Welcome to the world of
PIFC

Public Internal Financial Control

Foreword

The concept of Public Internal Financial Control (PIFC) has been developed by the European Commission in order to provide a structured and operational model to assist national governments in re-engineering their internal control environment and in particular to upgrade their public sector control systems in line with international standards and EU best practice.

This booklet provides a comprehensive overview of the main principles of modern public governance and will hopefully serve as a guide, or even better a roadmap, to government officials, consultants, twinning advisers and all others with a professional interest in this field.

The PIFC model has been widely welcomed and is used extensively by many countries, including some outside the EU. It has a track record of success and I strongly recommend embarking on the exciting journey of getting acquainted with the state-of-the-art internal control environment:

"Welcome to the world of PIFC"

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INTRODUCTION

A Public Internal Financial control system can provide assurance that government funds are being spent wisely

Public Administrations raise and spend money on behalf of their citizens and businesses. This is often referred to as taxpayers' money. Taxpayers are entitled to receive assurance that Public Administrations take due care in managing funds.

Public Internal Financial Control (PIFC) represents a structured model for guiding national governments in establishing a state-of-the-art control environment in their income and spending centres. It aims to give reasonable assurance that transactions comply with the principles of sound financial management, transparency, efficiency, effectiveness and economy, as well as with relevant legislation and budget descriptions.

This booklet explains the PIFC elements, the control environment in the public sector and the reasons why a country may wish to upgrade its internal control systems to the level of internationally agreed standards.

Adopting PIFC needs a strong commitment for change

Implementing PIFC should be seen as a long-term process which requires the commitment of all stakeholders. Experience has shown that the introduction of new policies and laws on the subject that have not been based on prior common understanding and approval of all the stakeholders, can risk invoking incomprehension and resistance that may jeopardise the whole change project. Therefore, changing internal control systems in the public sector should best follow a period of reflection and discussion amongst major stakeholders.

The European Commission, and DG Budget in particular, has gained much experience in the introduction and development of PIFC. That experience has shown that a strong commitment from a central authority is the most important condition for managing the PIFC change project. In nearly all cases this central authority has been the Ministry of Finance (MoF). This is the logical choice because the issue of adequate internal control is at the heart of sound financial management of the national budget.

and to be personally supported by the Minister in charge

Experience would also indicate the need for strong ownership of the reform exercise by the Minister of Finance in order to ward off resistance to PIFC or its piecemeal application. In addition, a good information and communication strategy should be set up and maintained by the Ministry of Finance throughout the process to explain how PIFC contributes to the sound management of public funds.

The process needs a clear and comprehensive strategy

At the start of the process of change, DG Budget promotes the drafting of a paper by the Ministry of Finance on PIFC Policy or Strategy. In short, such a paper is a gap analysis that describes the current internal control environment and the way ahead to come to a state-of-the-art internal control environment.

… and to be agreed by all stakeholders

The paper should be the outcome of prior consultations with external stakeholders such as the Supreme Audit Institution, existing control, audit or inspection services, important budget spenders and where appropriate, private and academic sectors. The final responsibility for the paper, however, rests with the Minister of Finance. The ultimate version, once understood and endorsed by all concerned in terms of principles and consequences, should be adopted by the Minister of Finance and sent to the Government for further approval.

1. CONTROL ENVIRONMENT AND THE PRINCIPAL ELEMENTS OF PIFC

The goal is that reasonable assurance can be provided that public funds are being used for the intended purpose...

Public Internal Financial Control (PIFC) systems aim to provide adequate and transparent methods and organisations to provide a reasonable assurance that public funds are being used for the objectives selected by the budgetary authority (i.e. Government and Parliament). In addition, a state-of–the-art internal control environment is an effective tool in preventing corruption and fraud. In the public sector, there is external oversight performed by the Parliament and the Supreme Audit Institution. The government is responsible to Parliament for managing, implementing and controlling its policies and requires systems to be put in place in relation to budgeting and accounting procedures, internal control measures and inspection services to fight against fraud and corruption.

… and in accordance with economy, effectiveness and efficiency

Usually, the more traditional systems of public internal control are based on a system of centralised ex ante control and ex post inspection that focuses on third party complaints, on questionable transactions, on violations of budget rules (no matter how trivial or how unavoidable in specific circumstances) and on punishing human error. In comparison with modern systems of public internal control, the traditional system with its emphasis on legality and regularity lacks the criteria of economy, efficiency and effectiveness in relation to managing and controlling public funds. Modern internal control is focused on transparency, both in terms of clear lines of responsibility and in terms of harmonised methodology and standards. Transparency is a manifestation of the principle of the government being held accountable towards the public that has elected it to raise income and spend on its behalf.

Managers need to be accountable whilst having the benefit of the internal auditor's opinion as regards to the systems for which they are responsible

PIFC encompasses international standards and EU best practice and aims to provide the optimum approach for reforming traditional national control systems. Central to PIFC are the concepts of managerial accountability and functionally independent decentralised internal audit. PIFC does not focus on the techniques of budgeting or accounting (although internal control may well recommend improvements in these systems), nor does it include inspection tasks such as the investigation and punishment of individual cases of fraud or serious irregularities. Public internal control is preventive in nature and aims to ensure that adequate systems are in place to thwart as much as possible the occurrence of corruption and fraud. Public internal control itself is subject to external assessment by the Supreme Audit Institution.

PIFC follows the latest in International Standards	The main international standards for Public Internal Financial Control are the INTOSAI[1] Guidelines for Internal Control in the Public Sector [2] and the EC IIA Position Paper on Internal Audit in Europe[3]. The main international standard for public External Audit is the INTOSAI Lima Declaration of Guidelines on Auditing Precepts of 1977[4].

Let us now focus more on the fundamentals of PIFC and also have a look at the relationship between PIFC and External Audit.

1.1. The 3 Fundamentals of PIFC

PIFC is based around 3 pillars	PIFC is defined as having three pillars: managerial accountability (financial management and control systems), functionally independent internal audit (IA systems) and a central harmonisation unit (CHU) for developing methodologies and standards relating to the first two pillars.

a) Managerial accountability – financial management and control

Managers must be made accountable	Managers of all levels in both public income and spending centres should be accountable for the activities they carry out - not only in operational policies but also in financial management and control policies. The first level of control should be at the level of the manager/spender. This means that each public manager is responsible for establishing and maintaining adequate financial management and control (FMC) systems to carry out the tasks of planning, programming, budgeting, accounting, controlling, reporting, archiving and monitoring.

Risk assessment is an objective tool, to be used as part of the control system, in order to help identify risks or risk areas. Risks should then be evaluated and managed/treated in line with organisational policy. Risk assessment is thus carried out by management – not by internal auditors.

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[1]   http://members.magnet.at/intosai/Level3/Guidelines/3_InternalContrStand/3_GuICS_PubSec_e.pdf

[2]   Annex 4 provides a summary of these Guidelines as well as giving practical examples

[3]   http://www.eciia.org/downloads/archive_05/2005_02_ECIIA_PosPap_Intl_Auditing_in_Europe.pdf

[4]   http://www.intosai.org/en/portal/documents/intosai/general/lima_declaration/

b) Functionally independent internal audit

Internal audit support must be functionally independent

Budget and spending centres should be equipped with a functionally independent internal auditor in order to support management through the provision of objective assessments of the internal control systems in place. Auditors report directly to the top manager in the hierarchical sense, but are independent of the manager's opinion on how they should audit. This is illustrated by the fact that the internal auditor is not part of the Financial Services Department, but is directly attached to the highest level of management. The auditor's role is to assess the adequacy of the internal control systems that have been put in place by management, to highlight weaknesses/provide recommendations for improvement where necessary. This role is formally outlined and explained in the Internal Audit Charter, a document signed by both the manager and auditor. Auditing work is governed by a set of rules and ethics that derive from professional auditing skills and standards and not from managerial instruction. This set of rules and ethics is usually contained in a document called the 'Code of Ethics for the Internal Auditor' and is signed by auditors upon their certification as a 'Public Internal Auditor'.

Auditing is not to be confused with inspection functions

The auditor is quite different from the traditional 'inspection and revision' expert. The auditor looks at the adequacy of the systems in place in terms of efficiency, economy and effectiveness, with a view to highlighting any potential weaknesses that could jeopardise the fulfilment of the organisation's objectives. The auditor then makes recommendations to the manager on where/how to improve the systems. Auditors should never get involved in managerial tasks (other than their own) for which they cannot bear responsibility. The auditor assesses and recommends; however, it is the manager that decides whether to follow the auditor's suggestions. Thus it is the manager that is ultimately responsible. The auditor does not sanction or punish; this is left to the manager in cases of human or systemic errors, or to the judicial authorities in case of serious irregularities and/or fraud.

c) The Central Harmonisation Unit as a driver for change

The PIFC approach should be harmonised throughout the Public Sector

Given the length of time required to fully implement PIFC and the scope of the task of harmonising the approach across all levels of government, it is vital to have in place a central structure – referred to as the Central Harmonisation Unit (CHU) – that is empowered to manage the development of PIFC.

The CHU is responsible for developing and promoting internal control and audit methodologies on the basis of internationally accepted standards and best practice and for co-ordinating the implementation of new legislation on managerial accountability (financial management and control systems) and internal audit. The CHU is best placed in the Ministry of Finance.

A CHU is such a fundamental condition to the successful introduction and development of PIFC that in reality the concept has become part of PIFC itself.

1.2. External Audit

Making sure that PIFC works well

The preceding remarks refer to PIFC as the government's internal control framework. However, it is essential that the PIFC system and the quality of its functioning be subject to an external audit or independent assessment by a Supreme Audit Institution (SAI) that is accountable not to the executive branch of power, but to the members of the legislature in their capacity as the people's elected representatives. The SAI should be a member of the International Organisation for Supreme Audit Institutions (INTOSAI) and actively adopt and implement appropriate public sector auditing standards and ethical principles. The SAI should regularly inform/discuss its activities and audit findings with Parliament and may propose legislative changes aimed at the more effective use of budgetary resources. The SAI reports should be published, since public scrutiny and opinion can greatly help in focussing attention on necessary remedial action.

