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CROATIA

PUBLIC INTERNAL FINANCIAL CONTROL (PIFC)

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1. Introduction

Largely as a consequence of the accession process, financial control in the Croatian public administration has undergone major changes during the last twelve months, notably as far as the legal framework is concerned. The process of reform – e.g. with the introduction of internal audit – started some years ago, but the pace of change and the magnitude of the reforms in that area have speeded up in the past three years, and PIFC development has been rather high on the political agenda.

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

2. Baseline Questions

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

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

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

As part of the efforts related to the accession process, public internal financial control has been subject to an overall approach, leading to the *Policy and Vision of Internal Audit* of July 2003, followed by a first *Development Strategy of PIFC in the Republic of Croatia*, adopted by the government on 2 September 2004. While constituting a substantial improvement in the area, the latter document was considered too vague and allusive to be really useful as a basis for the development of PIFC. The Croatian authorities (the new Department for Harmonisation of Internal Audit and Financial Control in the lead, but also sample line ministries and the supreme audit institution, i.e. the State Audit Office), in close co-operation with the technical assistance providers in place, drafted a second version of the strategy. This thoroughly revised document was adopted by the Council of Ministers on 15 June 2005, after receiving a positive opinion from the European Commission, and now constitutes the basis for further developments in this area. It can thus be regarded as a policy paper to help in the establishment of a comprehensive PIFC system. The text summarises the achievements so far in the area of PIFC and makes further suggestions for the full development and refinement of the current system. The document refers equally to national funds and EU funds. The PIFC principles mentioned in the policy document were to be translated into legal provisions, and the strategy foresaw the drafting and adoption of the PIFC framework law. The strategy has now been complemented by an action plan, aimed at describing the actions needed in the period 2007-2008 for the completion of the strategy and in particular the implementation of the adopted PIFC Law.

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

The resulting text deals with both financial management and control and internal audit, including central harmonisation functions. It contains the basic ingredients composing the strictly speaking PIFC part of chapter 32 and was accordingly considered favourably by EU authorities. However, the text that was

adopted, which does not seem to have raised many discussions in parliament, tends to over-regulate the area, at the expense of flexibility and adaptation capacity. This over-regulation could result in implementation problems, especially as a number of provisions are rather abstract, and their relation to administrative and financial realities in Croatia is not obvious. For the sake of clarity, an important effort of explanation and awareness-raising would be worthwhile, targeting key public officials, starting with the managers in charge of implementing the new framework. The provisions concerning audit activities sometimes give the impression of relating more to external audit than internal audit.

A better co-ordination between this text and the other existing (and applicable) texts is still needed. In particular, an assessment has to be made of the impact of the adoption of an overall PIFC Law on the current OBL, which already contains a number of provisions related to PIFC. Consequences should be drawn from such a review in terms of amending the OBL, including deleting its superfluous or contradictory provisions. This exercise would have to be done once the PIFC text is adopted.

According to the provisions of the Organic Budget Law, the secondary legislation relating to internal audit was practically completed with the adoption of the budget-users' internal audit rulebook in August 2004, which the new rulebook of 12 December 2005 revised completely. This more recent text adequately covered most issues now addressed by the PIFC Law, and the rulebook format was in many respects more appropriate than a law format for internal audit-related issues. It will remain valid until the adoption of secondary legislation, as foreseen by the PIFC Law within 12 months of the entry into force of the law.

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

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

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

The main innovation of the PIFC Law is that it defines the concept of financial management and control, its purpose and organisation. It defines more specifically the responsibility of the head of a budget-user and how his/her function can be delegated. It furthermore introduces two new functions in addition to the head of the budget-user: the head of financial management and control (responsible for setting up and implementing financial management and control) and the co-ordinator of financial management and control (responsible for “operationally carrying out and co-ordinating the establishment and development of financial management and control”). From the mere wording of the PIFC Law, the difference between these two functions is not very clear (both are involved in the establishment of the FMC system, but the co-ordinator is more involved with operational tasks).

