SIGMA

Support for Improvement in Governance and Management

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KOSOVO (under UNSCR 1244/99)[1]

PUBLIC INTERNAL FINANCIAL CONTROL (PIFC)

ASSESSMENT MAY 2009

[1] In accordance with UN Security Council Resolution 1244, since June 1999 Kosovo has been governed by the UN Interim Administration Mission in Kosovo (UNMIK).

1. Summary

Main Developments since last year

Kosovo appears to be making every effort to comply with the European Commission's legal requirements for PIFC. A number of technical changes have been made since last year to existing laws, which had to be changed to reflect the Constitution of Kosovo. However, the legal basis, while complying formally with EU requirements, does not always seem to comply with the needs and administrative capacity of the country.

A new Internal Audit Law was drafted and is currently going through the parliamentary process. This new law will modify previous requirements for setting up internal audit units in all budget organisations in a way that should result in greater efficiency in the use of audit resources and likewise rationalise the requirements for the introduction of audit committees.

The Central Harmonisation Unit for Internal Audit became operational in 2008 and now has seven staff. The development of an audit manual and of a reporting system to the CHU by internal auditors demonstrates that a coherent internal audit approach is emerging. The establishment of a CHU for financial management and control (FMC) was envisaged in the Law on Public Financial Management and Accountability approved in March 2008, but it has not yet been put in place.

Other legal changes associated with the decentralisation proposals of the Ahtisaari Plan involve the reform of the local government system, which could also impact on the PIFC and public expenditure management (PEM) systems.

Main Characteristics (strengths and weaknesses)

While progress has been made in introducing legal structures, hard evidence showing that these structures are having a significant effect on the quality of public financial management is difficult to find. For a functioning PIFC system, it is critical that the legal framework is wholly embraced by the management at all levels as a day-to-day aid in securing the efficient and effective utilisation of public resources in Kosovo and that it is not viewed as an "add-on" that exists only because of European Union requirements. There is little evidence that this is the case. While financial management and control systems are being put in place and internal audit is being implemented, the levels of understanding of the technical concepts and requirements and of the standards of application generally appear to be limited. There is also some evidence that not all managers are familiar with the specific requirements of the law.

In fact, the laws appear to be ahead of the current real state of development of PIFC, and officials do not always appear to appreciate the real purpose of the legislative requirements. This situation and the lack of relevant administrative capacity also mean that the legislative requirements are not always fully implemented. Another factor that has to be taken into account is a lack of ownership due to the fact that most legislation has been developed by external advisers. However, the CHU/IA now seems to have taken over the responsibility for further developing internal audit legislation in Kosovo. The CHU/FMC is not yet operational, and this means that local ownership of the development of FMC has yet to emerge other than where it is connected to the control of expenditure within the Treasury system. This situation is of some concern, as internal audit can only develop at the same pace as financial management and control are developing. In addition, the strategic document envisaging the establishment of the CHU/FMC reflects a limited perception of the role of the CHU/FMC. Consequently, there is a risk that "financial management" is perceived as somehow separate from management rather than an integral part of it.

It is clear that the international community has not sufficiently focused on increasing the understanding of, and developing the capacity for, the basic requirements for a sound financial management and control system, which should be in place before more sophisticated concepts can add value. Much more attention should be given also to systemic weaknesses, which include the lack of qualified staff, lack of resources, and overall a poor control environment caused by a lack of management appreciation of the objectives of PIFC.

A number of reforms are underway or under discussion that could make the development of the system more difficult, such as the proposed delegation of current Treasury control activity to budget organisations (which is welcomed but increases risk unless competency in those budget organisations can be assured) and proposals for the devolution of budgetary responsibilities to schools and clinics.

Recommendations for Reform

In the short term, the following actions would be beneficial:

- Undertake an assessment of management's understanding of PIFC and how it integrates with general management;
- Ensure that FMC legislation and the regulations implementing such legislation actually facilitate improvements in the quality of public expenditure (This would mean that the CHU/FMC should broaden its remit beyond ensuring the effective functioning of the Kosovo Financial Management Information System (KFMIS).].
- Improve the quality of the human resources and training approach with regard to the present cadre of internal auditors and introduce professional training (as opposed to just short-course training) for future internal auditors; develop networking between internal auditors; encourage the development of systems audit and in general develop quality control;
- Improve co-operation between the Auditor General's Office and internal audit;
- Address the PIFC issues that will arise from the delegation of budgets and ensure that other proposed legislative changes take PIFC implications fully into account;
- Develop a co-ordinated needs assessment and human resources development process for internal audit and FMC staff.

