to the National Agency.

- How many audits of EU funds has your SAI performed so far?
Very few concerning the Socrates, Leonardo and Youth funds
-

- What type of audit has your SAI perform?
 - Legality
 - Performance
 - Special investigations
 - Other **Financial**

 - What was the subject of the audits?
 - Administrative preparedness of ministries to receive EU funds?
 - Management of received EU funds?
 - Both
 - Other topics
 -

 - To whom were this reports addressed? **N/A**
 - Auditee
 - Ministry of finance
 - Parliament
 - EU
 - Other

 - Which funds have been audited? **N/A**
 - SAPARD
 - ISPA
 - PHARE
 - CARDS
 - Other **Funds under Council Regulation EC 555/2000**

 - Do you have a mandate to audit the final beneficiary?
 - Yes
 - No

 - Has there been follow-up on those audits?
 - Yes
 - No

 - If yes, what kind of?
-

- Have those audits been published?
 - Yes
 - No

- Is there a separate unit organized for carrying out audits of EU funds?
 - Yes
 - No **All units can be potentially involved in the audit of EU funds.**

- In the process
- How many staff are engaged in auditing EU funds? **N/A**

- How many auditors are trained to audit EU funds? **N/A**

- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - No **Currently being done. To date the Commission was directly involved in the procurement process.**
- Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes
 - No
- If so, is (was) development of Audit Manual for auditing EU funds the part of that project? **N/A**
 - Yes
 - No
- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - No
- If so, can you indicate the main sources used for the preparation of this Audit Manual? **N/A**

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - No
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - No
- Have there been pilot audit(s) on management of EU funds?
 - Yes
 - No
- Have they been assisted by SAIs of EU member states?
 - Yes
 - No
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes
 - No
- If so, should they be based on good practice and experience?
 - Yes
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)? **YES**
- Do you think that this issue should be further developed?
 - Yes
 - No

- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established
 - Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group
 - easier cooperation with other SAIs on the particular field
 - the wider access to the information on the same issue in SAIs of EU
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 - others, namely: _____
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - No
- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

On behalf of Head of SAI: **TOMAZOS GEORGIU**

CZECH REPUBLIC

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **THE CZECH REPUBLIC**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

P. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes**
 - Only for IC
 - No

- If so, how are IC and IA defined? **It is a Czech transcription of the IIA definition**

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes**
 - No

- Which organisation is responsible for developing and promulgating definition of IC/IA? **Ministry of Finance**

- Which organisation is responsible for implementing IC/IA in the state? **Ministry of Finance on the top, but directly all heads of Public Administration Bodies**

Q. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - Yes
 - No, but the relevant 320/2001 Law and 64/2002 Regulation refer to the IIA Standards**

- Which authority is in charge of issue standards and provides technical advice for ICS? **Ministry of Finance**

- Is ICS in your country based on the relevant professional standards?
 - Yes
 - No

Yes – in the basic concept, No – in the form

- Is this responsibility based on:
 - Constitution
 - Law**
 - Regulations**
 - Other: _____

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - Yes**
 - No

- Does your SAI participate in development and promulgation of IC standards?
 - Yes
 - Not directly (see above), it participates eg. in professional discussion**

- Does a Code of Professional Ethics for internal auditors exist in your country?
 - Yes – but it is linked with membership of the Czech IIA**
 - No

R. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - Yes**
 - No

- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - Yes**
 - No

- Regardless of legal obligation, are IA units established in line ministries?
 - o **Yes, in all of them**
 - o Yes, In most of them
 - o Yes, but only in some
 - o No
 - o SAI don't have this information
 - Regardless of legal obligation, are IA units established in other revenue and spending units?
 - o Yes, in all of them
 - o **Yes, In most of them**
 - o Yes, but only in some
 - o No
 - o SAI don't have this information
 - Do the IA units have a mandate to carry out : **all of them**
 - o Management audit
 - o Financial audit
 - o Performance audit
 - Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - o **Yes**
 - o Yes, but not the EU funds
 - o No
 - To whom do the IA units report on their work in line ministries? **IA units report to the relevant head of the public authority, these heads report generally on financial control results to the Ministry of Finance**
-
- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - o Yes
 - o No **It is not required yet; but it could not be excluded**

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

P. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - o **Yes**
 - o No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - o **Yes**
 - o No
- If so, which bodies/agencies? **It is a part of financial control systems on the line to the subordinated bodies**
- If your SAI implement audits of ICS, do you:
 - o **look at the ICS during the regular audits?**
 - o perform specific audits for the assessment of ICS? (It might be also possible)
- What number of the staff employed in your SAI is involved in audits of ICS?
 - o **It would be hardly assessed so early after commencement of the 320/2001 Law**
 - o Number of staff: _____ (Percentage: _____)
- Does a special department exist?
 - o Yes
 - o **No**
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - o **Yes (it is derived from European Guideline No. 21)**
 - o Yes, but as an integral part of the general Audit Manual
 - o No
- If so, do they meet INTOSAI and EU requirements?
 - o **Yes**
 - o No

Q. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?

- **Yes – the Ministry of Finance submits to the SAO The Annual Report on Financial Control (throughout public sector), all public bodies have to provide any IC and IA documents on SAO demand**
 - No
- Has any joint action been taken to avoid duplication of work?
 - Yes
 - **No**
- If so, what kind of action?

- Does your SAI assist in establishment of IA units?
 - Yes
 - **No**

SAO experts at trainings provide some co-operation
- If so, in which way:
 - By secondment of its staff
 - Through help in education of their staff within the SAI?
 - Through help in education by lectures or seminars in IA units?
 - By organising joint training in working methodology with IA units in public sector?

If so:

 - What kind of training?

 - How often?

 - Is there follow-up of the results of this training?
 - Yes
 - No
 - Did your SAI find such cooperation helpful in its work?
 - Yes
 - No

O By lending them equipment and materials for education?
 O In other ways: _____

R. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed? **Generally - yes**

| | |
|--------------------|------------|
| <u>Management:</u> | <u>IA:</u> |
| Yes | Yes |
| No | No |

It would be hardly assessed so early after commencement of the 320/2001 Law

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - **Yes – they are usually stressed particularly in the Annual report**
 - No
- From your experience, does management have a positive and encouraging attitude relating to ICs?
 - In all of the cases
 - **In most of the cases**
 - In some cases
 - Almost never
 - Never
- Does management in auditees support cooperation between SAI and IA units?
 - Always
 - **Mostly – in ministries and central state authorities**
 - **Rarely – in some non governmental public bodies**
 - Almost never
 - Never
- Does management follow recommendations concerning ICS given by SAI?
 - Always
 - **Mostly**
 - Rarely
 - Almost never
 - Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - **Yes – ("system" might be seen as a bit too strong expression)**

- No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - **Yes**
 - No
- If so, do you have some specific experiences? **Too broad area**

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen? **It should be evaluated later.**
 - Yes
 - No
- If so, what kind of problems/barriers are the most frequent?
 - lack of mandate,
 - weak communication, **all following factors are serious:**
 - overlapping of work,
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: **there should be added "lack of understanding of senior managers of the public sector authorities"**
- What action have you taken to deal with the problems? **patient effort to highlight the matter in the Parliament and Government**

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - Yes
 - No **Organizational chart of the SAO did not change, but procedures and workflow did.**
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; **training courses/seminars for auditors organised**/manual on auditing ICS developed, etc.)? **above mentioned Standard**

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)? **audit, evaluate, recommend**

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees? **not yet, it might be done**

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - **Yes**
 - No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - **No**
- Has your SAI been appointed as the certifying body for pre-accession funds?
 - Yes
 - **No**
- How many audits of EU funds has your SAI performed so far? **Six audits were focused on the EU sources, couple of others dealt with them in the framework of broader subject.**

- What type of audit has your SAI perform?
 - o **Legality**
 - o **Performance**
 - o Special investigations
 - o Other

 - What was the subject of the audits?
 - o Administrative preparedness of ministries to receive EU funds?
 - o Management of received EU funds? **partly**
 - o Both
 - o **Other topics: legality, regularity, performance**
 - o

 - To whom were this reports addressed?
 - o **Auditee**
 - o Ministry of finance – usually – it was one of auditees
 - o **Parliament**
 - o EU – EU delegation receives all SAO conclusions
 - o **Other – government and public; all audit conclusions are published**

 - Which funds have been audited?
 - o **SAPARD**
 - o **ISPA**
 - o **PHARE**
 - o CARDS
 - o Other

 - Do you have a mandate to audit the final beneficiary?
 - o **Yes**
 - o No

 - Has there been follow-up on those audits?
 - o **Yes**
 - o No

 - If yes, what kind of? **monitoring, in some cases repeated audit**
-
- Have those audits been published?
 - o **Yes**
 - o No

 - Is there a separate unit organized for carrying out audits of EU funds?
 - o Yes
 - o **No**
 - o In the process
 - o How many staff are engaged in auditing EU funds? **They are engaging step by step as new audit teams are called for subjects with EU funds**
-
- o How many auditors are trained to audit EU funds? **The process is in progress; about 15% are experienced more, next are still trained**
-
- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - o Yes
 - o **No**

