

NEWSLETTER • September 2002

For the Working Groups of the Presidents of the Supreme Audit Institutions of European Union Candidate Countries, Albania, Croatia, Turkey & the European Court of Auditors • Produced by SIGMA*

Auditing & Reviewing Public Internal Financial Control systems

This 3rd regular Newsletter of the SAI Presidents' Working Groups is about the audit of Public Internal Financial Control (PIFC) systems. The importance of this topic was already recognised collectively by the SAI Presidents and adopted as recommendation number 11 of the "Prague recommendations" of 1999 and it is also the theme of the upcoming workshop of the Working Group on Audit Manuals in Bratislava, 23-25 September 2002 (below). For this event we are particularly pleased that a good supporter of SIGMA and a much respected colleague from DG Budget, D.6, Robert de Koning will attend the workshop to provide information on the PIFC concept embedded in the so-called chapter 28 accession negotiations. He has also very kindly provided the feature article of this issue on pages 4-5.

In addition we also bring other items which can be of help or inspiration when auditing the PIFC system. This includes links to a number of guidelines posted in the EDG. Please note that it requires password and username to access it.

Finally, we use this opportunity again to inform about some of SIGMA's on-going projects in the field of external audit and financial control.

Best wishes from SIGMA

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The Progress Achieved by SAIs in the Development of Audit Guidance

As a natural part of following the progress made in the implementation of the 11 "Prague Recommendations" of 1999 SIGMA conducted a small survey in connection with the workshop in Sofia in June 2002. The survey showed that of the 13 responding SAIs:

- 10 now have in place *vision and/or mission statements* (1 in the process of preparing them and 2 not preparing them);
- 9 have in place their own *audit standards & policies* (4 in the process of preparing them);
- 3 have in place a *comprehensive audit manual* (8 in the process of preparing one and 2 not preparing one);
- 3 have in place detailed *guidelines for the audit of PIFC* (6 in the process of preparing them and 4 not preparing them);
- 3 have in place detailed *guidelines for Audit Quality Assurance* (6 in the process of preparing them and 4 not preparing them).

The information collected will be updated as progress is achieved.

Workshop of the Working Group on Audit Manuals in Bratislava, 23-25 September

On the 23-25 September the SAI of the Slovak Republic, the *Najvyšší kontrolný úrad* (NKU) will host the workshop on Guidelines for the Audit of Public Internal Financial Control for the Working Group on Audit Manuals. The workshop will include presentations made by representatives of INTOSAI, the European Commission, the European Court of Auditors and SAIs of both EU candidate and member state countries including Slovakia, Cyprus, Belgium, Spain, Sweden and the Netherlands. The workshop will take place in the [Hotel Forum](#) in the centre of Bratislava.

For more information, please consult the information posted at the web site of the NKU (<http://www.controll.gov.sk>).

The person in charge on the side of the NKU is Director of International Relations, Mr. Julius Molnar (molnar@controll.gov.sk).



Peer Assistance Project on Public Internal Financial Control (PIFC) in Slovakia

During the months of October and November SIGMA will be undertaking a PIFC Peer Review & Assistance project with the Slovak authorities. The peer team will comprise the following persons:

EU Member State peers: Mr. Alain Gerard Cohen, Former Inspector Général des Finances, France; Ms. Linda Dahlstrom, National Board for Public Procurement, Sweden; Mr. Gareth Evans, Former Head of Internal Audit at the UK Intervention Agency; Mr. Åke Hjalmarsson, Director of Budget Department, Ministry of Finance, Sweden.

Responsible for the SIGMA peer review *Organisational and Technical Management* will be:

Mr Nick Treen, SIGMA, Principal Administrator, on Secondment from the UK National Audit Office; Mr. Johannes Stenbæk Madsen, SIGMA, Administrator, on Secondment from the Danish Rigsrevisionen; Ms Esther Bright, SIGMA, Project Assistant for the peer assistance project;

The missions of the peer assistance team will take place during one week in October and one week in November and with a final report expected at the end of the year.

For 2002 a PIFC Peer Assistance project is also scheduled with the Slovenian authorities and for early 2003 Peer Assistance projects are scheduled in the Czech Republic and Hungary.