2. Baseline Questions

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

In principle, a coherent and comprehensive statutory base is in place, defining the systems, principles and functioning of the financial control system. This base rests on the Constitution as well as on a number of specific laws.

The Constitution of Kosovo (which came into force in June 2008) specifies in article 120 that:

- Public expenditure and the collection of public revenue shall be based on the principles of accountability, effectiveness, efficiency and transparency.
- The conduct of fiscal policy at all levels of government shall be compatible with the conditions for low-inflationary and sustainable economic growth and employment creation.
- Public borrowing shall be regulated by law and shall be compatible with economic stability and fiscal sustainability.

The most significant law in Kosovo affecting public internal financial control is the Law on Public Financial Management and Accountability (Law No. 03/L-048). This law covers the arrangements for the development of the budget and the processes for its approval, including parliamentary processes, as well as the arrangements for transfers and for reporting on budget outcomes. The law also defines "public money", the organisation of the Ministry of Finance and Economy and appointment of key officials, capital and operating expenditure, financial management, accounting, budget accountability, and financial reporting systems for public authorities and public undertakings in Kosovo; it prescribes the powers and duties of the Minister of Finance and Economy and other public authorities concerned with these matters.

The law prescribes the administrative structure that budget organisations of all types are to establish to ensure appropriate financial management arrangements. This structure includes a chief administrative officer (who is the chief official), an internal auditor, a chief financial officer, a procurement officer, and a certifying officer. The law also specifies the arrangements for the receipt and expenditure of public money for accounts within the Kosovo Consolidated Fund. Part VIII of the law sets out the requirements for reporting, accounting, auditing and financial control, including a requirement for the Ministry of Finance and Economy to prepare a budget classification system and chart of accounts using applicable standards prepared by the International Federation of Accountants (IFAC). However, the current reference is to the IFAC public sector cash standard, and this chart of accounts has to be compatible with the IMF General Finance Statistics (GFS).

In addition, the Law on Public Financial Management and Accountability also prescribes the accounting arrangements that require the Minister of Finance and Economy to maintain, at a minimum, accounting records for each budget organisation, showing aggregate information for each of the following categories:

- receipts;
- outstanding liabilities;
- assets;
- appropriations;
- adjustments to appropriations;
- appropriations made available to the budget organisation by means of allocated funds;
- extent to which allocated funds have been recorded as committed funds; and
- actual expenditures.

This law specifies that the chief financial officer of a budget organisation is to record transactions and maintain accounting records in accordance with the FMC Rules as described below and to provide copies of the accounting records to the Minister of Finance and Economy when requested. The chief financial officer of a budget organisation and the organisation's chief administrative officer are also required to provide unaudited financial statements within 30 days of the end of each fiscal year.

According to this law the Auditor General has to provide a report on the financial statements to the Assembly by 31 July following the end of the financial year.

The Law on Public Financial Management and Accountability is supported by secondary legislation, which includes the following:

- Treasury Financial Rule – Number 01 – PIFC (February 2006): This rule has been developed to further define the accountability chain and the minimum requirements for internal control. It applies to all public administration, which includes ministries, municipalities and reserved power organisations. Its coverage includes regulatory bodies but does not extend to designated entities.
- Treasury Guidelines and Financial Rule – Number 02 – Expenditure of Public Money (June 2006 and as amended November 2006): In the past, the Treasury had developed administrative instructions, which addressed many aspects of the expenditure and internal control issues regarding public monies. This Treasury document updates and consolidates these instructions in a single document. The previous administrative instructions continue to apply unless they differ with the instructions in this guideline document, in which case the instructions set out in this 2006 document are to apply.
- An administrative instruction is currently being developed (March 2009) concerning the delegation of expenditure management to budget organisations.