Criteria for an effective External Audit

INTOSAI has adopted Guidelines on Auditing Precepts, the so-called "Lima Declaration[5]" which provide institutional principles for SAIs. These address, inter alia:

- The requirement for independence of the SAI and its staff. This independence should be guaranteed by the Constitution and protected by the Supreme Court.

- The requirement that SAI audit powers be embodied in the Constitution and legislation. The mandate of the SAI should cover all public financial operations.

- The relationship with the legislature – including the fact that the SAI should be empowered and required to report annually to the legislature.

- The requirement that the government remains fully and solely responsible for its acts and omissions and cannot absolve itself by referring to audit findings.

1.3. Relationship between the SAI and PIFC

A common understanding is needed

The Ministry of Finance, in its role as the government's principal financial management agency, should - through the CHU - act as the interface between the SAI and the PIFC system. Close co-operation and the pursuit of a constructive dialogue between the SAI as external auditor and the Ministry of Finance as the apex of the PIFC system is essential in order to arrive at a comprehensive and effective system for managing and controlling the resources of the state budget. In order to achieve and sustain such cooperation and dialogue, it is suggested that contacts between the SAI and the Ministry are covered by a high-level advisory working group that would meet regularly to discuss problems of government financial management and internal control as they arise and devise appropriate solutions.

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[5] See paragraph 1 for further details on the Lima Declaration

2. THE VARIOUS STAGES OF IMPLEMENTING PIFC

4 stages to implement PIFC

In order to implement PIFC, the following stages have to be considered: conceptualisation, development of the organisational framework, development of the legal framework and the establishment of a staff development policy. In practice, these stages are inter-related and experience often shows that all of the stages begin soon after the concept has been agreed.

2.1. Conceptualisation

Get everyone on board; agree the Policy and a Plan of Action

The conceptualisation process usually takes long but is a necessary pre-condition for the successful implementation of the project. It is the most important phase as it will use the findings of a gap analysis between the current internal control systems in the country and the international standards for making the recommendations on which the future actions will be based. Ideally a Central Harmonisation Unit (see below) should draft a PIFC Policy Paper (possibly with the co-operation of technical consultants or Twinning Partners) for wide-scale discussion amongst relevant stakeholders. It should not, however, be left to 'outsiders' to take responsibility for drafting this Policy Paper.

The draft paper should take into account the results of the discussions with the various stakeholders in the public sector. However, the Ministry of Finance should take responsibility for the final text so that it can successfully defend its position in the Cabinet of Ministers and later on, during the discussions on the PIFC legislation in Parliament. Finally, the PIFC Policy paper should present a realistic Action Plan, specifying which major decisions are to be taken in what order and in which time-frame. The Policy Paper and Action Plan may well need to be updated in the light of the results of the implementation.

It is suggested that the PIFC Policy Paper should be structured in a certain logical fashion, both in terms of presentation and content. Annex 1 presents a checklist for structure and contents.

2.2. Development of the organisational framework

Central harmonisation is required to keep the momentum and ensure smooth implementation…

Given the length of time required to fully implement PIFC and the scope of the task of harmonising the methodologies and standards across all levels of government, it is vital to have in place a Central Harmonisation Unit that is empowered to manage the development and improvement of PIFC in a country. This CHU should be located in the Ministry of Finance and report directly to the Minister. The full functions of this unit are discussed in the next chapter.

… of Internal Audit systems and of Financial Management and Control systems.	The CHU supports the development of two elements of PIFC. Firstly, the CHU should initiate and support the process of establishing functionally independent internal audit services attached to income and spending ministries and agencies at all government levels. These audit services should report to the highest management level: to the minister in government ministries and to the director/head in public agencies. Lower levels of government (regions, municipalities) should "mirror" the PIFC control principles and set-up, taking into account the economy and efficiency in doing so.

Secondly, in relation to FMC systems, the CHU should support top management in ministries and public agencies to design, establish, implement and run financial services with procedures that are in accordance with the internal control standards. An important aspect of managerial accountability is the introduction of risk assessment and risk management. These are tools to help managers obtain a better assurance about the adequate functioning of their financial services and achieve their objectives.

The CHU has thus two distinct sections; one dealing with Internal Audit and the other dealing with FMC. Whereas it is important that the CHU for Internal Audit has the responsibility for advising the Minister of Finance and the Government on the status of PIFC in the country and should therefore directly report to the Minister, the CHU for FMC could be located e.g. in the Treasury or Budget Directorate that has the responsibility for developing FMC standards in the public sector.

The CHU should not be confused with the Internal Audit Unit of the Ministry of Finance	The CHU is not the same as the Internal Audit Unit of the Ministry of Finance. The Internal Audit Unit of the Ministry of Finance is responsible for undertaking internal audits of the systems in the Ministry of Finance, whereas the CHU is required to manage the proper implementation of PIFC throughout the whole public sector.

2.3. Legal framework

PIFC should be anchored in law	Based on the conclusions and recommendations of the Policy Paper, the next stage will be drafting comprehensive new legislation, covering both FMC and IA issues. It is good practice to make a primary framework law covering the main principles of PIFC, either embedded in a wider Public Finance Act or in a separate PIFC Act. Secondary legislation for implementation will be drafted in accordance with the stipulations of the framework act and where necessary be worked out in regulations or directives that can be updated without going through parliamentary approval procedures.

It should be stressed however that the role of the CHU is not to audit the Internal Audit service. The CHU is to oversee implementation of PIFC and then to monitor compliance with the PIFC model, whereas the Internal Audit service is to provide an opinion on an organisation's risk management, control and governance processes.

2.4. Staff development policy

It is delivered by people – so training them is key

All new functions require the setting up of an appropriate training environment. For this purpose, sustainable training institutions should be established in order to meet initial and ongoing training needs.

The training of managers, internal auditors and financial service staff on the new principles, tasks and responsibilities should start as soon as possible – ideally at the outset of the PIFC discussions or at least as soon as the Policy Paper has been adopted. Often, training courses and schedules are devised with the guidance of consultants and/or twinning partners who have proven experience in the field.

Training top management about the value of internal audit recommendations is most relevant since the "tone at the top" determines the correct place in the organisation to be accorded to internal audit. Modern, practical and to-the-point curricula will have to be developed by experts, in co-operation with the CHU and where possible with academic advice and with the local chapter of the IIA. These curricula should be developed with the public sector in mind. The title of public internal auditor should reflect professionalism that can only be obtained after at least two years of training combined with on-the-job experience.

3. THE FUNCTION AND ROLE OF THE CHU

Administrations often start the PIFC process by undertaking a gap analysis of their current internal control environment. As such, they have created a 'first CHU' because in practice, it is often those responsible for the gap analysis that go on to form the fully fledged CHU.

3.1. The first steps

Empower the Head of the CHU to function optimally

Ideally, the head of the CHU should have experience in state of the art financial management systems and/or in modern audit matters. He or she should enjoy a high degree of independence, i.e. not being part of operational management (although being responsible for the management of his/her own department) and above all, free from political pressure. The post holder should not be removed because of changing political landscapes, but should act as the guarantor of sustained and long-term PIFC policies, since the success of these policies will depend on long term commitment and guidance. This requires a special status, to be provided for in legislation, which should be comparable with the special status to be granted to internal auditors in accordance with the internationally recommended Internal Audit Charter and Code of Ethics.

Get to grips with the needs of key players

The CHU should start by developing a network for the adequate exchange of information on the change project between interested stakeholders. The CHU should define and explain the advantages and challenges that are inherent to the introduction of PIFC. This networking and policy-making (including the drafting of the PIFC Policy Paper) should provide for a steadily widening platform of understanding and involvement in the process. This collaborative process is a condition for the success of the change project.

3.2. Analysis of the current control systems: the gap analysis

Analysing the current system and seeing how to plug the gaps

Secondly, based on an analysis of the present financial management and control system and its gaps as compared to modern international standards, the CHU should draft framework or primary legislation to provide the government with a legal basis to introduce the various elements of PIFC. That analysis could be supported by outside specialist assistance, e.g. through a peer review[6]. The analysis needs careful monitoring and coaching. The results of the analysis of the current administrative capacities are then brought to the attention of the highest administrative levels for discussion and follow-up.

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[6] These have been carried out by organisations including Sigma (www.sigmaweb.org) and the World Bank (http://www.worldbank.org/)

3.3.   Introducing the new laws and regulations

Drawing up the laws

Development and implementation of primary and secondary law is to follow next. Primary and/or secondary law may require further regulation (tertiary), e.g. relating to manuals for Financial Management and Control (FMC) and Internal Audit (IA) systems, and templates for an Internal Audit Charter and the Code of Ethics. In addition, work should start on directives relating to risk management and other methodologies, templates for audit trails, audit reporting etc. These documents should all be used and adopted by the relevant services inside line ministries and other budget agencies. The CHU should guide these processes.

3.4.   From development to monitoring: compliance audit

Ensuring compliance

Once these tasks have been performed, the role of the CHU will gradually change from PIFC development to PIFC monitoring. It will be the task of the CHU to make compliance and quality assurance checks on whether its recommendations are being properly carried out and on how to overcome any bottlenecks in the implementation of the adopted policies. These "compliance checks" together with the results of analysing the annual audit reports from each of the budgetary income or spending centres will facilitate the reporting role of the CHU to the Ministry of Finance (MoF) on the progress of PIFC implementation.

Keeping you informed of progress

To enhance transparency, the CHU produces a consolidated annual report of the state of play of PIFC in the public sector that will allow for regular benchmarking over time. The report is to be submitted by the MoF to the Government with copy to the Parliament and the SAI. This will improve Parliament's oversight of the risk and control processes operated by management in the public sector. It could also support the SAI in its professional External Audit work. Effective vertical and horizontal networking, facilitated by the CHU, between the professions of financial managers and controllers and internal auditors, will contribute to the quality and impact of such reporting.