Similar projects are foreseen for Poland and Romania at a later stage.

New Law on Financial Control and Internal Audit in Turkey

In June and July this year, SIGMA was pleased to be asked by the EC delegation in Ankara to help support the Turkish Ministry of Finance prepare a new draft Public Financial Management and Internal Financial Control Law.

A draft law is now with the Turkish Parliament.

For further details on this please contact Nick Treen (nicolasjohn.treen@oecd.org).

SIGMA convention for 2003-04

The European Commission has signed a new convention for SIGMA extending its mandate to work with the EU candidate countries to the end of 2004. Like the current convention, which expires at the end of 2002, the new convention contains a specific reference to the continuing support to the network of the SAI Presidents.

We would like to use this opportunity to thank all those who have supported this extension.

Kind regards from SIGMA

Binder from Vilnius Workshop 24-27 March 2002

On 26-27 August SIGMA distributed to the Presidents of the participating SAIs hardcopies of a binder containing all papers presented and produced at the Workshop on Mission Statements & the Preparation of Audit Manuals in Vilnius, 24-27 March 2002. The workshop was hosted by Lithuanian Auditor General, Jonas Liaucius, and Co-chaired by Colin Maynard, ECA, and Nick Treen, SIGMA.

Apart from the conclusions, which were also presented in the [Special August Issue of this Newsletter](#) the binder contains the following:

- List of participants
- Agenda for Workshop
- Draft minutes of Workshop
- Marcus Popplewell (UK) presentation
- Brian Vella (Malta) presentation
- Aivo Vaske (Estonia) presentation
- Rainer Teschner (Germany) presentation
- Piotr Kownacki with NIK colleagues (Poland) presentation
- Rolf Elm-Larsen (Denmark) presentation
- Group exercises 1, 2 and 3
- Responses to exercises 1, 2 and 3
- Summary of evaluation
- Mission statements reflection paper by Dieter Böckem
- Report of Working Group III - Subgroup B
- SIGMA report on Audit Manuals preparation
- Drucker General Guidance for preparing Mission Statements and Guidance on "What is a Mission Statement?" and "What is a Vision?"

Electronic versions of these documents are also available from the EDG Category [Audit Manuals WG Workshops](#).

New Items in the Audit Manuals Reference Archive

During the summer the following new items have been posted in the Audit Manuals Reference Archive (A.M.R.A.) of the EDG:

- Financial Audit Manual - A Joint GAO/PCIE Publication (GAO-01-765G) (Category A.M.R.A., [topic III.a.](#));
- IFAC Guidelines for Financial Reporting by Government Enterprises (Cat. A.M.R.A., [topic II.a.](#));
- The Applicability of the International Standards on Auditing of Financial Statements of Government Business Enterprises (Cat. A.M.R.A., [topic II.a.](#));
- IFAC study on Performance reporting (Cat. A.M.R.A., [topic III.b.](#)).

You either submit new references directly in the EDG or by sending an e-mail to johannes.stenbaek-madsen@oecd.org, where you can also apply to become member of and obtain a username and password for the EDG.

To get an overview of the A.M.R.A. click here: (<http://appli1.oecd.org/pum/workingG.nsf/by+category>)

About the SIGMA web-site

As you may have seen in the last issue of this newsletter, SIGMA's web site has been changed in line with the OECD template. The structure and the idea behind this template is different from the old web pages and we are still in the process of adapting the information available from the site and there is still information from the old site, which is not available on the new. We hope to fix these problems in the very near future. The basic thinking of the new site is that once you are in the right directorate (SIGMA in this case) you can either pick an item directly on the homepage, e.g. go to the EDG in the blue right hand margin or click on news items, or you can pick a theme in the left hand margin. The administrative unit in SIGMA being responsible for audit & financial control (and primarily working in the current EU candidate countries) is responsible for the information available under the SIGMA themes "Supreme Audit Institutions & External Audit in the Public Sector" and "Public Internal Financial Control". We are hoping to launch a small user survey concerning the web site later this year but comments and suggestions for improvements would be welcome at all times. You can now reach the SIGMA web-site via the following web-address: www.oecd.org/sigma