The Government of Kosovo publishes each year an annual Budget Law (the most recent law is for 2009 – Law No. 03/L-105, Budget of Republic of Kosovo for Year 2009). This law sets out the way in which public funds are to be used and the limits that are to apply to both expenditure and staff numbers. The law applies to all ministries, municipalities and agencies that receive budget appropriations. It also prescribes restrictions on the transfers of money from one budget heading to another and between financial years. Thus resources made available for goods and services cannot be transferred for the payment of employees. The annual Budget Law also defines expenditure on capital investment and sets out the circumstances in which line ministries, municipalities and other organisations are to consult the Ministry of Finance and Economy. This law also ensures the effective cash management of all public funds, whether they be budget organisations' own resources or not, by requiring them to be deposited in the Kosovo Consolidated Fund managed by the Treasury. Independent agencies covered by the Budget Law are also required to deposit funds with the Treasury. Similar rules apply to available donor funds.

The 2009 Budget Law also prescribes that, prior to submitting any proposed new law to the government for consideration and following consultation with the Ministry of Finance and Economy, each budget organisation is required to provide the government with an estimate of the budget implications that the proposed law will have for the 2009 Kosovo Budget and for the budget for a period no less than the two succeeding years, as required in section 26 of the Law on Public Financial Management and Accountability.

The annual Budget Law in effect sets the context for the operation of the PIFC system in Kosovo.

The Law on Internal Audit (Law No. 02/L-74) was published in June 2007. This law is designed to ensure greater operational efficiency, budgetary and financial discipline, and legal and regulatory compliance of public sector entities. The law sets out the principles according to which internal audits are to be conducted, and it requires all public sector entities to ensure that their operations, records and management and control systems are regularly – at least once a year – and systematically subjected to a comprehensive internal audit. The audits are to be performed in accordance with the rules, policies, manuals, guidelines, code of ethics and professional standards developed by the

CHU/IA, which according to this law was to be established in the Ministry of Finance. Every budget organisation was to set up an internal audit unit. In addition, the law required the establishment of audit committees by each budget entity, composed of employees of that entity.

The Law on Internal Audit has been reviewed, and a draft law that would repeal Law 02/L-74 is currently under consideration by the Assembly. The main changes envisaged by this new internal audit law include the following:

- Harmonisation of internal audit practice according to EU good practice;
- Recognition that not all budget organisations should have internal audit units as for a smaller organisation the unit would be too small to be effective;
- Similarly, not all budget entities may wish to appoint audit committees for every second-level organisation; some may only want one committee to cover all activities;
- Setting of criteria for determination of the need for an internal audit unit and provision by the Ministry of Finance and Economy of audit services (a mobile team) to the smaller entities that decide not to set up an internal audit unit;
- Setting of criteria to determine the number of auditors required by a budget entity;
- Requirement for the elaboration of a strategic plan for internal audit;
- Plans for increasing the number of internal audit staff to at least two in the case of small internal audit units;
- Establishment of the CHU/IA as a special unit in the Ministry of Finance and Economy (this proposed change repeats the provision for the establishment of an internal audit CHU that was set out in the Law on Public Financial Management and Accountability).

In addition to the above laws, other laws have an impact on PIFC, including the laws governing the functioning of municipalities and the distribution of funds to them (Law on Local Government Finance).

The legal basis for financial control in Kosovo, as set out in both the Constitution and specific laws, provides evidence that an appropriate legal framework does exist. The proposed changes to the law (particularly to the Internal Audit Law) also suggest that where the established legislative framework has been shown to be deficient, revisions will be made to enhance it.

These laws in effect take over the proposals contained in the PIFC Policy Paper that was first published in 2005 and then revised and published in 2007.

While the PIFC laws correspond to EU and international standards, the real problem lies with the implementation and understanding by management of what those laws actually mean for the management process in practice. This problem is compounded by the weakness of current administrative capacities.

Although a comprehensive legal framework for financial control exists in Kosovo, it appears from the efforts that the government is making to modify some of these laws (e.g. Law on Internal Audit) and to implement some clauses in other laws (e.g. introduction of the CHU/FMC) that legal and operational reform and activity will be required to ensure the effective implementation of the legislation. There is also no evidence (which effectively functioning CHUs and an internal audit service could provide) that laws are fully understood and applied in practice and that government officials fully realise the implications of the laws. Indeed, the evidence suggests that this is not the case (see next section).