3.5. Ongoing staff development

Training shouldn't stop after the initial implementation

One of the basic objectives of the CHU is to improve the quality of the staff that are responsible for financial control and internal audit and thereby to enhance the successful implementation of the PIFC system. In this respect the CHU acts as co-ordinator or supervisor of the establishment of sustainable training arrangements and of setting practical criteria for the quality requirements of auditors and financial officers. Close co-ordination and co-operation with the State Audit Office, professional private organisations (such as the local IIA) and academic circles will facilitate this task.

3.6. The CHU as a Centre of Excellence

The CHU is the ongoing reference point'

The above mentioned tasks explain why CHUs are seen as the 'drivers' of the re-engineering process to convert traditional systems into PIFC compatible ones. This involves learning from, sharing and consolidating experience in implementing the adopted legislation and standards. Many governmental institutions wish and need to be continuously informed and updated about PIFC developments. They may also wish to receive training on the further implementation of these new developments. They address their questions to the CHUs, who thus become 'centres of excellence'. As a consequence, the CHU faces extra responsibilities for improving public sector governance.

3.7. CHU networking

Learning from others

Networking could be carried out by e.g. regularly organised meetings within the profession, the use of a website and/or of a regular magazine to disseminate the latest information and discussions on issues raised.

Whereas adequate internal networking is a condition for the optimal performance of a CHU, external networking is of equal importance. This external networking relates to co-operation with the State Audit Office, the private internal audit organisations, professional audit and accountancy bodies and relevant academic niches inside the country as well as to international contacts.

Since CHUs are recently established institutions, there is much benefit in learning from each other about common problems relating to the introduction and implementation of PIFC.

Challenges have already been identified

In the past, the European Commission contributed to networking by organising workshop meetings, in which national CHUs, SAIs and leading international experts in PIFC came together, shared information and exchanged best practice. The workshops highlighted the following main challenges:

- The degree of awareness by management levels about the rationale for PIFC principles and the level of hierarchical support for the work of the CHUs is too low.

- Higher priority should be given to raising the quality of Internal Audit; failure to achieve this could lead to a deterioration of the role and status of internal auditors. In addition, improved salary systems and other compensation schemes for attracting experienced staff should be put in place.

- The networking role of the CHU and its visibility to stakeholders are vital.

- A common approach to general audit rules and methodologies and to the training of control and audit officials requires improved co-ordination with the Supreme Audit Institutions.

- CHUs have a key role in defining training requirements for managers, financial officers and internal auditors, and in coordinating the organisation/frequency of training courses. Training content should be primarily focussed on raising management awareness and on practical control and audit skills.

Establishing the CHU

Some past experience...

DG Budget has overseen the development of PIFC in the EU-10. Our experience shows that the establishment of CHUs in these countries has not always been an easy matter. In most countries, the CHU developed out of specialised services in the Ministry of Finance and had to struggle to have their lead role in developing the modern internal control systems acknowledged by other ministries and budget agencies. In other countries, the absence of strong commitment by the hierarchy and/or resistance by established traditional inspection and other forces proved to be blocking factors for the proper development of the CHU functions. In many cases, this situation seriously hindered efforts to develop PIFC.

The Head of the CHU should be politically independent and have a strong audit background

There are some lessons to be learned in this respect. A CHU should, from the outset, be established under the inspiring leadership of a person that has proven qualities in management, knowledge of modern control and internal audit systems, easy access to professional literature and appointed in such a way that continuity of the project can be safeguarded. This means that the appointment should be independent of political changes in the government. Since visibility is an important issue, the CHU Director should have the same status as the Internal Auditor of a public institution, i.e. directly reporting to the highest level of the hierarchy. It is in the interest of the Ministry of Finance and of the general public (as tax-payers) that the CHU Director is the guardian of the well-functioning of the PIFC systems in the entire public sector. The CHU Director should be regarded as the General Internal Auditor of the public internal audit function. In this capacity, the CHU Director should be able to resolve conflicts of interest between the internal auditors and their hierarchy on issues of professional integrity and even to provide an opinion (or even authorisation) on the nomination, dismissal and transfer of internal audit staff.

Sometimes its possible to have 2 CHUs

Often, the question arises whether there should be one CHU or two, dealing separately with the issues of harmonisation and co-ordination of Financial Management and Control systems and of the Internal Audit systems. It is thought that from the outset it might be beneficial to establish only one CHU, dealing with both aspects through separate sub-units. This has the advantage that the harmonisation of PIFC is in one hand. Whether it would be necessary to split such CHU into two separate units later, e.g. for FMC systems in the Treasury of the Ministry of Finance (closer to proper budget management and control) and another for IA systems focussing on internal audit, is a matter for careful consideration. In case two units exist under the aegis of one CHU, both units should act in accordance with their own responsibilities and avoid interfering in each other's management. This issue should normally be dealt with at the level of drafting the PIFC Policy Paper and reconsidered when an update of the PIFC Policy Paper might be appropriate, taking into account the special characteristics of already existing organisations in each country.

4. THE EU ACQUIS IN FINANCIAL CONTROL

Compliance with PIFC requirements is compulsory

Countries that have received the status of 'Candidate country' by the European Union enter into negotiations on a number of chapters that aim at transposing the EU "Acquis communautaire" (or the acquired common legislation applicable to all Member States: the so-called "hard" acquis) into national law.

Chapter 32 of the Acquis communautaire consists of three elements: PIFC, External Audit and the protection of EU financial interests/fight against fraud. The first two elements are not covered by EU regulation as the Member States have always been free to make their own arrangements in the area of controlling national budgetary means. However the management and control of EU-funds are subject to specific EU regulations that have to be implemented by Candidate countries.

Since the accession negotiations with the EU-10 countries started around 2000, PIFC and External Audit were regarded as "soft" acquis. i.e. there is no specific EU legislation on these subjects. However, the European Institutions (Council, Parliament, Court of Audit and the Commission) have agreed that in this Chapter, the Candidate countries have to reform their public internal control and external audit systems in such a way as to follow and implement international standards and EU best practice.

PIFC is advocated through the European Neighbourhood Policy

Obviously, the obligations under Chapter 32 do not apply to countries that benefit from the European Neighbourhood Policy[7] (ENP). However, since the principles involved in PIFC and External Audit relate to administrative reform and institution building that may benefit any country that has an interest in rebuilding its public internal control systems, the European Union has introduced the principles of PIFC and External Audit into the Work Programme (called Action Plan) of all countries that are part of the ENP programme.

It is practical to make a distinction between the procedure that applies to Candidate countries and that which applies to countries that are part of the ENP.

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[7]   http://ec.europa.eu/world/enp/index_en.htm

4.1.   Procedures for Candidate countries

DG Enlargement is the main interlocutor…

In the technical negotiations, the issues of PIFC and EA are covered by DG Budget; the protection of EU-funds is covered by the relevant DG and the fight against fraud is covered by DG OLAF. The overall negotiations, however, are performed by DG Enlargement.

During the accession negotiations, the candidate country must agree to adopt the PIFC model and introduce the international standards. This agreement is to be reflected in the relevant national policy statements and thus form part of the country's commitment and legal basis during the course of the negotiations.

As far as the management and control of EU funds in the candidate country is concerned, there is also 'hard' acquis communautaire. This 'hard' acquis is dealt with in the relevant accession negotiations chapters such as Agriculture, Structural Funds etc.

4.2.   An overview of the Accession Negotiation procedures

… but DG Budget monitor the technical aspects of PIFC implementation

The contacts between DG Budget and a Candidate country may have started well before the Council decision is taken to give a country the candidate status. Such a decision is based on an analysis made by the Commission of the replies to a questionnaire for all negotiation chapters. After the decision, the Commission will organise a screening meeting with the country concerned to provide for an opportunity to explain what the chapter is about and to obtain from the country all relevant information. The Commission will establish the benchmarking criteria for opening and provisional closure of the negotiations on a specific chapter. Progress in the negotiations will be reflected in the so-called Annual Regular Reports until the last such report before the moment of Accession (called the Comprehensive Monitoring Report). These reports (as well as the monitoring tables with specific recommendations) will reflect the status of progress and enumerate the various fields in which further progress is needed.

4.3.   Procedures for countries benefiting from ENP Action Plans

PIFC will form part of any agreed ENP Action Plans

The ENP is managed by DG External Relations. Once an ENP Action Plan has been approved between the country concerned and the EU (or if the country has expressed an interest to launch discussions with the Commission prior to approval), DG Budget can meet with the relevant authorities to explain the principles of PIFC and the procedures that may lead to rebuilding the public internal control systems.

DG Budget provides conceptual support DG Budget focuses only on initial conceptual support and with monitoring of the implementation over the longer term. The implementation itself is left to technical assistance from specific DGs of the European Commission and other international institutions such as the World Bank, SIGMA as well as consultancy firms, twinning partners etc. The ENP programme foresees funding for such actions for the period 2007-2012. Further details of DG Budget's support is provided in the Chapter 5.

The Action Plan is subject to regular annual progress reporting by the Commission to the European Council.

5. DG BUDGET'S SUPPORTING ROLE

Many roads pass through DG Budget

DG Budget establishes contacts with national administrations, (and in the case of candidate countries, concludes so-called administrative co-operation agreements) in order to discuss the objectives of and the optimum approach to achieving modern public internal control. In addition, the DG organises bilateral and/or multilateral meetings to bring national organisations dealing with FMC and IA systems together to discuss issues of common concern.

DG Budget also holds discussions with consultants and twinning partners who have been contracted to perform long and short term activities relating to PIFC. The terms of references for such contracts are scrutinised for compliance with international standards and best EU practice.

DG Budget liaises closely with related DGs such as ELARG, RELEX, ECFIN, AIDCO, with SIGMA's experts in the reform of Public Administration, with the European Court of Audit, with the IIA (EU and local branches), with the World Bank and with many other organisations that have a stake in PIFC, with a view to sharing any relevant information.