 - Is (or was) your SAI beneficiary of TWINNING projects?
 - o **Yes**
 - o No

 - If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - o Yes
 - o **No – but there were developed Audit Manuals for Financial Audit and Performance Audit (applicable for EU funds too)**

 - If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - o Yes
 - o **No**

 - If so, can you indicate the main sources used for the preparation of this Audit Manual?
-

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - No**
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes – of course, in respect to the above mentioned Manuals**
 - No
- Have there been pilot audit(s) on management of EU funds?
 - Yes
 - No**
- Have they been assisted by SAIs of EU member states?
 - Yes**
 - No
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?**
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No**
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes – but not too detailed, national environment should be respected;**
 - No
- If so, should they be based on good practice and experience?
 - Yes**
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes**
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)? **It should be an integral part of preparation.**
- Do you think that this issue should be further developed?
 - Yes**
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established
 - Other proposals: **there might be desirable a “feasibility study”**
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No**
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - No**

It can be answered better after evaluation of results of previous questions

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group
 - easier cooperation with other SAIs on the particular field
 - the wider access to the information on the same issue in SAIs of EU
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 - others, namely: **all benefits would be useful, if they were feasible; furthermore e.g. sharing of web discussion page or network**
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - Not yet – we should gather more experiences**
- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

ESTONIA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **ESTONIA**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

S. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes**
 - Only for IC
 - No

 - If so, how are IC and IA defined?
-

Government of the Republic Act

Chapter 6¹ Internal Control and Internal Audit

(07.06.2000 entered into force 10.07.2000 - RT I 2000, 51, 320)

§ 92¹. Internal control system

(1) An internal control system is a comprehensive set of measures implemented in the directing of government agencies and state agencies administered by government agencies in order to achieve lawfulness and purposefulness and to ensure:

- 1) compliance with legislation;
- 2) protection of property from damage caused by squandering, non-purposeful use, incompetent management, etc.;
- 3) the purposefulness of the activities of the agencies in the performance of their duties;
- 4) collection, storage and publication of truthful, updated and reliable information concerning the activities of the agencies.

(2) The head of a government agency or a state agency administered by a government agency shall implement the internal control system in the agency and is liable for the efficiency of the system.

§ 92². Internal audits

(1) Internal audits are activities involving assessment and analysis of the existence of an internal control system in an agency of executive power, the efficiency of the system and its compliance with the requirements established by legislation.

(2) The head of an agency of executive power is liable for the organisation of internal audits.

(3) The general rules for the conduct of internal audits in government agencies and in state agencies administered by government agencies, including provisions for reporting, shall be established by the Government of the Republic.

(4) In order to conduct an internal audit, a person responsible for the internal audit shall be appointed and, if necessary, a corresponding structural unit shall be formed in direct subordination to the head of the government agency or the state agency administered by a government agency.

(5) Internal audits shall be conducted by the internal auditor. Additional requirements for the employment of internal auditors shall be established by the Government of the Republic.

-
- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes**
 - No

- Which organisation is responsible for developing and promulgating definition of IC/IA?

Ministry of Finance prepared definitions with assistance of State Audit Office, but were promulgated by the Parliament.

- Which organisation is responsible for implementing IC/IA in the state?

Ministry of Finance is responsible for co-ordination of the implementation of the internal control system of the Government and the organisation of internal audit

§ 92³. Competence of Ministry of Finance in organisation of internal controls and internal audits of state agencies of executive power

(1) The Ministry of Finance shall:

- 1) analyse the organisation of implementation of internal controls system and internal audits in government agencies and in state agencies administered by government agencies;
- 2) make proposals to government agencies and to state agencies administered by government agencies concerning improvement of the implementation of their internal controls system and their conduct of internal audits;

(2) In the performance of duties specified in subsection (1) of this section, the Minister of Finance has the right to address ministers, the State Secretary or county governors in order to obtain written explanations concerning the corresponding ministry, the State Chancellery or county government or agencies of executive power within the area of government thereof or administered thereby.

(3) In the performance of duties specified in subsection (1) of this section, persons authorised by the Ministry of Finance have, in agreement with a minister, the State Secretary or a country governor, the right to access documents in government agencies and in state agencies administered by government agencies and to receive information necessary for the performance of duties specified in subsection (1).

Minister as a head of ministry shall:

13¹) ensure implementation of the internal control system and the organisation of internal audit in the ministry, the government agencies within the area of government of the ministry and the state agencies administered by such government agencies;

T. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - o **Yes**
Best Practice Manual prepared in compliance with IIA standards
PIFS Manual
 - o No
 - Which authority is in charge of issue standards and provides technical advice for ICS?
-
-

Ministry of Finance

- Is ICS in your country based on the relevant professional standards?
 - o **Yes**
 - o No
- Is this responsibility based on:
 - o Constitution
 - o **Law**
 - o **Regulations**
 - o Other: _____
- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - o **Yes**
 - o No
- Does your SAI participate in development and promulgation of IC standards?
 - o **Yes**
 - o No
- Does a Code of Professional Ethics for internal auditors exist in your country?
 - o **Yes**
 - o No

U. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - o **Yes**
 - o No
- Are all other spending units required to have an IA if they are not served by that of a line ministry?

- **Yes**
- No
- Regardless of legal obligation, are IA units established in line ministries?
 - **Yes, in all of them**
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - Yes, in all of them
 - **Yes, In most of them**
 - Yes, but only in some
 - No
 - SAI don't have this information
- Do the IA units have a mandate to carry out :
 - **Management audit**
 - **Financial audit**
 - **Performance audit**
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - **Yes**
 - Yes, but not the EU funds
 - No

- To whom do the IA units report on their work in line ministries?

Minister; secretary general

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - **Yes**
 - No

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

S. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - **Yes**
 - No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - **Yes**
 - No
- If so, which bodies/agencies? **__Ministry of Finance (financial control department as the internal auditor of the Government) __**
- If your SAI implement audits of ICS, do you:
 - **look at the ICS during the regular audits?**
 - perform specific audits for the assessment of ICS (**only once**)?
- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: 90 (59auditors) (Percentage: 100%)
- Does a special department exist?
 - Yes
 - **No**
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - **Yes**
 - **As an integral part of the general Audit Manual**
 - No
- If so, do they meet INTOSAI and EU requirements?
 - **Yes**
 - No

T. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - Yes**
 - No
- Has any joint action been taken to avoid duplication of work?
 - Yes**
 - No
- If so, what kind of action?

Consultations, planning, coordination of financial audit tests

- Does your SAI assist in establishment of IA units?
 - Yes**
 - No
- If so, in which way:
 - By secondment of their staff**
 - Through help in training of their staff within the SAI?**
 - Through help in education by lectures or seminars in IA units?**
 - By organising joint training in working methodology with IA units in public sector?
 - If so:
 - What kind of training?

 - How often?

 - Is there follow-up of the results of this training?
 - Yes
 - No
 - Did your SAI find such cooperation helpful in its work?
 - Yes**
 - No
 - O By lending them equipment and materials for education?
 - O In other ways: _____

U. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

Management:

IA:

Yes
No

Yes
No

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - Yes**
 - No
- From your experience, does management have a positive and encouraging attitude relating to ICS?
 - In all of the cases
 - In most of the cases**
 - In some cases
 - Almost never
 - Never
- Does management in auditees support cooperation between SAI and IA units?
 - Always
 - Mostly**
 - Rarely
 - Almost never
 - Never
- Does management follow recommendations concerning ICS given by SAI?
 - Always
 - Mostly**
 - Rarely
 - Almost never

- Never
 - Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - **Yes**
 - No
 - In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - **Yes (to the Parliament, Government)**
 - No
 - If so, do you have some specific experiences?

We have pointed it out in our annual reports

If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?

 - Yes
 - **No**
 - If so, what kind of problems/barriers are the most frequent?
 - lack of mandate,
 - weak communication,
 - overlapping of work,
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: _____
 - What action have you taken to deal with the problems?
-

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - Yes
 - **No**
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

**More working agreements with internal auditors.
Helping to define role of Internal Auditors in process of auditing of annual financial statements.**

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?

By the management

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - **Yes**
 - No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - **No**
- Has your SAI been appointed as the certifying body for pre-accession funds?
 - Yes

- **No**
 - How many audits of EU funds has your SAI performed so far?
2000 – 2
2001 – 1 (in co-operation with ECA)
2003 – 1 (in co-operation with the financial control department of the MoF)
Also in the course of financial audits where EU funds are involved
-

- What type of audit has your SAI perform?
 - **Legality**
 - **Performance**
 - Special investigations
 - Other
 - What was the subject of the audits?
 - **Administrative preparedness of ministries to receive EU funds?**
 - **Management of received EU funds?**
 - **Both**
 - Other topics
 -
 - To whom were these reports addressed?
 - **Auditee**
 - **Ministry of Finance**
 - **Parliament**
 - **EU – (ECA)**
 - Other
 - Which funds have been audited?
 - **SAPARD**
 - **ISPA**
 - **PHARE**
 - CARDS
 - Other
 - Do you have a mandate to audit the final beneficiary?
 - **Yes**
 - No
 - Has there been follow-up on those audits?
 - Yes
 - **No**
 - If yes, what kind of?
-

- Have those audits been published?
 - **Yes**
 - No
- Is there a separate unit organized for carrying out audits of EU funds?
 - Yes
 - **No**
 - In the process
- How many staff are engaged in auditing EU funds?