2.2 Are relevant management control systems and other procedures in place?

The Law on Public Financial Management and Accountability established that the chief administrative officer (CAO) – that is, the permanent secretary – in each budget organisation is responsible for the financial management arrangements. This person is the most senior official and while his/her appointment is regarded as subject to political patronage (and therefore may change with a change of government), it is not a ministerial post (as is so often the situation in many other countries of the region). Therefore, the possibility exists that the appointee will be a person with at least some significant administrative background which, from a financial management point of view, is preferable to a situation where the person responsible for financial management and control is the minister, who may have no background in public administration. (However, in reality appointments made to permanent secretary posts may be made for political reasons that have nothing to do with administrative capabilities.)

It is not clear how far individual CAOs in line ministries understand the full implications of their responsibilities for financial management or the extent of training that had been provided to them to enable them to do so. The Treasury Financial Rule – Number 01 on Public Internal Financial Control defines internal financial control as “an integral process that is effected by an entities management and personnel and is designed to provide reasonable assurance that in pursuit of the entity’s mission, the following general objectives are being achieved:

- Executing orderly, ethical, economical, efficient and effective operations;
- Fulfilling accountability obligations;
- Complying with applicable laws and regulations;
- Safeguarding resources against loss.”

The purpose of this financial rule (issued under the authority of the Law on Public Financial Management and Accountability) is to establish a consolidated set of instructions and directions for the internal control and management of public finance in the Kosovo public sector. These rules apply to all public authorities, which include ministries, municipalities and other budget entities. The terms of this rule follow standard definitions, and no evidence has been provided to suggest that the management or internal audit have undertaken any activity that would enable them to confirm that “ethical, economical, efficient and effective operations” were being carried out. There was similarly no evidence that all relevant officials were aware of the Treasury Rules, and indeed as part of the Treasury proposals for the delegation of responsibility from the Treasury to line budget organisations, the Treasury has acknowledged that training is required (see below).

Effective financial control – in the narrow sense of ensuring that funds are spent in accordance with approved budgets and with the relevant regulations and cash flow forecasts – relies heavily on the effective management of the KFMIS, which is the responsibility of the Treasury in the Ministry of Finance and Economy. Individual budget organisations have access to this system through terminals generally located within the organisation, and operational access to these terminals is said to be carefully controlled. The Treasury maintains control, however; budget organisations are required to submit the relevant documentation supporting payments to the Treasury, which ensures that the appropriate officials, authorised by the Treasury, have signed the payment authority.

The practical effect of this is to transfer responsibility for financial control back to the Treasury from the budget organisation. However, the Treasury’s aim is to relax its control as internal control arrangements within budget organisations and as internal audit develop. Indeed, as from 2009 this relaxed control by the Treasury could occur. There is likely to be a six-month monitoring period and then, as budget-users become competent, the aim is to complete the transfer of responsibility by 2010. A training programme forms part of this process. The objective is to ensure that all current and future KFMIS users are trained to a proper level to use the KFMIS, with an understanding of their duties based on laws and financial regulations. The focus of the recently published Administrative Instruction aims to facilitate this transfer of responsibilities.

However, this training is not the same as management training in the responsibilities of financial management, which go well beyond a technical capacity to operate the KFMIS. Of course safe, secure and efficient management of the KFMIS is essential, and the strategy of the Treasury to ensure such management is welcomed. However, management also involves ensuring that funds are used in the most cost-effective way so as to deliver in terms of programme objectives, agreed performance standards and timetables. This level of management performance requires much more than a robust Treasury system and can only be achieved over time. (Also, as pointed out above, the perception of the role of the CHU/FMC seems to be limited to the effective operation of the Treasury system, which will not provide any evidence of ethical, economical, efficient and effective operations.)

The Law on Public Financial Management and Accountability also specifies the organisational structure that is to be put in place to ensure effective financial control through the allocation of responsibilities to various officials. The competence of the various officials to be appointed, as prescribed in the Law on Public Financial Management and Accountability, and the extent to which all of these posts are filled will be decisive for the effectiveness of the system.