Guidance for the Audit of Public Internal Financial Control Systems

In the Audit Manuals Reference Archive you currently find the following references to guidelines for the audit/review of internal financial control systems, including internal audit:

- **Guidelines for Internal Control Standards**, Issued by the Internal Control Standards Committee of INTOSAI.
- **Guidance for Reporting on the Effectiveness of Internal Controls: SAI Experiences in Implementing and Evaluating Internal Controls**, Issued by the Internal Control Standards Committee of INTOSAI.
- **Internal Control: Providing a Foundation for Accountability in Government**, Issued by INTOSAI.
- **Internal Control Management and Evaluation Tool**, GAO-01-1008G, A publication of the General Accounting Office.
- **New Directions for Internal Audit**, A publication of the Australian National Audit Office.
- **Standards for the Professional Practice of Internal Auditing** from the Institute of Internal Auditors.
- **Managing Public Expenditure**, SIGMA/OECD publication. Also available directly from the SIGMA homepage.

All these documents available from the A.M.R.A., [topic III.c.](#)

A Legal Basis for Public Internal Financial Control (PIFC)

By Robert de Koning, DG BUDGET, European Commission

Although necessary in its own right to bring national financial control systems up to international standards, the surge for new Public Internal Financial Control (PIFC) legislation in the applicant countries was primarily the result of the EU accession negotiations between the national authorities and the representatives of DG BUDG in the European Commission. The negotiations and progress monitoring took place in the framework of negotiating Chapter 28 called "Financial Control". This work started around 1996 and found its culmination in 2001/2002, when most of the current PIFC Laws were adopted in the Applicant Countries.

The challenge to both the European Commission and the prospective Member States to develop PIFC in the 10 PHARE Applicant Countries (with Cyprus, Malta and Turkey added in later years) was first acknowledged by the Commission in late 1996. The conclusions of analysing the replies to a survey undertaken by the Commission in April 1996, resulted into the development of strategies to start providing Commission support to and "coaching" Applicant countries for reform. It was obvious from the outset that reform of Public Financial Control (both external and internal) could not be realised without the necessary legal tools. At the same time it was clear that adequate legal tools would not by itself be enough to guarantee solid implementation of "sound financial management".

This requirement for legal tools quickly found explicit support from the Council (in EU Common Positions) and the European Parliament (COCOBU (Committee on Budgetary Control) Opinions. In the early years of the accession preparations the emphasis was - understandably - put on the management and control of EU-funds (pre- and post accession). However, since the Commission pressed for similar systems to be developed for both the national and the foreign inflow of budgetary means, the need for also changing the national systems for national budgets became obvious. In fact, this is what happened also in some of the Member States: the systems for management and control of the EU-funds as implemented by the Commission, were taken up in developing similar elements in the national control systems.

From the outset of the accession preparations, the Commission did not have pre-conceived ideas of how national PIFC systems in applicant countries should be best developed. The Union's Member States have different systems, although it was possible to distinguish between two large classes: the traditional, Mediterranean system of heavily centralised ex ante financial control and accountancy and the north-western European systems in which the public sector was recently reformed towards public managerial accountability (decentralisation of responsibilities) and public internal audit (management tool). During the previous accession procedures the issue of what national control systems to develop had not been an issue. The new Member States were expected to have financial control systems more or less in line with best international practice and standards. The new arrival of ten ex-communist countries changed that perception. Furthermore it was not in the line of the Commission's practice to answer the many questions for support from the applicant countries with a "just shop around in the Member States". To avoid the risk of increased confusion and further waste of time and resources, the Commission had to find another answer.

The Commission has no legal basis to harmonise financial management and control systems (as defined in PIFC) for the national budgets of Member States. Its own Financial Regulation relates only to the EU Budget and its institutions. As for the implementation and control of EU funds, specific regulations apply to the Member States. Therefore the Commission developed general guidelines for the reform of the national control systems in applicant countries based on the latest developments in the international area of control and audit and on best practices in Member States. By doing so, the Commission even anticipated the conclusions of the White Paper on Reforming the Commission of March 2000 (http://europa.eu.int/comm/reform/refdoc/index_en.htm), suggesting reforming its own procedures for ex ante financial control and internal audit. The main elements for Public Internal Financial Control (PIFC), as it gradually became known since 1998, are managerial accountability of the spending centres (including ex ante financial control), functionally independent internal audit and a central authority (or authorities) for harmonising and co-ordinating control and audit methodology.