2-3 auditors from every audit department are specialised on the audit of EU funds

- How many auditors are trained to audit EU funds?
 - **Special training is not provided, relevant topics are included into general training programme**
-

- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - **No**
- Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes
 - **No, but we have co-operation programme with the Netherlands (2000-2003) Court of Audit and MDF(management consulting company)**
- If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes

- **No**
- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - **No (will be a part of general Audit Manual)**
- If so, can you indicate the main sources used for the preparation of this Audit Manual?

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - **No**
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - No
- Have there been pilot audit(s) on management of EU funds?
 - **Yes**
 - No
- Have they been assisted by SAIs of EU member states?
 - **Yes**
 - No
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - **Both (they were found as useful development tool as a whole)?**
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - **Yes**
 - No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes
 - **No**
- If so, should they be based on good practice and experience?
 - Yes
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes
 - **No**
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?
- Do you think that this issue should be further developed?
 - Yes
 - **No**
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established
 - Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - **No**
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - **Yes**
 - No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group**
 - easier cooperation with other SAIs on the particular field
 - the wider access to the information on the same issue in SAIs of EU**
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 - others, namely: _____

 - Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - No**

 - Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

-

On behalf of Head of SAI: Aivo Vaske, Head of the Methodology, Planning and Reporting Service

HUNGARY

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **HUNGARY**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

V. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - **Yes**
 - Only for IC
 - No
 - If so, how are IC and IA defined?
See Annex to this Questionnaire
 - Has (or is) the SAI been involved in developing the definition of IC/IA?
 - **Yes (as external consultant)**
 - No
 - Which organisation is responsible for developing and promulgating definition of IC/IA?
for developing: the Ministry of Finance (MoF); for promulgating: the Parliament (by approving the Act on Public Finance)
 - Which organisation is responsible for implementing IC/IA in the state?
Government → Ministry of Finance → line ministries → budgetary organisation
-

W.

X. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - **Yes (under development)**
 - No
 - Which authority is in charge of issue standards and provides technical advice for ICS?
Ministry of Finance (for preparing standards and amendments of relevant acts and decrees on public internal financial control and audit in compliance with international standards, as well as for co-ordination and harmonisation)
 - Is ICS in your country based on the relevant professional standards?
 - **Yes**
 - No
 - Is this responsibility based on:
 - Constitution
 - **Law**
 - Regulations
 - **Other: Government Decrees**
 - Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - **Yes**
 - No
 - Does your SAI participate in development and promulgation of IC standards?
 - **Yes (in development, consultative role)**
 - No
 - Does a Code of Professional Ethics for internal auditors exist in your country?
 - **Yes (The Internal Audit Chart and Code of Ethics on Internal Audit are under elaboration)**
 - No
-

Y. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - **Yes (Act on Public Finance, Government Decrees)**
 - No
 - Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - **Yes**
 - No
 - Regardless of legal obligation, are IA units established in line ministries?
 - **Yes, in all of them**
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
 - Regardless of legal obligation, are IA units established in other revenue and spending units?
 - Yes, in all of them
 - **Yes, in most of them**
 - Yes, but only in some
 - No
 - SAI don't have this information
 - Do the IA units have a mandate to carry out :
 - **Management audit**
 - **Financial audit**
 - **Performance audit**
 - Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - **Yes**
 - Yes, but not the EU funds
 - No
 - To whom do the IA units report on their work in line ministries?
To the Head of Public Organisation (HPO), i.e. to the minister
-

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - **Yes (In compliance with the Act on Public Finance and Government Decrees, under the co-ordination and harmonisation of the MoF)**
 - No
-

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

V. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - **Yes**
 - No
 - Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - **Yes**
 - No
 - If so, which bodies/agencies?
Government Control Office, line ministries (on the level of the budgetary chapters), MoF as a general co-ordinator
-
- If your SAI implement audits of ICS, do you:
 - **look at the ICS during the regular audits**
 - **perform specific audits for the assessment of ICS**
 - What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: _____ (Percentage: _____) **variable,**

- **As part of regularity audits, internal controls are investigated and assessed according to the methodology applied by auditors who carry out the audit task (the number depends on the volume of the audit tasks);**
- **In case of specific ICS audits, the work is carried out by a separate section – if necessary – with the involvement of auditors of other units**

- Does a special department exist?
 - **Yes**
 - No
 - Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - **Yes (model for programming and procedures)**
 - **Yes, as an integral part of the general Audit Manual (under development)**
 - No
 - If so, do they meet INTOSAI and EU requirements?
 - **Yes (further improvement is going on)**
 - No
-

Z. B. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - **Yes**
 - No
- Has any joint action been taken to avoid duplication of work?
 - **Yes**
 - No
- If so, what kind of action?
 - The GCO harmonises its audit plans with the SAO, IA units of the line ministries harmonise their plans with GCO.**
 - The SAO staff relies on the work performed by the GCO and IC/IA units, utilises the reports on their control activity. Duplication of work can be avoid this way.**
- Does your SAI assist in establishment of IA units?
 - **Yes (but not directly)**
 - No
- If so, in which way:
 - By secondment of its staff
 - **Through help in education of their staff within the SAI**
 - Through help in education by lectures or seminars in IA units?
 - **By organising joint training in working methodology with IA units in public sector**
 - If so:
 - What kind of training?
Regular and special training courses organised by the SAO (on regularity and performance audits, other methodological courses)
 - How often?
every 2 or 3 months
 - Is there follow-up of the results of this training?
 - **Yes**
 - No
 - Did your SAI find such cooperation helpful in its work?
 - **Yes**
 - No
 - **By lending them equipment and materials for education**

- In other ways: By providing them with materials for developing methodological guidelines

AA.

BB. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

Management:

IA:

Yes

Yes

No

No

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (either in the audit report conclusions or as pointed out in the annual reports)?

- **Yes (by the means of "Management letters", audit reports, annual reports of the SAO)**

- No

- From your experience, does management have a positive and encouraging attitude relating to ICS?

- In all of the cases

- **In most of the cases**

- In some cases
- Almost never
- Never

- Does management in auditees support cooperation between SAI and IA units?

- Always

- **Mostly**

- Rarely
- Almost never
- Never

- Does management follow recommendations concerning ICS given by SAI?

- Always

- **Mostly**

- Rarely
- Almost never
- Never

- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?

- **Yes**

- No

- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?

- **Yes**

- No

- If so, do you have some specific experiences?

In previous years the SAO's recommendations included in its Annual Activity Reports had significant impact on the development of legal regulations and on the improvement of internal control systems.

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?

- **Yes**

- No

- If so, what kind of problems/barriers are the most frequent?

- lack of mandate,
- weak communication,
- overlapping of work,

- **lack of qualified staff in IC and IA units,**

- access to reports and documents,
- lack of relevant guides and procedures for audit ICS,
- lack of understanding of ICSs by the staff in SAI,

- **various definitions of IC and IA in public sector**

- others, namely:

- What action have you taken to deal with the problems?
Taking part in the improvement of the PIFC system as adviser, inviting internal auditors to the training courses of the SAO, continuous consultation regarding the development of relevant methodological guidelines
-

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - **Yes**
 - No
 - If so, what kind of changes has been made so far? (Briefly outline actions taken: **General reorganisation of the SAO as of 1 January 2002, establishment of a special unit for auditing internal control systems, organisation of training courses/seminars for auditors.**)
 - Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?
The SAO is not responsible for improving IC structures, but is indeed interested in maintaining well organised and well functioning IC structures. Therefore, it sets up requirements and gives advises and recommendations; participates as consultant in the ongoing PHARE Project at the Ministry of Finance which aims at – among others – the improvement of the Public Internal Financial Control system in Hungary; audits ICSs regularly.
 - Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?
 - Yes
 - **No**
 - If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)
 - Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?
 - Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?
-

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - **Yes**
 - No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - **Yes (The SAO carried out the pre-accreditation of the SAPARD Agency)**
 - No
- Has your SAI been appointed as the certifying body for pre-accession funds?
 - **Yes (concerning SAPARD)**
 - No
- How many audits of EU funds has your SAI performed so far?
Six audits were performed in this field (e.g. the utilisation of PHARE and ISPA funds, The monitoring system of the international assistance schemes). However, the Utilisation of EU resources were investigated within the framework of audits of budgetary institutions that are beneficiaries of these resources.

- What type of audit has your SAI perform?
 - **Legality**
 - Performance
 - **Special investigations**
 - Other

- What was the subject of the audits?
 - **Administrative preparedness of ministries to receive EU funds**
 - **Management of received EU funds**
 - **Both**
 - **Other topics: Monitoring system**

- To whom were this reports addressed?
 - **Auditee**
 - **Ministry of Finance**
 - **Parliament**
 - **EU**
 - Other

- Which funds have been audited?
 - **SAPARD**
 - **ISPA**
 - **PHARE**
 - CARDS
 - Other

- Do you have a mandate to audit the final beneficiary?
 - **Yes (This mandate is now extended within the framework of the "Glass Pocket Programme" which aims at increasing the transparency of utilising public resources.)**
 - No

- Has there been follow-up on those audits?
 - **Yes**
 - No

- If yes, what kind of?