All you need to know is on our web site

DG Budget established and maintains a Financial Control Contact Website (FccWebsite) on which all country-related and training-related information on PIFC can be found. If you would like to know what Internal Audit Law has been adopted by one country or what conclusions were drawn by e.g. the CHU workshops in 2003; what is the PIFC Policy Paper adopted by another country or what has been the EU Opinion about PIFC in yet another country; all this information and much more can be found on the FccWebsite. It provides a unique overview of the entire PIFC effort made by new Member States, Candidate countries, twinners and consultants as well as all other actors like SIGMA, the European Court of Audit and many others.

The web site can be found at
http://forum.europa.eu.int/Members/irc/budg/fccweb02/home. For access to the site, please send an e-mail to budg-fccweb@ec.europa.eu in order to request a password.

6. CONCLUSION

Who could say no to sound financial management?

Public Internal Financial Control plays a key role in ensuring sound financial management in public administrations and is thus a key objective for most governments.

It has a proven track record

The approach set out in this document should allow governments to create momentum in developing PIFC and to achieve what numerous other governments have achieved in the recent past in terms of modernising their internal control systems in a sustainable fashion.

There are many reasons for implementing PIFC. A properly functioning PIFC system should, amongst other things, increase public confidence in national governance, facilitate management to achieve organisational objectives, provide stakeholders with clear expectations of budgetary management capacity and provide Parliament with a clear overview of the control environment and performance in the public sector.

Let us know...

DG Budget welcomes feedback and questions on PIFC. Requests for further information can be made by contacting budg-fccweb@ec.europa.eu

ANNEX 1 - CHECKLIST ON THE CONTENTS OF A PIFC POLICY PAPER

1. ON FORMAT

The Paper should contain an executive summary, introduction, references to the objectives, description of national control environment, gap analysis (current situation benchmarked against international standards), gap plugging suggestions, recommendations and endorsement. In addition, it should be accompanied by an Action Plan.

2. ON CONTENTS

2.1. Executive Summary

This section should be short and concise in stating the purpose and background of the paper and provide the reader with the most relevant operational conclusions and recommendations. This section should be addressed to all management levels, the public audit profession as well as to Parliament and the public at large.

2.2. Introduction

a) Statement of who is responsible for the drafting and co-ordination of the Policy Paper and for the implementation of the paper's recommendations within set deadlines.

b) Clear statement of the reasons for the Policy Paper and, where appropriate, recall the recommendations of the EC and other bodies where applicable (SIGMA, World Bank) in relation to PIFC and EA.

c) Define the national stakeholders in the discussions.

d) Explain the gap analysis and who performed it.

2.3. National Control environment

Provide an overview/analysis of all existing control/audit bodies dealing with public internal control: Parliamentary Control, State Audit Institution with its relations to both Parliament and all government and other centralised and decentralised control bodies. Give a description of the specific public internal control organisation (audit trail from source to beneficiary).

2.3.1. Financial Management and Control systems:

a) Indicate to what extent the notion of managerial accountability for the budget implementation is being applied. Does the manager issue annual statements of assurance?

b) Is the Financial Service (e.g. directorate) in the manager's organisation organised to support the manager in his accountability responsibilities?

c) Describe the organisation and functions of the manager's financial services in income and spending centres; organisation (e.g. responsibilities of the director, ex ante financial controller, ongoing financial control, ex post financial control and/or decentralised inspection, accountant) and reporting.

d) Does the Financial Service cover all steps of the budgetary decision cycle: appropriations/commitments, tendering and contracting procedures, income, disbursements, management of assets and liabilities, recovery of unduly paid amounts?

2.3.2. Internal Audit

a) Is there an internal audit function? How is it organised (central, regional and local levels)?

b) What kinds of audits are performed by the internal audit services: financial or classical audits, systems-based audits, performance audits, IT or other audits?

c) Describe the objectives of internal audit, explain how the functional independence concept works, provide information on the status and contents of the Internal Audit Charter and Code of Ethics (could be added in annexes);

d) Provide information on the internal audit tools, audit planning and reporting procedures.

e) Do public internal auditors receive private or public training and certification? Does certification imply the signing of a Code of Ethics in accordance with international standards? Are internal auditors regularly assessed for their compliance with quality standards?

f) Are there templates to develop internal audit manuals in a harmonised way?

2.3.3. Central Harmonisation Unit

a) Is there a centralised organisation responsible for the harmonisation of Financial Management and Control systems in the entire public sector based on the principle of managerial accountability?

b) Will a centralised organisation, that is to be responsible for the harmonisation in the entire public sector for decentralised functionally independent internal audit, be established?

c) Is the status of these CHUs such that they report directly to the highest management level and that they have adequate power to reach ministries and public agencies for the implementation of relevant guidelines?

d) Do the CHUs take responsibility for determining training needs in the PIFC areas covered?

e) Will the status of the head of the CHU be such that it is a civil servant rather than a contract agent and that his or her nomination and dismissal will not be subject to political coalition changes?

2.3.4. External Audit

a) Has the SAI been asked to write a section on External Audit in the Paper, to explain its role in the national control environment, its latest developments in strategies to improve its functioning, in assessing the PIFC policy developments?

b) Is Parliament responsible for the nomination of the external auditor and for the SAI Budget?

c) Are there adequate procedures and committees in Parliament to discuss the SAI findings/recommendations?

d) Does the SAI enjoy functional and financial independence?

e) Is the SAI a member of INTOSAI and does it follow its recommendations?

f) Define the relations and co-operation between internal control and the SAI

2.3.5. Other public control or inspection bodies

a) Are there other public control or inspection bodies that may have an impact on the entire PIFC structure?

b) Are the objectives and tasks of General Inspectorates on centralised and decentralised levels or of Technical Inspection services in ministries well defined?

2.4. Gap analysis

Is a comprehensive description given of the strengths and weaknesses in the present control environment as compared with international control and audit standards (IIA and INTOSAI) and EU best practice? The analysis should focus for both PIFC and External Audit on major issues like: changes to the present legal framework; changes with an impact for administrative structures; qualification and staffing criteria for management; financial services, internal audit units and a central harmonisation unit(s); staffing and training needs.

3. CONCLUSIONS

The conclusions should give a short description of the main actions to be undertaken and inform the reader about who will be responsible for the change project organisation, management, and implementation and monitoring of the actions. The conclusions should also indicate the resource allocations for the change project and the need for foreign (e.g. EU) support. Finally, the Paper should be endorsed by the Minister of Finance and sent to the government (Cabinet of Ministers) for approval, after which it should be circulated to all stakeholders followed by a wide-scale public awareness campaign.

3.1. Action plan

The Paper should contain a realistic action plan, with clear deadlines and milestones required to implement the conclusions in the short/medium/long term.

The PIFC Policy Paper is a dynamic instrument and it should be adapted as a result of new thinking in relation to international standards or as a result of changes in the national environment. The document will thus ensure continued relevance during the time it takes to fully implement PIFC.

ANNEX 2 - PIFC GLOSSARY[8] OF DEFINITIONS

Term	Definition
Activity Based Management (ABM)	ABM is part of a wider strategic decision-making process that starts with the setting of political priorities through management planning and performance - taking into account the objectives and available resources of the organisation – right to the benchmarking of the programme achievements.
Accounting Control System	A series of actions, which are part of the total internal control system concerned with realising the accounting goals of the entity. This includes compliance with accounting and financial policies and procedures, safeguarding the entity's resources and preparing reliable financial reports.
Administrative Control System	A series of actions, which are part of the internal control system, concerned with administrative procedures needed to make managerial decisions; realise the highest possible economic and administrative efficiency and ensure the implementation of administrative policies, whether related to financial affairs or otherwise.
Audit	In its most generic sense this can mean any examination ex post of a transaction, procedure or report with a view to verifying any aspect of it – its accuracy, its efficiency, etc. The word usually needs to be qualified more narrowly to be useful.
Audit Evidence	Information, which supports the opinions, conclusions or reports of the auditors, internal audit services or SAI. It should be: • Competent: information that is quantitatively sufficient and appropriate to achieve the auditing results; and is qualitatively impartial such as to inspire confidence and reliability. • Relevant: information that is pertinent to the audit objectives. • Reasonable: information that is economical in that the cost of gathering it is commensurate with the result, which the auditor or, the internal audit service or the SAI is trying to achieve.

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[8] This Glossary has been developed by DG Budget and DG Enlargement

Audit Mandate   The auditing responsibilities, powers, discretion and duties conferred on any audit body (e.g. the SAI) under the constitution or other lawful authority of a country (as set out in primary or secondary national legislation).

Audit Objective   A precise statement of what the audit intends to accomplish and/or the question the audit will answer. This may include financial, regularity or performance issues.

Audit Procedures   Tests, instructions and details included in the audit programme to be carried out systematically and reasonably.

Audit Scope   The framework or limits and subjects of the audit.

Audit Trail   The phrase has a rather imprecise general meaning in general audit usage. However, annex 1 of Council Regulation 2064/97 has provided a specific detailed description of the requirements of 'a sufficient audit trail' for the purposes of the structural funds managed by the Member States on behalf of the Commission. In brief, it requires the maintenance of records giving the full documentation and justification at all stages of the life of a transaction together with the ability to trace transactions from summarised totals down to the individual details and vice versa.

The overriding objective of the audit trail is to ensure a 'satisfactory audit from the summary amounts certified to the Commission to the individual expenditure items and the supporting documents at the final beneficiary'.

The phrase 'audit trail' in the Regular Reports and the Accession Partnerships is to be understood in the light of the above definition which should be applied in the context of all Pre-Accession Funds to Candidate countries.

Audited Entity   The organisation, programme, activity or functions subject to audit by the SAI or the (internal) audit service.

Auditing Standards   Auditing standards provide minimum guidance for the auditor that helps determine the extent of audit steps and procedures that should be applied to fulfil the audit objective. They are the criteria or yardsticks against which the quality of the audit results is evaluated.

Central Harmonisation Unit	A policy unit attached and directly reporting to the Minister of Finance on the status of internal control in the entire public sector, responsible for redesigning, updating and maintaining the quality of the internal control systems, for harmonising and co-ordinating definitions, standards and methodologies, for networking between all actors (managers, financial officers, internal auditors), for the establishment and co-ordination of sustainable training facilities, including the setting of criteria for the certification of public internal auditors and for all other actions to improve public internal control systems.