(continues)

The introduction of such new concepts met with obvious resistance from vested interests in the more traditional areas of government. Sound financial management and control issues are normally not particularly in favour with politicians, because of their low degree of public attention (unless things go really awkward!) and their general (but misunderstood) tendency to interfere with policy implementation. It took a while to warm up Ministers of Finance to focus their full attention and support to this particular area, but with the increasing interest expressed by the European Council and Parliament in financial control matters as well as by the increasing number of visits of the Commissioner for Budget, Ms SCHREYER to Ministers of Finance and vice versa, the understanding for the need to take PIFC development seriously got into higher gear.

The search for a new language in the former communist countries describing modern concepts of “managerial accountability” and “functional independent internal audit” took off rather slowly. The real task was to change from a concept of police-like ex-post punitive investigations based on third party complaints to pro-active auditing techniques to assess on a continuous basis the quality of financial management and control systems in national budget centres and make efforts to improve them to such levels that irregularities (whether human errors or systematic) and fraud would be less and less likely. This task was nothing less than a “change of culture in governance attitude towards public financial control”, a task that even certain Member States have achieved only relatively recently, while others are still in the process of considering how to achieve and implement such a shift.

In this perspective the results already achieved (i.e. in legislative terms) by the Applicant Countries in the last couple of years can be called a watershed and even dramatic. Within the timeframe of about five years, virtually all the applicant countries have reoriented their complaint-based inspections towards modern control management and audit techniques. All of them have assigned internal auditors in their national budget centres and the best signal of progress is the fact that the first internal audit reports start indeed pointing at weaknesses in the managerial control systems and provide for recommendations to improve these systems.

Table 1: Overview of PIFC legislation in Applicant Countries

Applicant Country	Responsible organisation	PIFC Framework Law (FL)	PIFC FL in force as of	Internal Audit Law	Internal Audit Regulations
BG	PIFC Agency in MoF/PIFC Council	Yes	Amended in August 2002	No	Yes
CY	Accountant General/Internal Audit Board	Constitution	1960	No	Yes
CZ	MoF	Yes	01 Jan 2002	No	No
EE	MoF	Yes	2000	No	Yes
HU	MoF, Government Control Office	Yes	1992	No	Yes
LIT	MoF and PIC Committee	In draft	Maybe 2002	No	Yes
LV	MoF and IA Council	No	--	In draft	Yes
MA	Internal Audit and Investigations Board (PM Office) and Directorate	No	--	In draft	Yes
PL	MoF/General Internal Auditor	Yes	01 Jan 2002	No	Yes
RO	MoF	No	--	In draft	No
SL	MoF	Yes	03 Mar 2002	Yes	Yes
SR	MoF	Yes	01 Jan 2002	No	No
TR	MoF	In draft	Maybe 2002	No	No

The full text of explanation to the PIFC Compendium: <http://www.oecd.org/doc/M00033000/M00033970.doc>

BOX I

Systems for Public Internal Financial Control (PIFC)

Based on its experience in the candidate countries, the European Commission (DG Budget - responsible for negotiating chapter 28, financial control) frequently uses the term “public internal financial control” in assessing the progress made by these countries in meeting the requirements for EU membership. PIFC systems covers:

Public - covering all control activities in the public sector.

Internal - covering controls exercised by central and decentralised government agencies as opposed to external controls exercised by a body outside the government (e.g. the supreme audit institution).

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

Control - meaning all activities to oversee the entire field of financial management, enabling the government to be “in control” of its finances (therefore comprising all control tools such as ex ante control and ex post audit); and

Systems in this context covering organisations, staff training, methodology, reporting, responsibilities, sanctions and penalties.

Source: Adapted from European Communities, DG AUDIT, April 2000. See also below.