The Treasury's 2009 strategy also envisages the establishment of a CHU/FMC. The requirement for the provision of this CHU is set out in the Law on Public Financial Management and Accountability. The Treasury's strategy for 2009 envisages that this unit will become operational this year and to facilitate this, it apparently foresees to shift funds from other parts of the organisation. The strategy envisages the following developments regarding the CHU/FMC in 2009:

- Establish and implement a Public Internal Financial Control (PIFC) framework in consistency with EU standards;
- Develop and achieve best usage of the KFMIS in order to improve the financial management and control environment;
- Manage system controls in the KFMIS;
- Decentralise (although the strategy has questions about this stage of development).

As the CHU/FMC, according to the Treasury's strategy for 2009, appears to be concerned with issues related to the operation of the KFMIS, the above list represents a very limited vision of the role of the CHU/FMC. It would also suggest that while the "form" of PIFC exists, the "substance" in terms of it running like a thread through the whole management process does not seem to have been appreciated. The proposed technical assistance programme aims to assist with the development of FMC.

Another recent development has been the publication of a new chart of accounts operative for 2009.

Current control does rely heavily on the operation of the Treasury system and seems to focus on procedures and processes. The principles of management control do not appear to impact on operational management decisions in terms of ensuring ethical, efficient and effective public expenditures. Internal audit has not been able to provide the assurance that the framework is effective in these broader terms, and the evidence that has been provided by internal audit findings, which focus mainly on observance of rules and regulations, indicates weaknesses in compliance.

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

The Law on Internal Audit of 2007 provided for the establishment of a functionally independent internal audit mechanism. The proposed new law, which is currently before the Assembly, should clarify and strengthen the position of internal audit. The fact that an Internal Audit CHU now exists (established on 1 April 2008) is a significant step forward. The proposed new internal audit law will define key audit terms, including economy, efficiency and effectiveness, and various types of audit, including systems, compliance, performance and IT audit. The draft law refers specifically to a code of ethics and to the need for audit charters. The 2007 law is far less clear on any of these points. Under the proposed new law, internal audit would report to senior management, defined as "Senior Management of Public Sector Organisations", which means the position that has the ultimate operational responsibility in the public sector organisation, generally ministers or chief administrative officers (CAOs). (In municipalities it is the President of the Assembly.)

In addition, the new law reinforces the provisions of the previous law regarding the establishment of audit committees. However, there is now some degree of flexibility in the operation of this requirement and therefore the rationalisation of audit committees for very small organisations is possible. While this is a welcome step forward towards a more rational use of scarce human and financial resources, it is nevertheless questionable in terms of how far audit committees can add value at all in the context of the weak administrative capacity of Kosovo, as described above.

Rather unusual importance is attributed to the position of director of an internal audit unit because of the amount of the salary. The draft law provides that, because of the high level of competence required of the director of an internal audit unit, he/she is to have a salary equivalent to that of a permanent secretary. This is a very unusual requirement and the Head of Internal Audit should not be on the same level as the Permanent Secretary.

The new draft law lays down that the criteria for the establishment of internal audit units are to be prescribed in regulations, which provides scope for ensuring that internal audit units are of a minimum size. Clause 3 of the draft law allows public sector organisations to share internal audit resources and to procure such resources from the private sector, and it makes it possible for the Ministry of Finance and Economy to provide an internal audit service on behalf of other budget organisations.

The new draft law also specifies the training that is required and the requirement for new internal auditor recruits to possess a university diploma in economy, public administration, public finance, accounting or law. The training required will be specified by the CHU/IA.

Another recent development has been the publication of a comprehensive internal audit manual.

At the present time, at the central level there are 71 internal auditors including the seven CHU/IA staff, and at the local level/municipalities there are 35 auditors. The total number of internal auditors in Kosovo is therefore currently 106, not including auditors in social enterprises.