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

These provisions have started to be implemented with the appointment of the heads of financial management and control. Operational activity in this area will only begin once the appointed persons have undergone a training programme organised by the Minister of Finance. However, within six months after the enforcement of the PIFC Law, the appointed heads of financial management and control have to produce and to get adopted the “FMC system establishment and development plans” that are to be introduced in each budget organisation.

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

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

The Central Harmonisation Unit (CHU) for PIFC in the Ministry of Finance is headed by an assistant minister and has two clearly established components, one for internal audit – IA (five staff out of eight planned) and one for financial management and control – FMC (five staff out of seven planned). The additional two staff members to be recruited by the CHU in 2007 should in priority be assigned to the structure responsible for internal audit. The PIFC Law provides for a high-level PIFC Council, which will act in an advisory capacity to the Minister of Finance and as such should support the activity of the CHU.

The future tasks of the CHU are clearly set out in the PIFC Strategy and in the PIFC Law. However, carrying out those tasks in the area of FMC and addressing new issues, such as assessing the quality of internal audit work, will constitute new challenges.

Some ministries, including the Ministry of Finance, have been identified to act as pilot budget-users for the implementation of the new FMC schemes in the framework of the current technical assistance project. The basic process seems to be moving steadily forward, as shown by the fact that already 34 budget-users out of 36 concerned (including the City of Zagreb) had produced the annual report requested by the new PIFC Law on the establishment of financial management and control systems. These reports, analysed and compiled by the CHU, constituted the basic material for the “Consolidated Annual Report on Public Internal Financial Control in the Republic of Croatia for 2006”. The first issue of this consolidated report was released in April 2007 and submitted to the PIFC Council of Ministers and to the government, which passed a specific resolution addressing the main conclusions of the report (16 May 2007).

In the area of management of EU funds, a Central Financing and Contracting Unit was established in 2001. It is currently headed by an assistant minister and has 14 staff. A National Fund has been set up, and the State Secretary in the Ministry of Finance has been appointed as the National Authorising Officer. Procedures have started for the development of management capacities of agencies responsible for EU pre-accession funds – at the moment Phare, ISPA and ongoing CARDS support – in the framework of the Decentralised Implementation System. The process has been completed for Phare, ISPA and CARDS and now for the SAPARD programme. The process is now underway for the IPA programme, which replaces all former EU financial support schemes. The systems and procedures required for the management and control of EU pre-accession funds, as well as the process for setting them up, could serve as useful references for the domestic budget, and adequate linkage and co-operation have been organised in that respect, with regular – in principle weekly – meetings of key actors in the management of pre-accession funds, attended by the CHU.

The still planned Treasury Reform Strategy will have an impact on many aspects of the budget execution. This new policy is likely to have consequences for the control activities of budget-users, and proper co-ordination with PIFC development activities is still of the essence.

Systems and procedures for management and control are only partially in place at the moment in Croatia. However, the PIFC Strategy of 2005 should now start to produce results in the short term,

and this will be further supported in a consistent and structured manner by the implementation of the new PIFC Law, in force since January 2007. Effective progress is to a large extent linked to a good co-ordination of activities, e.g. between PIFC development, the new PIFC Law, budget execution procedures – including the planned Treasury reform – and activities pertaining to setting up the system for EU funds management.

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

Internal audit in the public sector is now based on articles 16 to 33 of the PIFC Law, which to a large extent reflect the contents of the rulebook of 12 December 2005, which is nevertheless still applicable until the new secondary legislation on internal audit is issued.

As it is unrealistic, and inappropriate in quality terms, for each budget-user to set up an operational internal audit unit, considering the number of these bodies, the rulebook of 2005 tried to introduce innovative and practical arrangements so that the function could be carried out even in the absence of a permanent unit. These procedures are maintained by the PIFC Law.

Internal auditors' jobs are now incorporated into the civil service scheme and salary scale. They are consequently included in the decree of 30 May 2005 amending the decree on titles of positions and job complexity coefficients in state administration, which defines the respective salary levels of civil servants in a way that makes the job competitive. No problems of recruitment or staff evaporation have so far been reported, which seems to be a better situation than in other parts of the Croatian public administration. This has been achieved primarily by increasing the complexity of job coefficients, resulting in an increase in the salaries of internal auditors, an issue that is addressed more generally in the 2007 Sigma assessment of the Public Service and the Administrative Framework in Croatia. By the end of 2007 or beginning of 2008, the salary act should have been amended, and the intention of the CHU is to maintain the relative level of salaries of internal auditors in the system.