Audits of EU funds cover – among others – the status of implementation of measures in relation to SAO recommendations included in its previous reports.

- Have those audits been published?
 - **Yes**
 - No

- Is there a separate unit organized for carrying out audits of EU funds?
 - **Yes**
 - No
 - In the process

- How many staff are engaged in auditing EU funds?

The number of permanent staff involved in auditing EU funds is increasing continuously. (The current number of staff is 15.) However, in certain cases, the audit team is supported by auditors of other units.

- How many auditors are trained to audit EU funds?

15 auditors

- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - **Yes (investigation of public procurements based on relevant legal regulations – including EU regulations in case of utilising EU funds – constitutes a part of regularity and comprehensive audits.)**
 - No

- Is (or was) your SAI beneficiary of TWINNING projects?
 - **Yes**
 - No
- If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - **Yes (concerning PHARE and ISPA)**
 - **No (concerning SAPARD)**
- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - **Yes (concerning Certifying Body of SAPARD Paying Agency)**
 - No
- If so, can you indicate the main sources used for the preparation of this Audit Manual?
INTOSAI and IFAC Auditing Standards, European Implementation Guidelines for INTOSAI Auditing Standards; relevant EU and Hungarian legal regulations and guidelines, instructions of experts of the European Commission
- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - **Yes**
 - No
- Has training been organised to assist with the implementation of the Audit Manual?
 - **Yes**
 - No
- Have there been pilot audit(s) on management of EU funds?
 - Yes
 - **No**
- Have they been assisted by SAIs of EU member states?
 - Yes
 - **No**
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - **Yes**
 - No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - **Yes**
 - No
- If so, should they be based on good practice and experience?
 - **Yes**
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - **Yes**
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?
 - **Yes**
 - No
- Do you think that this issue should be further developed?
 - **Yes**
 - No
- If so, do you think that:

- **The new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM**
 - Strategic Committee should be established
 - Other proposals: _____
 - If yes, would you be prepared to lead the group/committee?
 - Yes
 - **No**
 - If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - **No**
-

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - **exchange of experiences at the meetings of the Group**
 - **easier cooperation with other SAIs on the particular field**
 - **the wider access to the information on the same issue in SAIs of EU**
 - **development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements**
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - **No**
- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?
 - **No**

On behalf of Head of SAI: Mr. János Révész (Liaison Officer)

LATVIA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **LATVIA**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

CC. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - o **Yes**
 - o Only for IC
 - o No

- If so, how are IC and IA defined?

In the Internal Audit Law and in the Internal Audit Manual used in government internal audit services

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - o **Yes**
 - o No

- Which organisation is responsible for developing and promulgating definition of IC/IA?

Ministry of Finance

- Which organisation is responsible for implementing IC/IA in the state?

Ministry of Finance

DD. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - o **Yes**
 - o No

- Which authority is in charge of issue standards and provides technical advice for ICS?

International Internal Audit Standards are used. There is a draft for Latvian Internal Audit Standards prepared by the Ministry of Finance.

- Is ICS in your country based on the relevant professional standards?
 - o **Yes**
 - o No

- Is this responsibility based on:

- o Constitution
- o **Law**
- o Regulations
- o Other: _____

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - o **Yes**
 - o No

- Does your SAI participate in development and promulgation of IC standards?
 - o **Yes**
 - o No

- Does a Code of Professional Ethics for internal auditors exist in your country?
 - o **Yes**
 - o No

EE. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - o **Yes**

- No
- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - **Yes**
 - No
- Regardless of legal obligation, are IA units established in line ministries?
 - **Yes, in all of them**
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - **Yes, in all of them**
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
- Do the IA units have a mandate to carry out :
 - **Management audit**
 - **Financial audit**
 - **Performance audit**
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - **Yes**
 - Yes, but not the EU funds
 - No
- To whom do the IA units report on their work in line ministries?

Audit reports are presented to the State Secretary of the ministry and to the Internal Audit Department of the Ministry of Finance. The annual report is also sent to the Internal Audit Council and the State Audit Office.

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - **Yes**
 - No

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

W. **MANDATE AND ORGANIZATION**

- Is your SAI empowered to audit ICSs?
 - **Yes**
 - No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - **Yes**
 - No
- If so, which bodies/agencies? **The Ministry of Finance has the role of internal audit co-ordinator in the country.**
- If your SAI implement audits of ICS, do you:
 - **look at the ICS during the regular audits?**
 - **perform specific audits for the assessment of ICS?**
- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: 75 (Percentage: 60%)
- Does a special department exist?
 - Yes
 - **No**
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - Yes
 - **Yes, but as an integral part of the general Audit Manual**
 - No

- If so, do they meet INTOSAI and EU requirements?
 - Yes**
 - No

X. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - Yes**
 - No
- Has any joint action been taken to avoid duplication of work?
 - Yes**
 - No
- If so, what kind of action?

Information is provided about audit plans and results. Responsibilities are shared.
- Does your SAI assist in establishment of IA units?
 - Yes
 - No**
- If so, in which way:
 - By secondment of its staff
 - Through help in education of their staff within the SAI?
 - Through help in education by lectures or seminars in IA units?
 - By organising joint training in working methodology with IA units in public sector?

If so:

 - What kind of training? _____
 - How often? _____
 - Is there follow-up of the results of this training?
 - Yes
 - No
 - Did your SAI find such cooperation helpful in its work?
 - Yes
 - No

O By lending them equipment and materials for education?

O In other ways: _____

Y. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

| | |
|--------------------|------------|
| <u>Management:</u> | <u>IA:</u> |
| Yes | Yes |
| No | No |
- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - Yes**
 - No
- From your experience, does management have a positive and encouraging attitude relating to ICS?
 - In all of the cases
 - In most of the cases**
 - In some cases
 - Almost never
 - Never
- Does management in auditees support cooperation between SAI and IA units?
 - Always
 - Mostly**
 - Rarely
 - Almost never
 - Never
- Does management follow recommendations concerning ICS given by SAI?
 - Always
 - Mostly**

- Rarely
- Almost never
- Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - **Yes**
 - No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - **Yes**
 - No
- If so, do you have some specific experiences?

We have been reporting to the Parliament, Cabinet of Ministers, Ministry of Finance, other institutions.
- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
 - **Yes**
 - No
- If so, what kind of problems/barriers are the most frequent?
 - lack of mandate,
 - **weak communication,**
 - **overlapping of work,**
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - **lack of understanding of ICSs by the staff in SAI,**
 - various definitions of IC and IA in public sector,
 - others, namely: _____
- What action have you taken to deal with the problems?

Setting up informational meetings to exchange information, cases, knowledge and methods etc., co-ordination of audit plans, training of auditors, development of internal rules of the SAO.

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - **Yes**
 - No
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

We organize discussion forums with IA units, some audit sections have new audit responsibilities concerning ICs, development of the financial audit manual is started.
- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

Regular co-operation with internal audit in future, training and workshops on application of standards, common methodology in auditing.
- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?

Development of the financial audit and performance audit manuals is started.

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - **Yes**
 - No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - **No**

- Has your SAI been appointed as the certifying body for pre-accession funds?
 - o Yes
 - o **No**
- How many audits of EU funds has your SAI performed so far?
About 12.
- What type of audit has your SAI perform?
 - o **Legality**
 - o **Performance**
 - o **Special investigations**
 - o **Other**
- What was the subject of the audits?
 - o Administrative preparedness of ministries to receive EU funds?
 - o Management of received EU funds?
 - o **Both**
 - o **Other topics**
 - o
- To whom were this reports addressed?
 - o **Auditee**
 - o **Ministry of Finance**
 - o **Parliament**
 - o **EU (in case of joint audits with the European Court of Auditors)**
 - o **Other**
- Which funds have been audited?
 - o **SAPARD**
 - o **ISPA**
 - o **PHARE**
 - o CARDS
 - o **Other**
- Do you have a mandate to audit the final beneficiary?
 - o **Yes**
 - o No
- Has there been follow-up on those audits?
 - o **Yes**
 - o No
- If yes, what kind of?

Recommendations of the State Audit Office may be taken into account, changes are made to legal acts.

- Have those audits been published?
 - o **Yes**
 - o No
 - Is there a separate unit organized for carrying out audits of EU funds?
 - o **Yes**
 - o No
 - o In the process
 - How many staff are engaged in auditing EU funds?
About 12.
 - How many auditors are trained to audit EU funds?
About 25.
-
- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - o Yes
 - o **No**
 - Is (or was) your SAI beneficiary of TWINNING projects?
 - o **Yes**
 - o No
 - If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - o **Yes**
 - o No

- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - o Yes
 - o **No**
- If so, can you indicate the main sources used for the preparation of this Audit Manual?