The CHU/IA has developed a system of reporting, with quarterly and annual reports required from budget organisations and with the CHU providing similar periodic reports to the Ministry of Finance and Economy, which passes these on to the government. The CHU’s annual report covers the activities and developments in internal audit, and includes statistics on the number of audits and recommendations. Last year (2008) – according to this report – about 300 audits were completed and 1900 recommendations issued. 55% of recommendations had been implemented entirely, 24% were in the process of implementation, and 21% had not yet been implemented at the time of the report’s finalisation, although the Head of the CHU expected that some of these recommendations would be implemented in the future. It has to be said, however, that these figures alone do not give any information about the quality of the recommendations. With regard to audit committees, 48% of the possible total number was reported to have been established, and the rest to be in the process of being set up.

The CHU itself has developed a strategy for the period 2010-2012, which has been approved by the government. Actions are now being taken to implement the strategy.

There are different perceptions of the extent and quality of internal audit activity as expressed by the Auditor General’s Office as compared with the statistics produced by the CHU. This discrepancy may be partly due to a lack of effective interchange between the two organisations. There is also likely to be a mutual interest in training, and while there may be different needs in practice, given the overall small group of officials who need training, co-operation may be essential in order to secure economical training.

A strong view of outside observers was that the issues addressed by internal audit were limited and really reflected a continuation of the type of issues that would have fallen within the purview of traditional inspection, that is, they concerned transactions approved according to administrative requirements. There was limited evidence of a move to develop more advanced audit approaches. This was borne out in interviews with internal auditors. So far the main driver for improving internal audit quality has come from technical assistance, which has also provided the main training impetus. The establishment of the CHU/IA should change that, and therefore the developmental role of the CHU will be very important.

Many efforts have obviously been made again with the draft new Internal Audit Law to improve the legal basis for internal audit, and the proposed text once approved would improve the clarity of the provisions and help bring them in line with advanced international good practice. Given the current state of development of FMC and internal audit in Kosovo, the main immediate efforts should focus on developing the basic required skills of internal auditors and on ensuring that a) managers understand and accept their responsibility for delivering public services in a legal, economic, effective and efficient manner, and b) that the financial management systems are sufficiently developed to enable the managers to do so. Before basic requirements and the related understanding of those basics are in place, more advanced concepts, such as audit committees, will hardly add value to the development of public financial management in Kosovo.

Progress is being made towards the establishment of an independent internal audit. However, the evidence is that it is a considerable way from being fully functional. Internal audit units do exist in most organisations as do audit committees, but the range of their activity is limited and while a reasonable proportion of recommendations is accepted, discussions with internal auditors suggest that the scope of those recommendations are mainly concerned with transaction compliance-related matters and not with the wider issues, such as the strength of systems, the efficiency and effectiveness of expenditure, and the management of risk. There seems to be the risk that efforts focused on more advanced concepts draw attention away from basic requirements.

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

The Law on Public Financial Management and Accountability provides for penalties to be imposed on those who breach its provisions and regulations. There is no provision in this law to deal with irregularities and to recover amounts lost. Similarly, there does not seem to be any reference to the establishment of an AFCOS-type organisation (Anti-Fraud Co-ordinating Service) in the relevant laws, including in the annual Budget Law or in the 2007 Law (and new draft law) on Internal Audit. The evidence therefore is that no systems are in place to prevent and take action against irregularities and to recover lost amounts.

However, the PIFC Policy Paper issued in May 2007 specifically referred to the “fight against fraud”. This policy paper envisaged that the fight against fraud would be carried out by an inspection service, although the paper recognised the need to avoid any overlap with the internal audit activity. All fraud involving EU funds should be reported to the European Anti-Fraud Office (OLAF). The policy paper envisaged a programme of training for staff on the issues and on the development of new legislation (by the end of 2006). No specific references to the fight against fraud are included in the Law on Public Financial Management and Accountability or in the proposed new Internal Audit Law. The relevant Public Procurement Law (last amended in 2007) contains the usual provisions about corrupt practice, but has no specific reference to inspection or to the fight against fraud.

It is not clear if and to what extent special systems are in place to fight against irregularities or to recover lost sums other than through the normal legal processes.

3. Capacity to Further Develop the System

Nothing suggests that the Kosovo Ministry of Finance and Economy does not wish to continue with the development of the PIFC system, and the likelihood is that there will be a need for further development as one outcome of the proposed technical assistance project. The present technical assistance project proposals concerned with public expenditure management and with PIFC should provide a valuable incentive for improvement.