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

According to current legal criteria, 35 budget-users are obliged to set up internal audit units. In practical terms, internal audit units have been formally established in 13 central ministries and 18 state administration bodies, which have amended their respective systematisation decrees to that effect. The training scheme encompasses seven mandatory modules and a set of seven optional courses for more in-depth study of certain aspects. By the end of May 2007 a total of 177 internal auditors had been involved in training activities, of whom 157 had passed the examination and 68 had been fully certified as a result of their participation in pilot audits.

This training has been provided by the technical assistance project in place up until the end of 2005 and by the follow-up assistance project that started in April 2006. In this respect, the Ministry of Finance adopted in March 2007 a new programme for professional training and examination for the qualification of public certified internal auditor. This programme will serve as a basis for further training and examination. It remains the case that there are still no permanent training resources for the future that provide both initial and continuous training. Some auditors have nevertheless been trained as trainers and have started to deliver lectures and provide training to the newly appointed groups of internal auditors. A possible path to

explore would be through co-operation with the external audit body in the area of training, considering the opportunity and interest of designing a common syllabus, as has been the case in neighbouring countries. The possible future contributions of the training resources of the Central Office for State Administration should also be taken into consideration.

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

This risk is nevertheless difficult to assess, since in practice few audits have been performed so far, and most of those were in the Ministry of Finance. To a large degree, internal audit activity in Croatia continues to be a training activity. Internal audit is still in a building phase, although it is clear that in some ministries rapid progress has been made and this activity is no longer a trial procedure or a function that is alien to the organisation of the ministry.

In the framework of the PIFC technical assistance project, internal auditors are provided with substantial documentary support. The department for internal audit and control (precursor of the CHU) has issued an internal audit manual, which can be regarded as a basic handbook for the performance of systems and regularity audits. The guide refers to generally accepted standards in the area and covers the basic technical needs of a public internal auditor. In 2005-2006 chapters on risk management and the auditing of EU pre-accession funds were added. As the process of establishing internal audit is still in a building phase, the amount of audit work completed to date is still small and it is not yet possible to judge the usefulness and effectiveness of the guidance that has been provided. It can be expected that the manual will be reviewed as a consequence of the adopted PIFC legislation; an updated manual, due at the end of 2007, will also cover the practical module of the training activity. On 3 August 2005 the Ministry of Finance already produced a Code of Ethics for Internal Auditors, applicable across the whole Croatian administration, which is based on the principles of the Institute of Internal Auditors and on a template of the European Commission (DG-Budget). In addition, in October 2005 the CHU produced a template for an internal audit charter, which was transmitted to all budget-users, with the result that all of them were able to adopt their own charters by the end of 2006. These two documents are also expected to be subject to change as a result of the PIFC Law and the related action plan.

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

A Government Supervision (*nadzora*) Office was created in January 2001 as a part of the Prime Minister’s Office, with the functions of co-ordinating internal control bodies set up in accordance with the provisions of the then applicable budget law, and of carrying out such control tasks throughout government offices. According to the Organic Budget Law of 2003, the role of the Government Supervision Office should evolve so that this body becomes the Government Office of Internal Audit. It is to act as an internal audit body for budget-users that are too small to justify the existence of a permanent internal audit unit. This supervision is regulated by a decree of 25 June 2005, but beyond the legal framework the practical steps taken so far on this issue remain to be seen. The efficiency of this solution to provide internal audit

services to bodies that do not have their own units will need to be assessed in due course. Other cost-effective solutions are possible.

Significant progress has been made in the design of the internal audit set-up in the Croatian public administration, which is now supported by the relevant parts of the new PIFC Law. Future internal auditors have received basic training from technical assistance providers, and a respectable number of them have even been given advanced training. However, the establishment of internal audit units or capacities is not in line with the progress in training, with the result that some trained auditors are for the moment not used to carry out audit activities. The number of audits is still limited at the present time, and there is a need to undertake more of them, using the support of the new assistance project.