BOX II

Key Elements of Effective Systems of Financial Control identified by SIGMA

- Strong central ministry responsible for all financial matters.
- Central standards for accounting, financial reporting and internal audit and a system to enforce these standards.
- Clear and transparent lines of accountability for organisational units and government officials.
- Effective and coherent systems and procedures for preventive, detective and directive controls, (wherever situated) based on an evaluation of control risks.
- Clear, comprehensive and transparent procedures for financial and performance reporting for the government and all other public sector entities.
- An effective and efficient internal audit function.
- Strong external oversight by parliament and an effective public sector external audit.

Source: Adapted from [Managing Public Expenditure, OECD/SIGMA Publication](#), p. 263.

Segregation of Duties

One of the questions often asked by the candidate country administrations in connection with the development of PIFC concerns the segregation of duties.

First to remember what we want to do with internal control. Transaction processing controls are designed, inter alia:

to ensure that all, and only, legal and valid transactions are processed in an orderly, correct and efficient manner;

to secure, as far as possible, the completeness and accuracy of the records and the validity of the entries therein;

Internal controls in small organisations units are often weak. This may arise because there are insufficient staff to achieve an adequate separation of duties or because of an absence of qualified accounting staff with the ability to design and implement effective internal controls. One of the prime means of control is the separation or segregation of those functions, responsibilities or duties, which would, if combined, enable one individual to process a complete transaction. Segregation therefore reduces the risk of intentional manipulation and of error. Internal control should include supervision by responsible officials of day to day transactions. There are obvious examples such as a payments system where different people should do the preparation, authorisation, processing and dispatch of the cheque. The idea is not only to act as a check on each other's work but also to help prevent fraud. Internal management and supervisory check is a related procedure whereby another checks the work of one person again so as to minimise fraud and error. See below the "Segregation of Duties" checklist for further practical explanations and definition.

Table 1. Example of Segregation of Duties Checklist

Member of staff responsible for:	Physical Handling	Recording	Supervising and Authorising
Expenditure Approval:			
1. Approves the order for goods and services	–	–	√
2. Is responsible for receipt of goods/services including quantity and quality checks?	√	–	–
3. Is responsible for the collation of payments documentation including invoice price terms and accuracy checks and accounts coding?	–	√	–
4. Maintains bought ledger?	–	√	–
5. Prepares cheques?	–	√	–
6. Checks cheques?	–	–	√
7. Signs cheques: a) alone? b) with another signatory?	–	–	√
Reconciliations:			
1. Prepares bank reconciliations	–	√	–
2. Reviews bank reconciliations?	–	–	√
Bookkeeping:			
1. Who is responsible for safe custody of important books, documents of title, etc?	√	–	–
2. Maintains general/nominal ledger?	–	√	–
3. Approves journal entries?	–	–	√
4. Reviews monthly, quarterly or annual accounts?	–	–	√

Agenda of events in 2002

Week	Date	Event
36	4 – 5 September	Annual meeting of the Heads of Nordic and Baltic SAIs in Riga
39	23 – 25 September	Third workshop of the working group “Audit Manuals”: Methodologies for Audits of Public Internal Financial Control Systems in Bratislava
40	2 – 3 October	Meeting of the Liaison Officers of SAIs from EU Member States and the ECA in Luxembourg
40	3 - 4 October	Meeting of the Liaison Officers of SAIs from Central and Eastern European Countries, Cyprus, Malta, Turkey and the ECA in Luxembourg
42	15 October	Meeting of the INTOSAI Governing Board in Vienna
43	21 – 23 October	Fourth workshop of the working group “Audit Manuals”: Quality Assurance in Poland
48	27 – 28 November	Meeting of the Heads of SAIs from EU Member States and the ECA in Luxembourg; part of the meeting will include the Heads of SAIs from candidate countries
50	12 – 13 December	European Council meeting in Copenhagen
50	12 – 13 December	Meeting of the Heads of SAIs from Central and Eastern European Countries, Cyprus, Malta, Turkey and the ECA in Bucharest

Contributions to the next issues of the Newsletter are most welcome and should be send to nicolasjohn.treen@oecd.org or johannes.stenbaek-madsen@oecd.org