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - o **Yes**
 - o No
- Has training been organised to assist with the implementation of the Audit Manual?
 - o Yes
 - o **No**
- Have there been pilot audit(s) on management of EU funds?
 - o **Yes**
 - o No
- Have they been assisted by SAIs of EU member states?
 - o **Yes**
 - o No
- If so, did those audits
 - o provide useful input for preparation of Audit Manuals on EU issues?
 - o **provide the required experience in the implementation of certain audit methodologies and techniques?**
 - o Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - o **Yes**
 - o No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - o **Yes**
 - o No
- If so, should they be based on good practice and experience?
 - o **Yes**
 - o No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - o **Yes**
 - o No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?
 - o **Yes**
 - o No
- Do you think that this issue should be further developed?
 - o **Yes**
 - o No
- If so, do you think that:
 - o **the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?**
 - o **Strategic Committee should be established**
 - o Other proposals: **on-job training in best practices countries, detachments (3-6 month long), practical support by professionals from member countries for long term advisory work, exchange of specialists, involvement of people from candidate countries in Tacis for delivering experience (learning by teaching).**
- If yes, would you be prepared to lead the group/committee?
 - o Yes
 - o **No**
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - o Yes
 - o **No**

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 exchange of experiences at the meetings of the Group
 easier cooperation with other SAIs on the particular field
 the wider access to the information on the same issue in SAIs of EU
 development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 others, namely: personal contacts with auditors of other countries, development of similar audit approaches

 - Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - o Yes
 - o **No**

 - Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

-

On behalf of Head of SAI: _____ **completed in Department of Auditing Methodology, Analysis and Development** _____

LITHUANIA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: LITHUANIA

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

FF. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - o **Yes**
 - o Only for IC
 - o No
 - If so, how are IC and IA defined?
 - ***Internal Audit is the part of the internal control system of a public legal entity which provides an independent, objective assessment (examination, evaluation and consulting) by the internal auditors with a view to improving the performance of the public legal entity.***
 - ***Internal Control is the entire set of controls established by the management of a public legal entity in order to provide reasonable assurance that the operations of the public legal entity are legal, economic, efficient, effective and transparent, that the strategic and other plans are implemented, that assets are safeguarded, that financial information and reporting are reliable and exhaustive, that contractual liabilities to third persons are satisfied and that all identified risks are managed.***
-

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - o **Yes**
 - o No
 - Which organisation is responsible for developing and promulgating definition of IC/IA?
 - ***The IC/IA definitions are set up in Law on Internal Control and Internal Audit. The Law was drafted by the Ministry of Finance in close cooperation with the SAI of Lithuania. The Law was promulgated by the Parliament of the Republic of Lithuania on December 10, 2002.***
-

- Which organisation is responsible for implementing IC/IA in the state?
 - ***According to the Law on Internal Control and Internal Audit, the head of each public legal entity is responsible for establishing effective internal control system and internal audit service (unit) in the entity.***
 - ***According to the Law on Internal Control and Internal Audit, the Ministry of Finance shall give methodical guidance in financial control (which is a part of IC) and internal audit matters.***
-

GG.

HH. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - o **Yes**
 - o No
 - Which authority is in charge of issue standards and provides technical advice for ICS?
 - ***According to the Law on Internal Control and Internal Audit, the Ministry of Finance shall give methodical guidance on financial control, which is the part of the IC.***
 - ***The Financial Control Manual was developed by the Ministry of Finance in compliance with the Guidelines of Internal Control Standards issued by Internal Control Standards Committee of the INTOSAI.***
-

- Is ICS in your country based on the relevant professional standards?
 - o **Yes**
 - o No
- Is this responsibility based on:
 - o Constitution
 - o Law

- Regulations
 - Other: ***The Financial Control Manual was developed by the Ministry of Finance in compliance with the Guidelines of Internal Control Standards issued by Internal Control Standards Committee of the INTOSAI.***
- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - **Yes**
 - No
 - Does your SAI participate in development and promulgation of IC standards?
 - **Yes**
 - No
 - Does a Code of Professional Ethics for internal auditors exist in your country?
 - Yes
 - **No**

- But it will be prepared according to the requirement of the Law on Internal Control and Internal Audit.

II. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - **Yes**
 - No
 - Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - **Yes (depending on the size of legal public entity)**
 - No
 - Regardless of legal obligation, are IA units established in line ministries?
 - **Yes, in all of them**
 - Yes, In most of them
 - Yes, but only in some
 - No
 - SAI don't have this information
 - Regardless of legal obligation, are IA units established in other revenue and spending units?
 - Yes, in all of them
 - **Yes, In most of them**
 - Yes, but only in some
 - No
 - SAI don't have this information
 - Do the IA units have a mandate to carry out :
 - **Management audit**
 - **Financial audit**
 - **Performance audit**

- Yes, they have.
 - Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - **Yes**
 - Yes, but not the EU funds
 - No
 - To whom do the IA units report on their work in line ministries?
 - **All IA units according to the Law on Internal Control and Internal Audit, report directly to the head of the legal public entity. The Ministry of Finance has a right to get the information about IAU activities, accomplished internal audits of EU funds and annual reports on Implementation of annual work plan of the IAU.**
-
- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - **Yes (according to the Law on Internal Control and Internal Audit each IAU shall draw up its own internal audit methodology/manual in compliance with the model (recommended) internal audit methodology set up by the Ministry of Finance)**
 - No

PART II: ROLE OF SAI IN ASSESMENT OF ICS

Z. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - **Yes**

- No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - Yes
 - **No**
- If so, which bodies/agencies? _____
- If your SAI implement audits of ICS, do you: - **both**
 - **look at the ICS during the regular audits;**
 - **perform specific audits for the assessment of ICS.**
- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: 105 (Percentage: 68) (*These are all auditors involved in financial audits*)
- Does a special department exist?
 - Yes
 - **No**
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - Yes
 - **Yes, but as an integral part of the general Audit Manual**
 - No
- If so, do they meet INTOSAI and EU requirements?
 - **Yes**
 - No

AA. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - **Yes**
 - No
- Has any joint action been taken to avoid duplication of work?
 - **Yes (partially)**
 - No
- If so, what kind of action?

Harmonisation of the external and internal audit annual plans.
- Does your SAI assist in establishment of IA units?
 - **Yes (by providing the recommendations to establish IAU in particular public entities)**
 - No
- If so, in which way:
 - By secondment of its staff
 - Through help in education of their staff within the SAI?
 - Through help in education by lectures or seminars in IA units?
 - By organising joint training in working methodology with IA units in public sector?

If so:

 - What kind of training? _____
 - How often? _____
 - Is there follow-up of the results of this training?
 - Yes
 - No
 - Did your SAI find such cooperation helpful in its work?
 - Yes
 - No

○ **By lending them equipment and materials for education?**

○ In other ways:

BB. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

Management:

IA:

Yes
No

Yes
No

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (either in the audit report conclusions or as pointed out in the annual reports)?
 - o **Yes**
 - o No
- From your experience, does management have a positive and encouraging attitude relating to ICs?
 - o In all of the cases
 - o In most of the cases
 - o **In some cases**
 - o Almost never
 - o Never
- Does management in auditees support cooperation between SAI and IA units?
 - o Always
 - o Mostly
 - o **Rarely**
 - o Almost never
 - o Never
- Does management follow recommendations concerning ICS given by SAI?
 - o Always
 - o **Mostly**
 - o Rarely
 - o Almost never
 - o Never
- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - o **Yes**
 - o No
- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - o **Yes**
 - o No
- If so, do you have some specific experiences?

SAI of Lithuania submits to the Parliament an annual Conclusion on the State Budget Implementation, which includes as a separate part recommendations on ICS work and development. The SAI's Conclusion is considered by the Parliament Committee on Finance and Budget as well as by the Audit Subcommittee of the said Committee which shall consider public audit reports submitted by the SAI.
- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
 - o **Yes**
 - o No
- If so, what kind of problems/barriers are the most frequent?
 - o lack of mandate,
 - o weak communication,
 - o overlapping of work,
 - o **lack of qualified staff in IC and IA units,**
 - o access to reports and documents,
 - o lack of relevant guides and procedures for audit ICS,
 - o lack of understanding of ICSs by the staff in SAI,
 - o various definitions of IC and IA in public sector,
 - o others, namely: **Lack of understanding of ICS by the top management and staff of the audited entities.**
- What action have you taken to deal with the problems?
 - **Education of the top management and staff of the audited entities in all forms;**
 - **Establishment of the web-side for methodology on ICS;**
 - **Special publication about ICS and IA for appropriation managers.**

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - o **Yes**
 - o No

- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?
 - **Organised seminars for auditors;**
 - **Developed the Financial audit manual with the separate section on evaluation and auditing ICS.**
 - **A pilot audit on the IC Assessment Across the Public Sector is currently performed within the Twinning project with the United Kingdom NAO.**
 - **Since March 1, 2002 the Lithuanian SAI structure was changed by separating financial and performance audit departments. All financial auditors are conducting IC audits.**
-

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?
 - **A pilot audit on the IC Assessment Across the Public Sector is currently performed within the Twinning project with the United Kingdom NAO. The outcome of the audit should be a report that should include assessment of the current state of the ICS and recommendations on its improvement; the report will be submitted to the parliament and the Government.**
-

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?
 - **Since the 1st of March, 2002 the financial audit is to be carried out all-year-round. Financial auditors are assessing and monitoring ICS in audited entities. At the end of the financial audit cycle (approximately in May 2003) an overall assessment of the ICS across the public sector should be drawn up. As it is the first cycle of financial audit conducted in line with new Public Auditing Requirements (have come in force on March 1, 2002) the self-assessment procedures will be carried out later.**
-

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - Yes**
 - No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - No, but this may happen in future.**
- Has your SAI been appointed as the certifying body for pre-accession funds?
 - Yes (for ISPA so far)**
 - No
- How many audits of EU funds has your SAI performed so far?