A CHU can cover both areas of Financial Management and Control systems and Internal Audit in one Directorate with each area to be developed independently (two sub-directorates). Alternatively a country may decide to establish a special CHU for the development of Internal Audit, directly reporting to the MoF and a special CHU for FMC-systems that could be attached to the Treasury or the Budget Department. |
| **Charter**

(Internal Audit Charter) | Also called Internal Audit Mission Statement. The Charter/Mission Statement of the internal audit activity is a formal document that defines the internal audit activity's purpose, scope, and responsibility. It aims to ensure that the internal audit is looked upon with trust, confidence and credibility.

The charter should:

- Ensure the functional independence including specification of the position of the internal audit activity within the organisation;

- Permit unrestricted access to records, personnel, and physical properties relevant to the performance of engagements;

- Define the scope of internal audit activities;

- Define reporting requirements to auditees and, where necessary, to judiciary institutions and

- State the relationship with the State Audit Office. |
| **Compliance Audits** | See Regularity Audits |

Conflict of Interest (Conflict of Roles)	There is a conflict of interests where the impartial and objective exercise of the functions of a player in the implementation of the budget or an internal auditor is compromised for reasons involving family, emotional life, political or national affinity, economic interest or any other shared interest with the beneficiary.
Constitutional	A matter which is permitted or authorised by, the constitution of fundamental law of a country.
Controls	Any kind of control on an organisation or beneficiaries of public funds, whether internal or external
Due Care	The appropriate element of care and skill which a trained auditor would be expected to apply having regard to the complexity of the audit task, including careful attention to planning, gathering and evaluating evidence, and forming opinions, conclusions and making recommendations.
Economy	Minimising the cost of resources used to achieve given planned outputs or outcomes of an activity (including having regard to the appropriate quality of such outputs or outcomes).
Effectiveness	The extent to which objectives of an activity are achieved i.e. the relationship between the planned impact and the actual impact of an activity.
Efficiency	Maximising the outputs or outcomes of an activity relative to the given inputs.
Ethics	Ethics in the public sector cover four main areas: setting public service roles and values as well as responsibilities and levels of authority and accountability; measures to prevent conflicts of interest and ways of resolving them; setting the rules (standards) of conduct of public servants; setting rules for dealing with serious irregularities and fraud. Management responsible for the FMC system is expected to make use of tools promoting and raising awareness of ethical values in management and control. For internal auditors in particular, ethics imply the four principles of integrity, objectivity, confidentiality and competency.

Evaluation   Can mean

- The evaluation of tenders as part of the contracting process; or

- Specific reviews designed to examine the overall performance of a programme or project. Its scope may vary. Its core should be setting out, obtaining or calculating the outcomes of the programme or project and considering their economy, effectiveness and efficiency, but it usually covers a much wider range of issues including the appropriateness and achievement of output objectives as well. It may be carried out before, during or after the programme or project has been completed (usually known as ex ante, mid-term or ex post). It shares many characteristics with performance audit

Ex ante financial control (EAFC)   Ex ante financial control (EAFC) is the set of control activities prior to carrying out financial decisions relating to appropriations, commitments, tender procedures, contracts (secondary commitments), and related disbursements and recovery of unduly paid amounts. Such decisions can only be made on the basis of and taken after the explicit approval of the ex ante financial controller.

EAFC is sometimes also called "preventive control". This is the narrower meaning of financial control. If described as EAFC there can be no ambiguity.

Ex post internal audit (EPIA)   The set of audit activities that take place ex post i.e. in this context, after financial decisions have been made by the management. EPIA can be carried out by centralised government audit bodies, responsible and reporting to the highest levels of government (Ministry of Finance or even the Cabinet of Ministers) or decentralised audit bodies (Internal Audit Units in government budget implementation spending units, like Ministries or Agencies).

Ex post   When referring to audit, "ex post" usually means an audit performed after the initial legal commitment of a transaction. When referring to evaluation, "ex post" usually means an evaluation performed after the transaction has been fully completed.

External audit   Any audit carried out by an auditor who is independent of the management being audited. In public finance, it means audit external to the Government financial management and control policy. This is carried out by the national Courts of Auditors or the Supreme Audit Office and aims to objectively ensure that such management and control systems are compliant with the definition of PIFC above.

Field Standards   The framework for the auditor to systematically fulfil the audit objective, including a) planning and supervision of the audit, b) gathering of audit evidence which is competent, relevant and reasonable, and c) an appropriate study and evaluation of internal controls.

Financial Audits   Cover the examination and reporting on financial statements and examine the accounting statements upon which those statements are based.

Financial controller   The function of the financial controller may mean different things in different organisations e.g.;

    a) the role which gives ex ante approval to individual transactions that they are in conformity with regulations and procedures; or

    b) the same as auditor; or

    c) the management role which combines responsibility for the recording and processing of transactions (financial accounting) with the preparation of and reporting against budget targets (management accounting).

In the Commission, Financial Control was originally (1973) defined as ex ante approval of any kind of financial decisions. Later the internal audit function was added to the functions of the Finance Controller. Recently the trend is to split the two functions and the term "financial control" refers again only to ex ante approval.

In the framework of Enlargement the term is used for the ex ante approval function.

Financial controls	The phrase has a wide meaning in some organisations and a narrow meaning in others. The wide meaning follows the meaning of internal controls except that it refers to controls, which have a specific financial component. In practice, in this context, there are few controls, which do not have a financial component and the phrase financial control can often be virtually interchangeable with internal control. The narrower meaning follows the narrower meaning of financial controller and refers to the specific review of the conformity of transactions with regulations and procedures described in ex ante financial control.
Financial management (FM)	In the framework of Enlargement the term is understood to be the set of responsibilities of the management (which is responsible for carrying out the tasks of government budget handling units) to establish and implement a set of rules aiming at an efficient, effective and economic use of available funds (comprising income, expenditure and assets). It refers to planning, budgeting, accounting, reporting and some form of ex ante financial control. FM is subject to internal and external audit.
Financial Systems	The procedures for preparing, recording and reporting reliable information concerning financial transactions.
Findings, Conclusions and Recommendations	Findings are the specific evidence gathered by the auditor to satisfy the audit objectives; conclusions are statements deduced by the auditor from those findings; recommendations are courses of action suggested by the auditor relating to the audit objectives.
Functional Independence (FI)	The special status of a financial controller (narrow sense) or an internal auditor (whether central or decentralised), providing him/her with the power of maintaining a free professional judgement vis-à-vis his superior of the organisation in matters of control and audit. This concept requires the maintenance of a balance between those who are responsible for managing the organisation and those who are controlling/auditing the organisation. FI should be embodied in relevant legislation. Another way to ensure FI is to have the central control/audit organisation nominate a delegate Internal Auditor into the organisation to be audited or to allow the Internal Auditor (in case of conflict of interests) to report his findings freely to the central audit body.

Fundamental

A matter becomes fundamental (sufficiently material) rather than material when its impact on the financial statements is so great as to render them misleading as a whole. See also Significant Control Weakness

General Standards

The qualifications and competence, the necessary independence and objectivity, and the exercise of due care, which shall be required of the auditor to carry out the tasks related to the fields and reporting standards in a competent, efficient and effective manner.

Impact

The same as result or outcome.

Independence

For an external audit it means the freedom of the national Courts of Auditors or similar institutions in auditing matters to act in accordance with its audit mandate without external direction or interference of any kind. From an internal audit viewpoint it means that the internal audit service should be organised directly under the top management. Nevertheless, the internal audit service should be free to audit any area that it considers to be an area of risk for material errors, even when management might not think so. See also functional independence.

Internal Audit

The Institute of Internal Auditors definition is:

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

More concretely, it is the functional means by which the managers of an entity receive an assurance from internal sources (including internally subcontracted sources) that the internal controls are achieving their internal control objectives. It will cover, inter alia, Financial Audits, System Based Audits, Performance Audits, IT-Audits It has most of the characteristics of external audit except that it finally reports to the management and therefore can never have the same level of independence as external audit. In public finance a distinction is made between centralised internal audit and decentralised internal audit as follows:

Centralised internal audit (CIA)

CIA is public ex post internal audit performed by a centralised body (e.g. the Ministry of Finance or another Internal Audit body (like the Government Control Office in Hungary or the Internal Audit Board in Malta)) on systems.

Decentralised internal audit (DIA)	DIA is the internal audit performed by specialised Internal Audit Units located inside government or lower public budget implementation spending centres (Ministries or Agencies).
Internal Auditor (IA)	The Internal Auditor (IA) (whether located outside or inside the organisation of the Managing Director) is responsible for carrying out all relevant kinds of ex post internal audit. In public finance terms, Internal Auditors should be subject to a special "statute" (preferably written in the Internal Audit Law governing the PIFC-system in a given country) allowing them an adequate degree of functional independence. The IA can report to the MD or be assigned by a central Public Internal Audit Service, like the Ministry of Finance or an Internal Audit Board responsible to the Prime Minister of the Cabinet of Ministers
Internal Control	The whole system of financial and other controls, including the organisational structure, methods, procedures and internal audit, established by management within its corporate goals, to assist in conducting the business of the audited entity in a regular, economic, efficient and effective manner. Internal control relates to the following categories: Control environment; Risk assessment; Information and Communication; Control activities, and Monitoring of controls.
Internal Control Objective	The primary objectives of internal control are to ensure: • The reliability and integrity of information. • Compliance with policies, plans, procedures, laws, and regulations. • The safeguarding of assets. • The economical, efficient and effective use of resources. Each organisation should design its own system of internal control to meet the needs and environment of the organisation.
International Organisation of Supreme Audit Institutions (INTOSAI)	An international and independent body which aims at promoting the exchange of ideas and experience between Supreme Audit Institutions in the sphere of public financial control.