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

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

Seventeen irregularities officers had been appointed at the central state level at the time of this assessment. It is of course too early to judge how operational and efficient these procedures can be in the current administrative context of Croatia. However, these innovative solutions demonstrate a degree of commitment on the part of the Croatian authorities in relation to the issue of irregularities. Few candidate countries, if any, have opted for such arrangements, and it will be interesting to see how they will operate in practice.

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

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

A decision has finally been made as to which body should be the contact point for the European Anti-Fraud Office (OLAF), and fulfil the functions of an Anti-Fraud Co-ordinating Service (AFCOS). As indicated above, the unit for combating irregularities and fraud has been established within the Budget Supervision Service of the State Treasury in the Ministry of Finance (in accordance with amendments to the systematisation of the Ministry of Finance adopted on 14 December 2006). The functions of the Organisational Unit for Combating Irregularities and Fraud (OUCIF) are further defined in the rulebook and are in line with the suggestions made previously for the setting-up of AFCOS. A specific action plan for the implementation of the provisions related to the establishment of OUCIF was adopted as early as January 2007 and suggests that every step, including staffing and training, will have been carried out by the end of 2007. This time frame is rather ambitious and somewhat early as it is doubtful that there will be full-time work for the three staff composing the OUCIF (its head had already been recruited at the time of this assessment). Beyond the formal measures to be taken in order to establish the OUCIF (such as signing co-operation agreements with other authorities, such as the State Prosecutor), it would be worthwhile for this body to start reflecting on its missions and remit, which could possibly be covered by a specific anti-fraud strategy. An interesting feature is that this body, although created after prompting by EC authorities, is not specialised in EU matters. In accordance with the PIFC Law, all budget-users, and in particular the

irregularities officer, are supposed to report to OUCIF, as the “body in charge of irregularities and fraud within the Ministry of Finance”.

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

3. Capacity to Further Develop the System

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

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

4. Summary and Next Steps

The PIFC system in Croatia has experienced some development and made good progress in the past year, starting with the adoption of a specific and comprehensive strategy and plan for PIFC. The adoption of the PIFC Law and the related implementing actions and rules have given a new impetus to the development of the PIFC policy and to the activity of the CHU within the Ministry of Finance. PIFC is nevertheless still largely at the start of the institution-building phase, in particular as the new act introduces relatively new concepts in the area of FMC (less in the case of internal audit, for which it is more relevant to speak of consolidation). It is only from now on that it will be possible to measure the impact of the audit activity, which is just starting to operate in an autonomous way and separately from project-supported activities.

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

The Public Internal Financial Control Strategy will contribute to progressively bringing Croatian financial control arrangements in line with good practices of other candidate countries and EU Member States. However, some clarification is still needed with regard to the various key functions. A better balance should be sought between institutional and legal procedural aspects on the one hand and practical working aspects on the other, so as to keep PIFC from becoming a matter reserved for some specialist functions only. Besides the further development of the still new internal audit function, priority should now be given in practical terms to the development and improvement of internal control systems and procedures and to the strengthening of the Central Harmonisation Unit. This has been done in legal terms by the PIFC Law but now has to be translated into practice. To date the design and implementation of policies have been very closely linked to the technical assistance provided in recent years. The concern about ownership and sustainability has been repeatedly expressed by providers as well as by the direct counterparts in assistance projects. Technical assistance will continue in the medium term and presumably for as long as Croatia is a candidate country; it is therefore important that policies and measures in the area of PIFC are designed and implemented as a self-standing and fully-fledged Croatian administrative reform activity.

These policies and measures should take into particular account their efficiency and operational character beyond the period of technical assistance. This advice holds true most specifically for training and qualification activities. In that regard, it seems that the last period has constituted a relevant test, as the disruption of assistance activities has not adversely affected the progress made during that period. It is now possible to say that the CHU, not the TA project, is really leading and controlling the PIFC development policy.

The adopted PIFC Law covers all major requirements, in particular those of the European Commission. However, there are some risks attached to its still highly formalistic contents as well as to the prospects for its smooth implementation, including issues of co-ordination/overlapping with other texts.