However, a number of reforms are underway that may make development of the system more difficult, including the following:

- Proposals for the devolution of budgetary responsibilities to schools and clinics: A pilot scheme is currently being implemented, covering a limited number of municipalities; if successful, it would be “rolled out” on a full-scale basis. There does not seem to be any particular discussion about the impact of this scheme on public internal financial control, and the main initial impact would be on the KFIMS. Clarification is required on this point.

- The idea that line ministries and other budget organisations assume much more responsibility for PIFC, thus reducing the role of the Treasury, could be appropriate in some circumstances. However, a competency comparison should be made between the Treasury and the organisations that would take over these responsibilities. It can be seen from the Treasury strategic plan that training programmes are envisaged and that one of the reasons for the devolution of responsibility is the development of internal control and internal audit. Even so, significant improvements need to be put in place for both of these elements of PIFC before any large-scale devolution occurs. The training of staff in the use of Treasury procedures is not in itself a sufficient precondition for devolution.

- There is apparently a limited perception of the role of the CHU/FMC. The activity and related training to be initiated by the CHU/FMC should go well beyond the effective implementation of the KFMIS. Attention has to be paid to the capabilities of the CAOs and their understanding of their responsibilities as managers of public expenditure and of the implications for improving the quality of public expenditure. This training would be provided in addition to the technical training of designated officials to be appointed according to the provisions of the Law on Public Financial Management and Accountability that would prepare them for properly fulfilling their roles. Indeed, below the level of the CAOs there would also be a range of officials who would assume responsibility for public financial management.

In addition to the above specific reservations, the following comments are to be made:

- There appears to be no co-ordinated needs assessment and human resouces development process for internal audit and FMC staff. This situation may change with the development of the CHUs, but this is a priority issue that needs to be addressed, as otherwise the best recruits will prefer not to fulfil these functions or if they do, there is a greater likelihood that they will leave.

- There is a strong need to develop professional training (as opposed to short-course training) for both internal auditors and those concerned with financial management, with such a programme leading to the award of appropriate certificates. Crucial to raising the quality of public expenditure (which means achieving better value for money) is the need to ensure that capable managers are appointed and trained and that the PIFC system and the public expenditure management system provide incentives for improving the performance of public expenditure. Although this is a long-term aim, initial steps should be taken as soon as practical.

- While the new draft internal audit law is now under discussion in the Assembly, there is no assurance with regard to the form that it will eventually take. However, assuming that there are no major changes in the draft law, the Ministry of Finance and Economy is encouraged to think in terms of rather large internal audit units rather than what appears to be the current thinking, i.e. units of two persons. More economical and effective units staffed by a minimum of three persons – although four or five persons would seem to be a better scheme – would of course mean a greater sharing of internal audit resources. Again, creating structures where a “parental” institution would assume the internal audit function for smaller institutions of the same sector could also result in a more efficient use of scarce internal audit resources.

- The development of the CHU/IA is an encouraging step forward.

- The CHU/FMC is in a very early stage of development and has a limited scope of activity; this scope should be expanded.

- No evidence has been given of the establishment of co-operation arrangements between the two CHUs, and yet there is a need for extensive co-operation between these two units.

- From the interviews with a small number of internal auditors, a very high commitment could be observed, and some audits seemed to be of a high quality, although the majority appeared to be limited and similar in scope to traditional inspection reviews. This may be inevitable at this early stage of internal audit development, but for real progress to be made this situation has to change. Without such a change, there is a risk that internal audit will not be able to add value and that managers will become disillusioned with internal audit.
- Following from the previous comment, the CHU/IA should consider how it might improve the quality of the internal audit process. Ways of improving quality should be explored.
- Networking between internal auditors does not seem to exist so far, and it should be encouraged as a way of sharing experiences, generally supporting the development of new ideas, and gradually helping to improve quality. This networking would have the further benefit of helping to improve the “esprit de corps” of the internal audit cadre.
- Co-operation between internal and external audit also does not seem to exist. This is unfortunate because there are common interests and confidence-building is also required.The application of regulations (when available) on corporate governance to publicly-owned enterprises (including municipal enterprises) should be reviewed by both internal and external audit.