IT systems audits	These examine the sufficiency and adequacy of the protection of the security of the systems of IT applications in order to guarantee the confidentiality, integrity and availability of information and IT systems
Managerial Accountability	Represents the obligation to be accountable for a given task. Accountability covers issues like separation of duties (authorising officer, accountant, ex ante financial controller); development of Financial Management and Control manuals (powers, responsibilities, reporting and risk management), all financial transactions (commitments, contracts, disbursements, recovery of unduly paid amounts), links with the central harmonisation facilities, and evaluation and reporting on FC systems.
Management control	Control by management: the same as internal control, including financial control.
Management Information System (MIS)	Centralised data base collecting and processing information to be timely and accurately given to managers at all levels for decision making, planning, programme implementation and control.
Managing Director (MD)	The Managing Director (MD) can be a Minister or his delegates, responsible for the implementation of Programmes/projects relating to national or lower budget income or expenditure. The MD is responsible for setting up financial management and control systems inside his organisation and the development of financial management and control manuals. The MD and the Accountant should create a double signature system (DSS) to provide for the highest degree of transparency in financial management.
Materiality and Significance (Material)	In general terms, a matter may be judged material if knowledge of it would be likely to influence the user of the financial statements or the performance audit report. Materiality is often considered in terms of value but the inherent nature or characteristics of an item or group of items may also render a matter material - for example where the law or some other regulation requires it to be disclosed separately regardless of the amount involved. In addition to materiality by value and by nature, a matter may be material because of the context in which it occurs. Audit evidence plays an important part in the auditor's decision concerning the selection of issues and areas for audit and the nature, timing and extent of audit tests and procedures.

Mission Statement   See Charter (Internal audit Charter)

Monitoring by the Internal Audit   The internal auditor establishes and maintains a system to monitor the follow-up by management of the audit recommendations communicated to management. This system may include periodic internal and external quality assessments and ongoing internal monitoring by management. The internal auditor should also develop and maintain a quality assurance and improvement programme that covers all aspects of internal audit activity and continuously monitors its effectiveness.

Opinion   This is the auditor's written conclusions on a set of financial statements as the result of a financial or regularity audit.

Organic Budget Law   A law specifying the schedule and procedures by which the budget should be prepared, approved, executed, accounted for and final accounts submitted for approval. Objectives of the organic budget law are:

- Creating a legal framework regulating the budget process

- Adjusting budget procedures legal, cultural and political conditions of the country

- Strengthening the transparency of budget information

- Clearly indicating division of responsibilities

Outcomes   The effects of a programme or project measured at the highest meaningful level in proportion to the programme or project (e.g. jobs created). In practice there are always at least some external non-controllable elements, which influence whether outcomes are achieved or not.

Outputs   The directly tangible deliverables of a programme or project insofar as they are, for practical purposes, completely under the control of the implementers of the project (e.g. training seminar executed).

Passer-outre   PO is the procedure whereby the opinion of the ex ante financial controller (refusal to approve) can be overridden by the body that is ultimately responsible for the management of government budget implementation (e.g. Council of Ministers). A reasoned and extensive request by the MD should be the basis for such a decision, while the MD remains responsible for his acts.

Performance Audit	An audit of the economy, efficiency and effectiveness with which the audited entity uses its resources in carrying out its responsibilities. In practice there can be difficulty distinguishing Performance Audit from Evaluation. Sometimes Performance Audits are limited to consideration of outputs but this considerably limits the value of the audit. Also, evaluation may create data, particularly on outcomes, whilst Performance Audit would usually be limited to a review of data which was available (and if necessary identification of missing data). Performance Audit is usually concerned with testing performance against some given standards.
Planning	Defining the objectives, setting policies and determining the nature, scope, extent and timing of the procedures and tests needed to achieve the objectives.
Postulates	Basic assumptions, consistent premises, logical principles and requirements which represent the general framework for developing auditing standards.
Public Accountability	The obligations of persons or entities, including public enterprises and corporations, entrusted with public resources to be answerable for the fiscal, managerial and programme responsibilities that have been conferred on the manager, and to report to those that have conferred these responsibilities.
Public Internal Financial Control (PIFC)	PIFC is the overall financial control system performed internally by a Government or by its delegated organisations, aiming to ensure that the financial management and control of its national budget spending centres (including foreign funds) complies with the relevant legislation, budget descriptions, and the principles of sound financial management, transparency, efficiency, effectiveness and economy. PIFC comprises all measures to control all government income, expenditure, assets and liabilities. It represents the wide sense of internal control. It includes but is not limited to ex ante financial control (EAFC) and ex post internal audit (EPIA)
Reasonable Assurance	Internal control, no matter how well designed and operated, can provide only reasonable assurance to management regarding the achievement of an entity's objectives. The likelihood of achievement is affected by limitations inherent in all internal control systems. These limitations may include faulty decision-making with respect to the establishment or design of controls, the need to consider costs as well as benefits, management override, the defeat of controls through collusion and simple errors or mistakes. Additionally, controls can be circumvented by collusion of two or more people. Finally, management may be able to override elements of the internal control system.

Reasonable assurance is provided when cost-effective actions are taken to restrict deviations to a tolerable level. This implies, for example, that material errors and improper or illegal acts will be prevented or detected and corrected within a timely period by employees in the normal course of performing their assigned duties. Management, during the design of systems should consider the cost-benefit relationship. The potential loss associated with any risk is weighed against the cost to control it.

Regularity Audit   Attestation of financial accountability of accountable entities, involving examination and evaluation of financial records and expression of opinions on financial statements; attestation of financial accountability of the government administration as a whole; audit of financial systems and transactions, including an evaluation of compliance with applicable statutes and regulations; audit of internal control and internal audit functions; audit of the probity and propriety of administrative decisions taken within the audited entity; and reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed. This is normally not applicable to Internal Audit Services.

Report   The auditor's written opinion and other remarks on a set of financial statements as the result of a financial or regularity audit or the auditor's findings on completion of a performance audit.

Reporting Standards   The framework for the auditor to report the results of the audit, including guidance on the form and content of the auditor's report.

Results   The same as outcomes or impacts.

Risk   An event which can result in an undesirable or negative outcome. It is characterised by the probability or likelihood of the event occurring and the resulting impact or consequence if it does occur. These two factors combine to result in a level of risk exposure.

Risk Assessment   Auditor's tool to help identify audit projects offering the highest added value to the organisation. Risk assessment is the identification of all local financial management and control (FMC) systems and of their associated risks according to a number of risk factors (IIA).

The risk assessment approach has to be used at, at least two levels:

- for the establishment of the annual audit programme - selecting projects of highest expected return; and

- in the planning phases of the individual audit itself.

Risk factors are: assessment of volume, sensitivity and materiality of data, the control environment, confidence in management, complexity of activities and Information Systems, geographical diversity, and prior audit knowledge.

Risk Management (RM)	The overall process of identifying, assessing and monitoring risks and implementing the necessary controls in order to keep the risk exposure to an acceptable level. Best practice suggests that it should be an embedded part of the management process rather than something, which is added at a later stage.
	RM acts as an awareness raising exercise and as a forum for sharing views at all levels in organisations; it informs and trains management and staff and increases the likelihood for success in the achievement of the objectives.
	Management creates the conditions and establishes tools necessary to evaluate, prioritise and decide before carrying out an activity, to allow it to obtain a reasonable assurance of achieving the objectives with reasonable value for money. The internal control system ensures that management protects itself from unacceptable risks.
	Processes need to be developed to identify these risks and conceive and implement a system to control the most significant risks. A success factor for implementing the risk management system throughout the organisation is the management's general interest in the exercise. RM should be put on the agenda for the development of its own system for assessing the risks to which the organisation is subject.
Significant Control Weakness	Significant is the level of importance or magnitude assigned to an item, event, information, or problem by the internal auditor. Significant audit findings are those conditions that, in the judgement of the director of internal auditing, could adversely affect the organisation. Significant audit findings (as well as weaknesses cited from other sources) may include conditions dealing with irregularities, illegal acts, fraud, errors, inefficiency, waste, ineffectiveness, conflicts of interest, and control weaknesses.

Supervision	An essential requirement in auditing which entails proper leadership, direction and control at all stages to ensure a competent, effective link between the activities, procedures and tests that are carried out and the aims to be achieved.
Supreme Audit Institution (SAI)	The public body of a State which, however designated, constituted or organised, exercises by virtue of law, the highest public auditing function of that State.
Systems based Audit	Systems based audit refers to an in-depth evaluation of the internal control system with the objective to assess the extent to which the controls are functioning effectively. It is designed to assess the accuracy and completeness of financial statements, the legality and regularity of underlying transactions and the economy, efficiency and effectiveness of operations.
	A systems based audit should be followed-up through substantive testing of a number of transactions, account balances, etc. to determine whether the financial statements of the auditee are accurate and complete, if the underlying transactions are legal and regular and/or the criteria for economy, efficiency and effectiveness have been achieved.
Tone at the top	See ethics. Management should promote ethical values throughout the entity they manage, especially by giving/leading by good example.

ANNEX 3 – USING INTOSAI GUIDELINES FOR INTERNAL CONTROL STANDARDS FOR THE PUBLIC SECTOR

The 1992 INTOSAI guidelines for internal control standards were updated in 2004 in order to take account of recent and relevant evolutions in the field. This annex presents a synthesis – produced by DG Budget – of the revised guidelines. The full text of the revised guidelines can be found at www.intosai.org

1. THE MAIN FACTORS THAT INFLUENCED THE REVISED GUIDELINES

- The COSO model has been incorporated into the guidelines in order to update the concept of internal control and to contribute to a common understanding of internal control among SAIs.

- The ethical aspect of operations (impartial treatment for all citizens on the basis of legality and justice and the expectation that public servants should serve the public interest with fairness and manage public resources properly) has been added, as this is regarded as a pre-requisite to public trust and good governance in general.

- Since resources in the public sector generally embody public money and their use in the public interest generally requires special care, the significance of safeguarding resources needed to be stressed. This is particularly the case given that the process of cash based accounting is still widespread and has shown defects related to the ability to maintain up-to-date records of assets.