6

- What type of audit has your SAI perform?
 - Legality**
 - Performance**
 - Special investigations**
 - Other
- What was the subject of the audits?
 - Administrative preparedness of ministries to receive EU funds?
 - Management of received EU funds?
 - Both**
 - Other topics**
- To whom were this reports addressed?
 - Auditee**
 - Ministry of finance**
 - Parliament**
 - EU (ECA)**
 - Other**
- Which funds have been audited?
 - SAPARD**
 - ISPA**

- **PHARE**
- **CARDS**
- **Other**
- Do you have a mandate to audit the final beneficiary?
 - **Yes**
 - No
- Has there been follow-up on those audits?
 - Yes
 - **Not yet**

- If yes, what kind of?

N/A

- Have those audits been published?
 - **Yes (some of them)**
 - No
- Is there a separate unit organized for carrying out audits of EU funds?
 - **Yes**
 - No
 - In the process
- How many staff are engaged in auditing EU funds?
10

- How many auditors are trained to audit EU funds?

5

- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - **No specific procedures for EU funded projects are necessary as they are regulated by respective financial or performance audit procedures set in the approved Financial Audit Manual and Performance Audit Manual**
- Is (or was) your SAI beneficiary of TWINNING projects?
 - **Yes**
 - No
- If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes
 - **No**
- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - **No**

- If so, can you indicate the main sources used for the preparation of this Audit Manual?

N/A

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - **No specific procedures for EU funded projects are necessary as they are regulated by respective financial or performance audit procedures set in the approved Financial Audit Manual and Performance Audit Manual**
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - **No (N/A)**
- Have there been pilot audit(s) on management of EU funds?
 - **Yes**
 - No
- Have they been assisted by SAIs of EU member states?
 - **Yes**
 - No
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?

- **provide the required experience in the implementation of certain audit methodologies and techniques?**
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - **Yes**
 - No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - **Yes (common guidelines)**
 - **No (AM)**
- If so, should they be based on good practice and experience?
 - **Yes**
 - No
- Do you think that technical **guidelines** (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - **Yes**
 - No
- Do you think that common AM and **guidelines**, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?
 - **Yes**
 - No
- Do you think that this issue should be further developed?
 - **Yes**
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - **Strategic Committee should be established**
 - Other proposals: **Present/future role and functions of each SAI auditing pre-accession/post-accession EU funds should be examined first. They may essentially differ from country to country.**
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - **No**
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - **No**

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - **exchange of experiences at the meetings of the Group**
 - **easier cooperation with other SAIs on the particular field**
 - the wider access to the information on the same issue in SAIs of EU
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 - others, namely: _____
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - **No**
- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

No

MALTA

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: MALTA

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

JJ. DEFINITION

- Is there a legal definition of IC and IA in your country?
 - Yes (for IA)**
 - Only for IC
 - No

- If so, how are IC and IA defined?
 - (1) In terms of recent legislation entitled "Internal Audit and Investigations Act", 2003, "internal audit" is defined as "an independent, objective assurance and consulting activity designed to add value and improve the operations of auditees, helping the auditee to accomplish its objectives by bringing a systematic, disciplined approach to evaluate and improve the effectiveness of risk management, control, and governance processes."
 - (2) There is no legal definition of IC. However, the National Audit Office (Malta) Audit Manual defines internal control as "all the policies and procedures conceived and put in place by an entity's management to ensure:
 - The economical, efficient and effective achievement of the entity's objectives;
 - The adherence of external rules (laws, regulations, etc) and to management policies;
 - The safeguarding of assets and information;
 - The prevention and detection of fraud and error; and
 - The quality of accounting records and the timely production of reliable financial and management information."

- Has (or is) the SAI been involved in developing the definition of IC/IA?
 - Yes
 - No**

Legal definition of IA was prepared by the Internal Audit and Investigations Directorate (which carries out the Government's internal audit function), not by the NAO. There is no legal definition of IC. However, the NAO defines this term in its Audit Manual, as indicated in the previous answer.

- Which organisation is responsible for developing and promulgating definition of IC/IA?

The Internal Audit and Investigations Directorate has developed and promulgated the legal definition of internal audit (as indicated above). Definition of IC is understood as having the same definition as that indicated in the INTOSAI Auditing Standards (from the NAO's perspective) and the IFAC Auditing Standards (from the private sector's perspective). The necessity for having a strictly legal definition of Internal Control by government has locally not been felt.

- Which organisation is responsible for implementing IC/IA in the state?

Management in the respective Government Ministries and Departments, primarily the Ministry of Finance and Treasury Department, are responsible for implementing Internal Controls. The Internal Audit and Investigations Directorate (IAID), which is a centralised government body responsible for internal audit in government, is responsible for implementing IA

KK. STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?
 - Yes
 - No**

- Which authority is in charge of issue standards and provides technical advice for ICS?

The National Audit Office (as the state external audit body) and the Internal Audit and Investigations Directorate (as the state internal audit body) provide recommendations whenever shortcomings in ICs in Government operations are detected. The Ministry of Finance and Economic Affairs and the Treasury Department issue guidelines and directives, though circulars, on financial management and accounting matters, which may include IC issues.

- Is ICS in your country based on the relevant professional standards?
 - Yes
 - No (internal controls in Government are based on best known IC practices)**

- Is this responsibility based on:
 - o Constitution
 - o Law
 - o Regulations
 - o **Other: Best overseas practices**
- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?
 - o **Yes (government financial administration rules and regulations encourage good internal control practices government-wide, though the term Internal Control is not specifically mentioned in such rules and regulations)**
 - o No
- Does your SAI participate in development and promulgation of IC standards?
 - o Yes
 - o **No (However, SAI recommends implementation of appropriate ICs where these are found lacking in a Ministry or Department that it would have audited)**
- Does a Code of Professional Ethics for internal auditors exist in your country?
 - o **Yes**
 - o No

LL. ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?
 - o Yes
 - o **No (Internal Audit is a centralized function and is performed by the Internal Audit and Investigation Directorate).**
- Are all other spending units required to have an IA if they are not served by that of a line ministry?
 - o Yes
 - o **No (Internal Audit is a centralised function. It falls under the responsibility of the Internal Audit and Investigations Directorate, which is a Directorate falling under the Office of the Prime Minister)**
- Regardless of legal obligation, are IA units established in line ministries?
 - o Yes, in all of them
 - o Yes, In most of them
 - o Yes, but only in some
 - o **No (as indicated above, IA is a centralised function falling under the Office of the Prime Minister)**
 - o SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - o Yes, in all of them
 - o Yes, In most of them
 - o Yes, but only in some
 - o **No (IA is a centralised function as indicated above)**
 - o SAI don't have this information
- Do the IA units have a mandate to carry out :
 - o **Management audit**
 - o **Financial audit**
 - o **Performance audit**
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - o **Yes**
 - o Yes, but not the EU funds
 - o No
- To whom do the IA units report on their work in line ministries?

To Permanent Secretaries (Heads of Ministries) and to the Internal Audit and Investigations Board, the chairman of which is the Secretary to the Government Cabinet of Ministers.
- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - o **Yes (the Internal Audit and Investigations Directors has its own manual)**
 - o No

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

CC. MANDATE AND ORGANIZATION

- Is your SAI empowered to audit ICSs?
 - o **Yes**
 - o No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - o **Yes**
 - o No
- If so, which bodies/agencies?

The National Audit Office (as the state external auditor) and the Internal Audit and Investigations Directorate (as the state internal auditors) are the main bodes responsible for assessment of IC. The Ministry of Finance and Treasury Department are responsible for the control of IC. The Management Efficiency Unit - which is Government's in-house management consultancy organisation with the primary function of facilitating the improvement of Government services and falls under the Office of the Prime Minister - may also introduce new government processes that would improve IC, as part of its functions.

- If your SAI implement audits of ICS, do you:
 - o **look at the ICS during the regular audits? Yes**
 - o **perform specific audits for the assessment of ICS? Yes**
- What number of the staff employed in your SAI is involved in audits of ICS?

Number of staff: around 40 (Percentage: 65) Review of IC systems is carried out as normal part of the financial and compliance (regularity) audits. The Performance Audit Units may also carry out audits of IC systems in certain Performance Audits.

- Does a special department exist?
 - o Yes
 - o **No**
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - o Yes
 - o **Yes, but as an integral part of the general Audit Manual**
 - o No
- If so, do they meet INTOSAI and EU requirements?
 - o **Yes**
 - o No

DD. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - o **Yes**
 - o No
- Has any joint action been taken to avoid duplication of work?
 - o Yes
 - o **No**
- If so, what kind of action?
- Does your SAI assist in establishment of IA units?
 - o Yes
 - o **No**
- If so, in which way:
 - o By secondment of its staff
 - o Through help in education of their staff within the SAI?
 - o Through help in education by lectures or seminars in IA units?
 - o By organising joint training in working methodology with IA units in public sector?