Local government is concerned by the recent developments of PIFC, as it is subject to most legal provisions and their recent amendments, not only for internal audit but also for financial management and control. Internal audit units have been established at a steady pace in municipalities and other local bodies so that at the end of 2006, 47 such units had been created and internal auditors had participated in training (this concerns a total of 83 local bodies, out of 576 existing self-government units). A significant contribution of the assistance project seems to have been the training of local staff. This will remain so in the future and in particular, as previously recommended, it is expected that the new two-year project will focus even more on this area. It is nevertheless difficult to measure, except in large centres, the impact that these new policies have had so far. The CHU and its current assistance, as previously recommended, plan to draft a specific PIFC strategy for the local level, which could be issued by mid-2007; a first draft has already been produced. This is a significant initiative but it is of the utmost importance that local authorities, including political bodies, are involved as soon as possible in the development of the strategy. Again, ensuring the availability of properly resourced internal audit at these levels of government – without running the risk of scattering – is an important task. If this issue is not adequately addressed, there is a risk that these scarce audit resources will become uneconomical and useless.

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

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

Priority should be given to the following actions:

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

- The PIFC Law should be fully turned into reality as a priority activity, and the adopted action plan for that purpose should be steadily implemented. Plans for resources should be made early enough, as well as outlines for the likely secondary legislation.
- The consistency amongst FMC-related texts, such as the PIFC Law and the Organic Budget Law, has to be ensured by appropriate scrutiny in order to avoid ambiguities, redundancies or discrepancies.
- Connections should be established between the implementation of the concept of managerial accountability in the PIFC framework and the development of strategic planning in relation to budget preparation and budget execution as well as related reporting obligations.

- Efforts to explain the new provisions of the law as well as more generally to raise awareness of PIFC issues should continue to be undertaken by the Ministry of Finance, in particular the Central Harmonisation Unit.
- Practical steps to implement a renewed PIFC system wherever possible, in order to save time, raise awareness, and test new arrangements and procedures, are to be taken by pilot organisations, starting with the Ministry of Finance.
- Efforts to establish and staff viable internal audit units wherever relevant should continue.
- A proper strategy for PIFC at local government level should be adopted in 2007, involving local authorities at an early stage. Such a task would benefit from the experience gained at state level.
- The CHU should continue to strengthen its internal structure, with increased staff as appropriate, and its relations with line ministries, agencies and other PIFC-implementing bodies.
- The development of PIFC could benefit from the further elaboration of policies and measures in the area of management and control of EU funds; the finalised process of accreditation for EU pre-accession funds management would provide an example of good practice that could be shared in the area of PIFC.
- The testing of existing internal audit standards, methodologies and manuals should be included in the upcoming audit work to be carried out under the guidance of the CHU.
- Pilot internal audits should continue to be carried out, in particular in budget-users other than the Ministry of Finance.
- The results of pilot activities carried out in the framework of technical assistance or autonomously need to be properly assessed and disseminated to the entire public administration.
- The system for preventing and taking action against irregularities will need to be further developed, defined and eventually tested.
- In addition to secondary law development, the anti-fraud co-ordination structure should explore its remit of activities, set up appropriate linkages with likely partners within and outside the Ministry of Finance, such as the National Fund, implementing agencies and law enforcement bodies. The action plan would need to be further developed in that respect so as to address the institution-building activities to be carried out by OUCIF before the unit gets involved in operational tasks. Advice and support could be usefully sought from existing counterpart organisations in former candidate countries.

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

- The PIFC strategy should be reviewed in due course to check its implementation and relevance in relation to reality.
- Based on the above-mentioned policy, the plans for public internal financial control at local level should be implemented.
- Beyond the definition of the status of internal auditors as part of the Croatian civil service, an appropriate human resources policy for internal auditors will have to be developed by the CHU, in co-operation with other bodies responsible for human resources management.
- In that context, the development of training schemes and the organisation of future training of internal auditors should continue, in particular in view of the sustainability of results once

technical assistance has terminated, and based on an analysis of needs and of the relevance of the current syllabus, as was recently done.