- Given the extensive use of information systems in all public organisations, information technology controls have become increasingly important. IT controls should apply to each component of an entity's internal control process, including the control environment, risk assessment, control activities, information and communication, and monitoring.

- The revised guidelines also stress the importance of non-financial information (as internal control is not limited to the traditional view of financial and related administrative control but also includes the broader concept of management control).

2. ADDED VALUE OF THE REVISED GUIDELINES

Since evaluating internal control is a generally accepted field standard in government auditing,[9] auditors can use the revised guidelines as an audit tool. The revised guidelines

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[9] INTOSAI Auditing Standards

can therefore be used both by government management[10] as an example of a solid internal control framework for their organisation and by auditors as a tool to assess internal control.

3. WHAT IS INTERNAL CONTROL?

Internal control is defined as an integral process that is effected by an entity's management and personnel and is designed to address risks and to provide reasonable assurance that in pursuit of the entity's mission, the following general objectives are achieved:

- Executing orderly (methodical), ethical (moral and impartial treatment), economical (right amount of resources and of right quality, delivered at the lowest cost), efficient (minimum input to achieve a given quantity and quality of output) and effective (extent to which outcomes of activity match the objective of that activity) operations.

- Fulfilling accountability obligations: Accountability is the process whereby public service organisations and individuals within them are held responsible for their decisions and actions and all aspects of performance. This will be realised by developing, maintaining and making available reliable and relevant financial and non-financial information, in a fair and timely way.

- Complying with applicable laws and regulations.

- Safeguarding resources against loss, misuse and damage.

3.1. The characteristics of Internal Control

- Internal control is a dynamic integral process and should adapt to changing conditions and risks.

- Internal control should be built in rather than built on. It should be integrated into, and seen as, part of the basic management processes of planning, executing and monitoring.

- The implementation of internal control is effected by people. People must know their roles, responsibilities and limits of authority. Management plays a key role here in that it must exercise significant initiative and communication in order to establish the control environment, communicate this and provide clear limits of authority.

- One task of management is to identify and respond to risks that may affect the likelihood of achieving the organisation's mission. Internal control can help to identify and address these risks.

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[10] Operative personnel are not specifically mentioned as a target group. Although they are affected by internal control and take actions that play an important role in effecting control, they, unlike management, are not ultimately responsible for all activities of an organisation, related to the internal control system.

- Internal control provides reasonable assurance. Reasonable assurance equates to a satisfactory level of confidence under given considerations of costs, benefits and risks. Determining how much assurance is reasonable requires judgement. In exercising that judgement, managers should identify the risks inherent in their operations and the acceptable levels of risk under varying circumstances, and assess risk both quantitatively and qualitatively.

- There are factors outside the control of the organisation that can affect its ability to achieve its objectives. In addition, there are limitations in terms of faulty decisions, management overriding the internal control system etc.

- Reasonable assurance recognises that the cost of internal control should not exceed the benefit derived. Designing internal controls that are cost beneficial while reducing risk to an acceptable level requires that managers clearly understand the overall objectives to be achieved.

3.2. Limitations of Internal Control Effectiveness

Internal control cannot by itself ensure the achievement of the general objectives above. An effective system of internal control reduces the probability of not achieving the objectives, however there is always the risk that the internal control system may fail to operate because for example:

- It depends on the human factor – and is therefore subject to flaws in design, errors of judgement, collusion, override etc.

- Its design faces resource constraints. Maintaining an internal control system that eliminates the risk of loss is not realistic, therefore the benefits of controls must be considered in relation to their costs and the likelihood and potential effects on the entity of the risk occurring.

- Organisational changes and management attitude can have a profound impact on the effectiveness of internal control. Thus, management needs to continually review and update controls, communicate changes to personnel and set an example by adhering to those controls.

4. INTERNAL CONTROL COMPONENTS

Internal control consists of five interrelated components, control environment, risk assessment, control activities, information and communication, and monitoring. These components define a recommended approach for internal control in government and provide a basis against which internal control can be evaluated. These components apply to all aspects of an organisation's operation.

While the internal control framework is relevant and applicable to all organisations, the manner in which management applies it will vary widely with the nature of the entity and depends on a number of entity-specific factors including organisational structure, risk profile, operating environment, size, complexity, activities and degree of regulation. As it considers the entity's specific situation, management will make a series of choices

regarding the complexity of processes and methodologies deployed to apply the internal control framework components.

4.1.   Control Environment

The control environment sets the tone of an organisation. It is the foundation for all other components of internal control, providing discipline and structure. It has the following elements:

- the personal and professional integrity as well as ethical values of management and staff (application of code of conduct and supportive attitude towards internal control at all times).

- commitment to competence (managers and staff maintain and demonstrate a level of skill necessary to assess risks and help ensure efficient and effective performance, and understand internal control objectives sufficiently).

- the 'tone at the top' (a supportive attitude by management towards internal control is required. Also there should be a code of conduct set by management as well as counselling and performance appraisals that support the internal control objectives).

- organisational structure (the appropriate assignment of authority and responsibility, empowerment and accountability, including appropriate lines of reporting and an internal audit unit, that should be independent from management, reporting directly to the highest level of authority).

- human resource policies and practices (to ensure professional and transparent policies of recruitment, training, evaluation, promotion and compensation and remedial actions).

4.2.   Risk Assessment

Risk assessment involves identifying and analysing risks that may be relevant to the achievement of the entity's objectives and determining the appropriate risk response.

- Risk identification. The identification of key risks is important in terms of the resources and responsibilities allocated for the management of these risks. Risk identification is a comprehensive and ongoing activity that is performed by means of two main tools, risk review (top-down procedure performed by a team to identify the associated risks) and risk self-assessment (bottom-up procedure performed by each department of the entity to self-identify relevant risks).

- Risk evaluation. This is an assessment of the significance and likelihood of risks occurring. Systematic rating criteria could help mitigate the subjectivity of the risk evaluation process. Risks can be ranked in order, so that appropriate management priorities and decisions can be taken.

- Assessment of the 'risk appetite' of the organisation. This is the amount of risk to which the entity is prepared to be exposed before any action is taken. Both inherent risks (risks present before any management action is taken to deal with it) and residual

risks (risks that remain after management responds to them) should be considered to determine risk appetite.

- Development of responses. All these actions lead to a risk profile. Risks are then transferred (done by conventional insurance, contract stipulations, or by paying a third party to take the risk), tolerated (in case the cost of action is disproportionate to the potential benefits), or terminated (the risks could be terminated by terminating the relevant activity). However, in most instances, the risk will have to be treated and the entity will need to implement and maintain an effective internal control system to keep risk at an acceptable level. The purpose of treatment is not necessarily to obviate the risk, but more likely to contain it. Risk profiles and controls have to be regularly reviewed in order to ensure that they remain valid.

4.3. Control Activities

Control Activities are the policies and procedures established to address risks and to achieve an entity's objectives. They include a range of detective and preventive control activities including:

- Authorisation and approval procedures. Authorisation and approval procedures should be documented and clearly communicated to managers and staff.

- Segregation of duties. Duties and responsibilities should be assigned systematically to a number of individuals to ensure that effective checks and balances exist. Key duties include authorising and recording transactions, processing, and reviewing/auditing transactions.

- Controls over access to resources and records. Access to resources and records should be limited to authorised individuals who are accountable for the custody/use of such.

- Verifications. Transactions and events are to be verified before and after processing.

- Reconciliations. Records are to be regularly reconciled with relevant documents.

- Reviews of operating performance. Performance is to be reviewed against a set of standards assessing efficiency and effectiveness and if necessary, decisions taken for corrective action.

- Reviews of operations, processes and activities. Operations, processes and activities are to be reviewed periodically to ensure that they comply with current regulations, policies, procedures and other requirements.

- Supervision (assigning, reviewing, approving, guidance, training). This entails clearly communicating the duties, responsibilities and accountabilities assigned to each staff member, systematically reviewing each member's work and approving work at critical points. Note that the delegation of a supervisor's work does not diminish his/her accountability for the responsibilities and duties.

- IT control activities. There are two main types of IT control activities – i.e. general controls and application controls. General controls include entity-wide security programmes, access controls, controls on the application software, system software

controls, segregation of duties and service continuity. Application controls apply to separate individual application systems (accounts payable, inventory etc) and are performed in three phases - input, processing and output. General and application controls over computer systems are interrelated and needed in order to help ensure complete and accurate information processing.

4.4. Information and Communication

Information and communication are essential to realising all internal control objectives.

- Information. The prompt recording and proper classification of transactions and events are preconditions for reliable and relevant information. Information systems produce reports that contain operational, financial, non-financial and compliance related information. The quality of information is important in the sense that management decision-making is affected by the information. Therefore, information needs to be appropriate, accurate, timely, current and accessible.

- Communication. Effective communication should flow down, across and upwards in the organisation. One of the most critical communication channels is that between management and staff. Management must be kept up-to-date on performance, developments, risks and the functioning of internal control. Equally, management should communicate to its staff what information it needs and provide feedback and direction. There also needs to be effective communication with external parties.

4.5. Monitoring

Internal control systems should be monitored to assess the quality of system performance over time. Monitoring is accomplished through ongoing monitoring, separate evaluations, or a combination of both. Monitoring internal control activities themselves should be clearly distinguished from reviewing an organisation's operations.

Apart from information channels created in the normal course of operations, alternative communication channels should also exist for reporting sensitive information such as illegal or improper acts. Monitoring should also include policies and procedures to ensure that the findings of audits and reviews are adequately and promptly resolved.

- Ongoing monitoring. This should be built into the normal recurring operating activities of an entity. It includes regular management and supervisory activities, covering each of the internal control components and involves actions against irregular, unethical, uneconomical, inefficient and ineffective internal control systems. It is often more effective than separate evaluations.

- Separate evaluations. The scope and frequency of separate evaluations depend on the assessment of risks and the effectiveness of ongoing monitoring. Separate evaluations could be useful in assessing the effectiveness of a specific control at a specific time. Separate evaluations may also be performed by the SAIs, by external or internal auditors.