If so:

 - What kind of training?
 - How often?
 - Is there follow-up of the results of this training?
 - o Yes

- No
- Did your SAI find such cooperation helpful in its work?
 - Yes
 - No

O By lending them equipment and materials for education?
 O In other ways:

EE. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

Management:

IA:

Yes
No

Yes
No

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (either in the audit report conclusions or as pointed out in the annual reports)?

- **Yes**
- No

- From your experience, does management have a positive and encouraging attitude relating to ICs?

- In all of the cases
- **In most of the cases**
- In some cases
- Almost never
- Never

- Does management in auditees support cooperation between SAI and IA units?

- Always
- **Mostly**
- Rarely
- Almost never
- Never

- Does management follow recommendations concerning ICS given by SAI?

- Always
- **Mostly**
- Rarely
- Almost never
- Never

- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?

- **Yes**
- No

- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?

- **Yes**
- No

- If so, do you have some specific experiences?

We provide recommendations and advice whenever weaknesses in ICs are identified in our audits so that shortcomings may be addressed by auditee. Examples relate to, for instance, shortcomings in internal controls in transport, travel abroad by government officials, bank reconciliations, upkeep of fixed asset registers, arrears of revenue due to government, etc.

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen? (**understood as meaning cooperation with Internal Audit and Investigations Directorate**)

- **Yes**
- No

- If so, what kind of problems/barriers are the most frequent?

- lack of mandate,
- **weak communication,**
- **overlapping of work,**
- lack of qualified staff in IC and IA units,
- access to reports and documents,
- lack of relevant guides and procedures for audit ICS,
- lack of understanding of ICSs by the staff in SAI,
- various definitions of IC and IA in public sector,

- o others, namely:
- What action have you taken to deal with the problems?

A Task Force was set up with members from both the National Audit Office (NAO) and the Internal Audit and Investigations Directorate (IAID) in order to identify good practices in cooperation between NAO and IAID.

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - o **Yes**
 - o No
- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

Certain audit training courses and seminars are attended by staff from both NAO and IAID.

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

As is done at present, we will continue recommending improvements to ICSs whenever IC weaknesses are detected. Increased emphasis may be made on upkeep of fixed asset registers and arrears of revenue due to government. In view of the introduction of accrual accounting over the next two or three years in the Malta Government Accounting system and Financial Reporting, more emphasis will be made on Balance Sheet items and certain Income and Expenditure items of an accrual nature that at the moment are not recorded in the Government Financial Report but which will start being recorded with the introduction of accrual accounting.

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?
NO

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - o **Yes (audit of EU funds is not directly referred to in NAO legislation. However, latter is interpreted as including audit of overseas funds received, administered or held directly or indirectly by Malta Government, including EU funds)**
 - o No
- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - o Yes
 - o **No (Not applicable)**
- Has your SAI been appointed as the certifying body for pre-accession funds?
 - o Yes
 - o **No (the Internal Audit and Investigations Directorate is responsible for the certification of such funds)**
- How many audits of EU funds has your SAI performed so far?

No statistics available. Audit of EU-related funds is carried out as part of normal audit work on Government Ministries, Departments and other public sector entities.

- What type of audit has your SAI perform?
 - o **Legality**
 - o **Performance**
 - o **Special investigations**
 - o **Other: Financial and Compliance (Regularity).**
- What was the subject of the audits?
 - o Administrative preparedness of ministries to receive EU funds?
 - o Management of received EU funds?
 - o Both

- Other topics
 - **Financial and Compliance Issues**
- To whom were this reports addressed?
 - **Auditee**
 - Ministry of finance
 - **Parliament**
 - EU
 - Other
- Which funds have been audited?
 - SAPARD
 - ISPA
 - PHARE
 - CARDS
 - **Other - EU Funds relating to the Financing Memorandum have been audited as part of the normal Financial and Compliance Audits**
- Do you have a mandate to audit the final beneficiary?
 - **Yes**
 - No
- Has there been follow-up on those audits?
 - Yes
 - **No**
- If yes, what kind of?
- Have those audits been published?
 - Yes
 - **No (except as part of normal financial and compliance audits on Government Ministries and Departments)**
- Is there a separate unit organized for carrying out audits of EU funds?
 - Yes
 - **No**
 - In the process
- How many staff are engaged in auditing EU funds?

No special unit exists for the auditing of EU funds. These are audited as part of the normal financial and compliance audit process
- How many auditors are trained to audit EU funds?

No specialised training. However, a significant number of NAO employees (over 10 or around 25% of total audit staff) have attended local and/or overseas courses and seminars (of a general nature) on the financial control aspect of EU funds.
- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - **No**
- Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes
 - **No**
- If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes
 - No
- If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - **No (Audit of EU funds is considered as part of the normal financial and compliance audits)**
- If so, can you indicate the main sources used for the preparation of this Audit Manual?
- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - **No**
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - **No**

- Have there been pilot audit(s) on management of EU funds?
 - Yes
 - No**
- Have they been assisted by SAIs of EU member states?
 - Yes
 - No**
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No**
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes**
 - No
- If so, should they be based on good practice and experience?
 - Yes**
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes**
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?

YES
- Do you think that this issue should be further developed?
 - Yes**
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established (as a first step prior to creation of subgroup for development of Audit Manuals on EU funds)**
 - Other proposals:
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No**
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - No (would be useful to have guidelines on this matter, although implementation of such guidelines should be left at discretion of SAI concerned).**

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group (3)**
 - easier cooperation with other SAIs on the particular field (4)**
 - the wider access to the information on the same issue in SAIs of EU (1)**
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirem. (2)**
 - others, namely:
- Are you interested in preparing country paper on this topic for the next meeting of LOs?
 - Yes
 - No**

- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

Working Group should consider (perhaps in a future development on this topic on Internal Controls) requesting information from Accession/Member SAIs on the type of control mechanisms that exist which ensure the effective transfer of EU funds flowing to/from EU Member and Accession States and what experiences the SAIs (or, alternatively, the certifying bodies of EU funds) have in the audit of such control mechanisms. To provide a few examples, such Control Mechanisms for EU funds may include, 'inter alia' such key players as:

- **National Aid Coordinator**
- **EU Directorate**
- **Inter Ministerial Committee**
- **National Authorising Officer**
- **Senior Programming Officer**
- **Implementing Authority**
- **Joint Monitoring Committee**

On behalf of Head of SAI: BRIAN VELLA (Personal Assistant to Auditor General)

POLAND

QUESTIONNAIRE ON INTERNAL CONTROL SYSTEMS

Country: **POLAND**

PART I: LEGAL FRAMEWORK FOR AND ROLE OF ICS

DEFINITION

- Is there a legal definition of IC and IA in your country?

Yes
 Only for IC
 No

- If so, how are IC and IA defined?

See annex no. 1

- Has (or is) the SAI been involved in developing the definition of IC/IA?

Yes
 No

- Which organisation is responsible for developing and promulgating definition of IC/IA?

Ministry of Finance with assistance of the General Internal Auditor

- Which organisation is responsible for implementing IC/IA in the state?

Ministry of Finance with assistance of the General Inspector of Internal Audit

STANDARDS

IC practices are often designed to comply with internal control standards developed and promulgated by a central authority, usually designated by a legislative body:

- Are there any relevant IC standards in your country?

Yes
 No

- Which authority is in charge of issue standards and provides technical advice for ICS?

Minister of Finance with assistance of the General Internal Auditor

- Is ICS in your country based on the relevant professional standards?

Yes
 No

- Is this responsibility based on:

Constitution
 Law
 Regulations
 Other: _____

- Do you consider that regulations and rules of government assist the development and application of ICs in public sector?

Yes
 No

- Does your SAI participate in development and promulgation of IC standards?

Yes
 No

- Does a Code of Professional Ethics for internal auditors exist in your country?

Yes
 No

ROLE OF IA IN CONTROL OF PUBLIC REVENUE AND EXPENDITURE

- Is there a legal obligation for establishing IA units within the public sector in your country?

Yes
 No

- Are all other spending units required to have an IA if they are not served by that of a line ministry?

Yes

- o No
- Regardless of legal obligation, are IA units established in line ministries?
 - Yes, in all of them
 - o Yes, In most of them
 - o Yes, but only in some
 - o No
 - o SAI don't have this information
- Regardless of legal obligation, are IA units established in other revenue and spending units?
 - o Yes, in all of them
 - Yes, In most of them
 - o Yes, but only in some
 - o No
 - o SAI don't have this information
- Do the IA units have a mandate to carry out :
 - o Management audit
 - Financial audit
 - o Performance audit
- Do the IA units have the legal mandate to audit all relevant funds, including the EU funds?
 - Yes
 - o Yes, but not the EU funds
 - o No
- To whom do the IA units report on their work in line ministries?
to directore of the ministry where the IA unit exists

- Where they exist, do IA units draw up their own manuals or guides for auditing?
 - o Yes
 - No

PART II: **ROLE OF SAI IN ASSESMENT OF ICS**

A. **MANDATE AND ORGANIZATION**

- Is your SAI empowered to audit ICSs?
 - Yes
 - o No
- Are there any other state agencies or governmental bodies responsible for the control/assessment of ICS?
 - Yes
 - o No
- If so, which bodies/agencies?
Ministry of finance with assistance of the General Internal Auditor
- If your SAI implement audits of ICS, do you:
 - look at the ICS during the regular audits?
 - perform specific audits for the assessment of ICS?
- What number of the staff employed in your SAI is involved in audits of ICS?
 Number of staff: _____ (Percentage: _____) According to the Audit Manual (June 2003) every SCC auditor should evaluate an internal control system of auditee within every SCC audit.
- Does a special department exist?
 - o Yes
 - No
- Has your SAI developed any specific guidelines or procedures for audit of ICS?
 - o Yes
 - Yes, but as an integral part of the general Audit Manual
 - o No
- If so, do they meet INTOSAI and EU requirements?
 - Yes
 - o No

B. RELATIONSHIP BETWEEN SAI AND IA UNITS IN PUBLIC SECTOR

- Does your SAI have access to IA plans, reports and related working papers?
 - Yes
 - No

- Has any joint action been taken to avoid duplication of work?
 - Yes
 - No

- If so, what kind of action?

- Does your SAI assist in establishment of IA units?
 - Yes
 - No

- If so, in which way:
 - By secondment of its staff
 - Through help in education of their staff within the SAI?
 - Through help in education by lectures or seminars in IA units?
 - By organising joint training in working methodology with IA units in public sector?
 - If so:
 - What kind of training?

 - How often?

 - Is there follow-up of the results of this training?
 - Yes
 - No
 - Did your SAI find such cooperation helpful in its work?
 - Yes
 - No
 - By lending them equipment and materials for education?
 - In other ways: _____

C. MANAGEMENT RESPONSE TO SAI REVIEW OF ICS

- Does your SAI discuss identified weaknesses or failures on ICS with the management of the entity and IA where the audit has been performed?

| | |
|--|--|
| <p><u>Management:</u></p> <p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> | <p><u>IA:</u></p> <p><input checked="" type="checkbox"/> Yes <input type="checkbox"/> No</p> |
|--|--|

- Does your SAI report and give recommendations on identified weaknesses or failures in ICS of entity (ether in the audit report conclusions or as pointed out in the annual reports)?
 - Yes
 - No

- From your experience, does management have a positive and encouraging attitude relating to ICS?
 - In all of the cases
 - In most of the cases
 - In some cases
 - Almost never
 - Never

- Does management in auditees support cooperation between SAI and IA units?
 - Always
 - Mostly
 - Rarely
 - Almost never
 - Never

- Does management follow recommendations concerning ICS given by SAI?
 - Always
 - Mostly
 - Rarely
 - Almost never
 - Never

- Has your SAI established a system to monitor the auditees' progress in implementing SAI's recommendations?
 - Yes
 - No

- In the case of a general conclusion that ICS are weak in most of the auditees, does the SAI have a mandate to give a sign (warning, advice, recommendation for improvement, etc.) to the responsible authorities?
 - Yes
 - No
- If so, do you have some specific experiences?

- If your SAI has experience in the audit of ICS, have any problems or specific barriers to effective cooperation arisen?
 - Yes
 - No

- If so, what kind of problems/barriers are the most frequent?
 - lack of mandate,
 - weak communication,
 - overlapping of work,
 - lack of qualified staff in IC and IA units,
 - access to reports and documents,
 - lack of relevant guides and procedures for audit ICS,
 - lack of understanding of ICSs by the staff in SAI,
 - various definitions of IC and IA in public sector,
 - others, namely: lack of understanding of ICSs by the in audited units

- What action have you taken to deal with the problems?

Audit meetings: audit results are discussed with the head of the audited unit within the signing of the audit report or during post-audit meeting (On the request of the auditor the head of the audited unit or of the superior unit convenes a post-audit meeting, with the participation of the employees concerned, with the purpose of discussing the detected irregularities and recommendations based on the results of the audit).

We issue audit recommendations (The head of the audited unit or other body that was submitted the post-audit statement is obliged to inform the Supreme Chamber of Control, within the time limit determined in the statement but not less than 14 days, about the way of using the comments and implementing recommendations as well as about the undertaken actions or about the grounds for not having undertaken these actions).

PART III: RECENT CHANGES

- Have any changes been introduced recently into the structure of your SAI for the purpose of carrying out audits on ICS and cooperation with IA units in auditees?
 - Yes
 - No

- If so, what kind of changes has been made so far? (Briefly outline actions taken: special department/unit established; training courses/seminars for auditors organised/manual on auditing ICS developed, etc.)?

- Which steps concerning the improvement of IC structures in the public sector are intended to be taken by your SAI in the near future (please describe)?

_____The SCC participates in the works of draft laws; 1) on internal control, 2) on public finances. _____

- Has your SAI made some form of self-assessment to review its position regarding development of high-quality and effective ICSs in auditees?

_____Yes we have; changes concern appropriate audit approach_____

PART IV: THE ROLE OF SAIs WITH REGARD TO EU FUNDS

The application for EU membership by Candidate Countries and current provisions of pre-accession funds, have rendered more urgent the need for SAIs to improve their organisation by carrying out audits more professionally and by increasing the necessity to adhere the best European practices in state auditing. It is generally agreed that the existence, preparation, dissemination and implementation of appropriate Audit Manuals are essential requisites for the proper functioning of SAIs.

- Does your SAI have clear mandate to audit EU funds?
 - Yes
 - No

- Has your SAI been involved formally in the accreditation of the SAPARD Agency?
 - Yes
 - No

- Has your SAI been appointed as the certifying body for pre-accession funds?
 - Yes
 - No
- How many audits of EU funds has your SAI performed so far?
35 so-called coordinated audits

- What type of audit has your SAI perform?
 - Legality
 - Performance
 - Special investigations
 - Other
- What was the subject of the audits?
 - Administrative preparedness of ministries to receive EU funds?
 - Management of received EU funds?
 - Both
 - Other topics
 -
- To whom were this reports addressed?
 - Auditee
 - Ministry of finance
 - Parliament
 - EU
 - Other
- Which funds have been audited?
 - SAPARD
 - ISPA
 - PHARE
 - CARDS
 - Other
- Do you have a mandate to audit the final beneficiary?
 - Yes
 - No
- Has there been follow-up on those audits?
 - Yes
 - No
- If yes, what kind of?

-
- Have those audits been published?
 - Yes
 - No
 - Is there a separate unit organized for carrying out audits of EU funds?
 - Yes
 - No
 - In the process
 - How many staff are engaged in auditing EU funds?
About 80, core group about 20
 - How many auditors are trained to audit EU funds?
About 50

-
- Has your SAI set up procedures to audit public procurements within EU funded projects?
 - Yes
 - No
 - Is (or was) your SAI beneficiary of TWINNING projects?
 - Yes
 - No
 - If so, is (was) development of Audit Manual for auditing EU funds the part of that project?
 - Yes
 - No
 - If not, has your SAI developed its own Audit Manual for auditing EU funds?
 - Yes
 - No

- If so, can you indicate the main sources used for the preparation of this Audit Manual?

- Has your SAI set up procedures to audit IC in connection with EU funded projects?
 - Yes
 - No
- Has training been organised to assist with the implementation of the Audit Manual?
 - Yes
 - No
- Have there been pilot audit(s) on management of EU funds?
 - Yes
 - No
- Have they been assisted by SAIs of EU member states?
 - Yes
 - No
- If so, did those audits
 - provide useful input for preparation of Audit Manuals on EU issues?
 - provide the required experience in the implementation of certain audit methodologies and techniques?
 - Both (they were found as useful development tool as a whole)?
- Have joint audits of EU funds with other SAIs been carried out in your Office?
 - Yes
 - No
- Do you think that a common Audit Manual for auditing EU funds is needed?
 - Yes
 - No
- If so, should they be based on good practice and experience?
 - Yes
 - No
- Do you think that technical guidelines (supplementary Audit Manuals) with worked examples and case studies should also be developed to help promote practical use of Audit Manual?
 - Yes
 - No
- Do you think that common AM and guidelines, once prepared, should be tested in each country to assure that it is applicable to its circumstances and environment (eg. Through pilot audits)?
- Do you think that this issue should be further developed?
 - Yes
 - No
- If so, do you think that:
 - the new subgroup for development of Audit Manuals on EU funds should be established within the existing WGAM?
 - Strategic Committee should be established
 - Other proposals: _____
- If yes, would you be prepared to lead the group/committee?
 - Yes
 - No
- If not, does it mean that development, adoption and implementation of audit standards, manuals and guidelines should stay upon by each SAI, in accordance with its mandate, legislation and environment?
 - Yes
 - No

PART V: GENERAL QUESTIONS

- Since you declared your interest in this topic, what were your main expectations of this Working Group?
 - exchange of experiences at the meetings of the Group
 - easier cooperation with other SAIs on the particular field
 - the wider access to the information on the same issue in SAIs of EU
 - development of specific guidance (in the form of standards or questionnaires) on audit of ICSs, preferably concerning the EU requirements
 - others, namely: _____
- Are you interested in preparing country paper on this topic for the next meeting of LOs?

- Yes
- No

- Do you have any additional comments or suggestions to the Working Group on this topic or on the questionnaire?

On behalf of Head of SAI: _____ Jacek Kolasinski, Director _____

ROMANIA