5. ROLES AND RESPONSIBILITIES IN THE ORGANISATION

Everyone in an organisation has some responsibility for internal control:

- Managers are directly responsible for all activities of an organisation, including designing, implementing, supervising the proper functioning of, and maintaining and documenting the internal control system. Their responsibilities vary depending on their function in the organisation and the organisation's characteristics.

- Internal auditors examine and contribute to the ongoing effectiveness of the internal control system through their evaluations and recommendations and therefore play a significant role in effective internal control. However they do not have management's primary responsibility for designing, implementing, maintaining and documenting internal control.

- Staff members contribute to internal control as well. Internal control is an explicit or implicit part of everyone's duties. All staff members play a role in effecting control and should be responsible for reporting problems of operations, non-compliance with the code of conduct, or violations of policy.

External parties also play an important role in the internal control process. They may contribute to achieving the organisation's objectives, or may provide information useful to effect internal control. However, they are not responsible for the design, implementation, proper functioning, maintenance or documentation of the organisation's internal control system.

- Supreme Audit Institutions (SAIs) encourage and support the establishment of effective internal control in the government. The assessment of internal control is essential to the SAI's compliance, financial and performance audits. They communicate their findings and recommendations to interested stakeholders.

- External auditors audit certain government organisations in some countries. They and their professional bodies should provide advice and recommendations on internal control.

- Legislators and regulators establish rules and directives regarding internal control. They should contribute to a common understanding of internal control.

- Other parties interact with the organisation (beneficiaries, suppliers, etc.) and may provide useful information regarding the achievement of its objectives.

Example - Fulfilling accountability obligations (1)

A department that is responsible for the management of safe transport by water and sea has been organised by different service departments responsible for piloting, buoyage, inspection of the quality of the water, promotion of the use of waterways, investments in and maintenance of infrastructure (bridges, dikes, canals and locks).

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
For each of the service departments an operational manager is appointed who has to report to the general manager of the department. The operational managers have the appropriate skills and have the authority to make certain decisions. All of them also sign a code of proper conduct.	Possible risks are collisions of ships, draining off toxic waste or fuel, and bursting of dikes. If mishaps are related to negligence of the government department, it could face a huge liability.	Control activities that can be organised are the pilotage of ships by competent pilots, placing buoys, beacons and markers; visual inspection by air, and taking water samples.	The information and communication related to this situation can be the reporting of collisions to warn other ships; informing ships of weather conditions, and publishing the names of polluters and the sanctions they are facing, and the remedial actions undertaken.	A follow-up of the number of collisions, environmental violations, results of the samples and a comparison with other countries and with historical data, can help to monitor the effectiveness and efficiency of the pilotage of ships, the placing of the beacons and markers, the inspections, and the water samples.

Example - Fulfilling accountability obligations (2)

The manager of the department of sports stipulated last year the objective that the practice of sports would increase by 15% in the coming years.

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
Because of the manager's good reputation, the executive committee trusted the manager and did not carry out the usual status meetings to check on the manager's progress.	By not specifying the objectives, the risk arises of not achieving them. Also the danger exists that reporting will not be timely as the manager wants to wait with this report until he can say he realised the objective of 15% growth. Moreover how to measure the 15% growth was not revealed so he can say the number of people doing sports has increased or the number of hours people do sports, or even the number of sports centres or sports clubs has increased by 15%. This way the quality of the reported information decreases substantially.	This risk can be decreased by installing appropriate lines of reporting and a reporting model which defines the information that should be given.	This report should be delivered in time and according to the specified reporting model. It should specify the growth objectives, how they are measured and why they are measured this way. All the back-up information should be available.	The verification of whether or not the report is satisfactory and what information is given and what information is still missing can be a form of monitoring.
(The abovementioned situation is not an example of good practice!)				

Example - Compliance with applicable laws and regulations example

The ministry of defence wants to buy new fighter planes via a public contract and publishes all stipulations and procedures for this government tender. All tenders received are left unopened until the end of the tender period. At that moment all tenders are opened in the presence of the responsible managers and some officials. Only these tenders will be investigated and compared to decide which tender is the best.

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
The team that will execute this transaction is composed of competent people who signed a document that they have no financial or relational bond with any of the tenderers. The responsible managers and officials also signed this document.	One of the risks related to government tenders and public contract is insider dealing. One of the tenderers may have prior knowledge of the bids of the other tenderers and could make a winning tender with this information resulting in what may not be the best choice of all tenders. Another risk consists of choosing the wrong tender which may result in a new public contract because the other one did not meet the expectations. Also other tenderers who feel they were unfairly treated may make claims.	In order to mitigate risks, procedures should be developed and applied in accordance with all relevant laws and regulations concerning public contracts.	The procedures relating to the publication of all stipulations for this government tender, the assessment of the received tenders and the announcement of the selected tenderer, should be documented in writing and detail all actions to be taken. When assessing the tenders, all reasons why a tender was or was not chosen should be documented.	Internal audit can do file-reviews and follow-up on claims.

Example - Orderly, ethical, economical, efficient and effective operations example (1)

The department of culture wants to increase museum visits by the public. In order to accomplish this, it proposes to build new museums, give every citizen a cultural cheque and decrease ticket prices. To be economical, effective and efficient, management has to consider and evaluate whether or not the objectives as formulated can be achieved by its proposals and how much each of these proposals will cost.

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
The department of culture needs to make sure that its organisation structure is suited to support overseeing design and construction of the proposed additions, as well as planning and operations of the new museums.	The fact that the number of museum visits does not increase is one of the possible risks. Also the risk that some of the proposals will backfire and exceed their budget is possible. For instance, if decreasing ticket prices does not increase museum visits, this decreases the government receipts. Further, building new museums without proper planning and consideration of requirements of lighting, temperature and security can result in expensive adjustments during or after construction.	The control activities related to the before mentioned risks can be a budgetary control that compares actual to budget, observations of the progress of the construction, and demanding justifications for overspending the budget.	The information and communication related to this example can consist of the documentation of meetings with architects, fire department (for safety regulations), artists and others. It can also contain different reports concerning following up on the budget and the progress of the construction work.	The analysis of the justifications for exceeding budget and related interest costs due to delayed work or payments are a part of monitoring.

Example - Orderly, ethical, economical, efficient and effective operations example (2)

The government wants to develop agriculture and increase the quality of life in the countryside. They provide funds to subsidise the construction of irrigation and the drilling of wells.

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
The government must ensure that it has the appropriate department in place to implement and conduct the subsidy operation, and create the appropriate tone for the timely and efficient completion of this project.	The risks involved are that unscrupulous associations qualify for a grant but do not use the money for what it was intended.	Control activities can be: • Checking the qualifications of the associations applying for a grant. • Checking on site the progress of and reviewing progress reports on the construction works. • Checking the expenditures of the associations by reviewing their invoices, and delaying payment of (or part of) the subsidy until this review is completed.	• Progress reports detailing the costs and the number of wells that were drilled and the number of acres that were irrigated. • (Copies of) invoices are requested as justifications for the subsidised expenses.	Monitoring can consist of a follow-up of the drilling of wells and the construction of irrigation, and a comparison with other similar projects. Also a follow-up on the proceeds of the irrigated land can be considered.

Example - Safeguarding resources example (1)

The ministry of defence has some warehouses, military stores and fuel depots. The army command has the policy that these supplies are only for professional military use and not for personal use.

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
Good human capital policies would be effective in recruiting and maintaining the appropriate personnel to staff and operate such warehouses.	The risk exists that people will want to try to steal weapons to use them inappropriately or sell them. Also other supplies like fuel can be vulnerable to theft.	Control activities that deal with these risks can be putting fences and walls around the warehouses and depots, or placing armed guards with dogs at the entrances. Regularly checking the stock records and a procedure which states that supplies can only be given with approval of a superior officer will also help to safeguard the assets.	Reports of damaged fences and differences noticed during stock takes. Supply approvals and procedures also provide information and communication related to this objective.	Monitoring can be an inspection of the fence, unannounced stock takes, follow-up of stock movements or even a secret test of security.

Example - Safeguarding resources example (2)

Large amounts of sensitive information are stored on computer media in an agency of the ministry of justice. However the importance of IT controls is neglected and consequently the IT control has numerous deficiencies.

Control Environment	Risk Assessment	Control Activities	Information & Communication	Monitoring
Management must dedicate its commitment to competence and proper behaviour involving IT, and provide proper training in this area. Human capital policies also play a key role in establishing a positive control environment for IT issues.	At the general controls level, the agency has not: • limited user access to only that needed by users to perform their duties; • developed adequate system software controls to protect programs and sensitive data; • documented software changes; • segregated incompatible duties; • addressed service continuity; • protected its network from unauthorized traffic. At the application controls level, the agency has not maintained access authorizations. (This is not an example of good practice!)	The agency can : • implement logical (e.g. passwords) and physical access controls (e.g. locks, ID badges, alarms). • deny the ability to log in to the operating system for application users. • limit access to the production environment for the application development staff. • use audit logs to register all access (attempts) and commands to detect security violations. • have a contingency and disaster recovery plan to ensure the availability of critical resources and facilitate the continuity of operations. • have firewalls and monitor the web server activity to secure the network traffic.	Procedures on IT control should be available and software changes should be documented before the software is placed in operation. Policies and job descriptions supporting the principles of segregation of duties should be developed. Audit logs on access (attempts) and (unauthorized) commands should be periodically reported and reviewed.	Performing an IT audit, doing a disaster simulation exercise, and monitoring the web server activity, can be part of monitoring the IT environment

For more information on the EU budget and financial programming:

EU budget:
http://ec.europa.eu/budget/index.htm
(available in English, French and German)

European Commission Directorate-General for Budget:
http://ec.europa.eu/dgs/budget/index.htm
(available in all 20 official languages of the European Union)

Dalia Grybauskaitė, Commissionner for Budget and Financial Programming:
http://ec.europa.eu/commission_barroso/grybauskaite/index.htm
(available in English and Lithuanian)