



**REPUBLIC OF CROATIA**  
Government of the Republic of Croatia  
Ministry of Finance

**Development Strategy**  
**of**  
**PUBLIC INTERNAL FINANCIAL CONTROL**  
**in the Republic of Croatia**

Zagreb, April 2005.

Prepared in cooperation with CARDS 2002 project "Development of PIFC and Internal Audit"

---

**TABLE OF CONTENT**

<i>Foreword</i> .....	5
<b>1. Summary</b> .....	6
<b>2. Definition of Public Internal Financial Control</b> .....	9
<b>2.1. Managerial accountability for the collection and spending of public funds, including the responsibility for establishing and maintaining effective Financial Management and Control (FMC) systems</b> .....	9
<b>2.2. A functionally independent Internal Audit, capable of performing systems-based and performance internal audit</b> .....	10
<b>2.3. Central harmonisation and co-ordination for Financial Management and Control as well as for Internal Audit</b> .....	10
2.3.1. Coordination and harmonisation of methodology and standards .....	10
2.3.2. Coordination and harmonisation of professional training and certification of Public Internal Auditors.....	11
2.3.3. Guaranty of the independence of the overall Internal Audit function .....	11
2.3.4. Coordination and harmonisation role in terms of FMC .....	12
2.3.5. Segregation of duties within the Central Harmonisation Unit.....	12
<b>2.4. An adequate structure aimed at taking actions against irregularities</b> .....	12
<b>3. Existing structures encompassed in the scope of PIFC in the Croatian State Administration Bodies</b> .....	13
<b>3.1. Institutional and Legal Framework</b> .....	13
3.1.1. Institutions.....	13
3.1.2. Legal framework and activities to date in the development of the PIFC system .....	19
3.1.3. Funds for the Preparation of Republic of Croatia's Accession to the European Union (NATIONAL FUNDS, PHARE, ISPA AND SAPARD PROGRAMMES).....	20
<b>4. Development of adequate PIFC in the Republic of Croatia</b> .....	23
<b>4.1. General principles</b> .....	23
<b>4.2. Internal Audit</b> .....	23
4.2.1. Existing situation and weaknesses .....	23
4.2.2. Development of Internal Audit .....	24
4.2.3. Training of Internal Auditors .....	25
<b>4.3. Establishment of financial management and control</b> .....	27
4.3.1. Ex ante control.....	28
4.3.2. Ex-post controls .....	31
<b>4.4. Development of Central Harmonisation Unit</b> .....	33

<b>4.5.</b>	<b>Establishing PIFC in local and regional self-government units .....</b>	<b>34</b>
<b>4.6.</b>	<b>Taking actions against significant irregularities and fraud.....</b>	<b>35</b>
<b>4.7.</b>	<b>Internal Audit Council .....</b>	<b>35</b>
<b>5.</b>	<b><i>Conclusion.....</i></b>	<b>36</b>
<b>6.</b>	<b><i>Proposed timeframe of next activities in the PIFC development.....</i></b>	<b>37</b>
	<b><i>Appendix 1. Legislation from the PIFC field.....</i></b>	<b>39</b>
	<b><i>Appendix 2. Ministry of Finance organization scheme.....</i></b>	<b>40</b>

## LIST OF ABBREVIATIONS

<b>CARDS</b>	Community Assistance for Reconstruction, Development and Stabilisation
<b>CFCU</b>	Central Finance and Contracting Unit
<b>CHU</b>	Central Harmonisation Unit
<b>COSO</b>	Committee of Sponsoring Organisations of the Treadway Commission
<b>EC</b>	European Commission
<b>EU</b>	European Union
<b>FMC</b>	Financial Management and Control
<b>GOIC</b>	Government Office for Internal Control
<b>GOIA</b>	Government Office for Internal Audit
<b>IA</b>	Internal Audit
<b>IIA</b>	Institute of Internal Auditors
<b>ISPA</b>	Instrument for Structural Policies Pre-Accession
<b>LRSKU</b>	Local and Regional Self-Government Units
<b>OLAF</b>	Organisation de Lutte Anti Fraude (Organisation for Fight Against Fraud)
<b>MoF</b>	Ministry of Finance
<b>NAO</b>	National Authorising Officer
<b>PHARE</b>	Programme of Community Aid to the Countries of Central and Eastern Europe
<b>PIFC</b>	Public Internal Financial Control
<b>SAB</b>	State Administration Bodies
<b>SAO</b>	State Audit Office
<b>SAPARD</b>	Special Accession Programme for Agriculture and Rural Development
<b>SIGMA</b>	Support for Improvement in Governance and Management
<b>USAID</b>	United States Agency for International Development

## Foreword

The Government of the Republic of Croatia has passed the document titled „Development Strategy of Public Internal Financial Control (PIFC) in the Republic of Croatia“ in its session held on 2 September 2004. Given the last changes regarding the field of PIFC and experience gained so far, It was agreed with the European Commission (DG-Budget) to update and improve the above mentioned document.

This second version of the Development Strategy of Public Internal Financial Control (PIFC) in the Republic of Croatia“ is the result of work in collaboration between the experts of CARDS 2002 Project and the staff of the Central Harmonisation Unit whereas the advisory body for the same purpose was consisted of representatives and internal auditors from the Ministry of Agriculture, Forestry and Water Management, the Ministry of Health and Social Welfare, the Republic of Croatia's Government Office for Internal Control and the State Audit Office. The decision on the appointment of the working group for the preparation of amendments to the Strategy was made by the Minister of Finance, within whose Ministry the Central Harmonisation Unit operates.

The purpose of the PIFC Strategic Paper is to present the key elements concerning the present state of affairs and the development strategy for establishment and the development of an all comprehensive and efficient public internal financial control in the Republic of Croatia. The significance of this document development was pointed out in Republic of Croatia's Government responses to the questionnaire provided by the European Commission (chapter 28)

PIFC will be continuously developing, and the Government of the Republic of Croatia will accordingly upgrade the existing document at the proposal of the Central Harmonisation Unit.

The PIFC Development Strategy, which is equal for both the national and EU funds, is of great importance for the process of Republic of Croatia's integration into the European Union.

The PIFC principles described in this document will be incorporated into the new Framework Law on PIFC as well as into the secondary implementation regulations. Chapter 2 of this Strategic Paper describes what type of PIFC system should be established in the Republic of Croatia, and chapter 3 describes the current status in the field coupled with the overall control environment and the existing legal framework providing for this subject matter. Chapter 4 describes the existing situation and weaknesses, as well as the development of an appropriate PIFC in the Republic of Croatia with the reference to objectives to be achieved. Chapter 5 presents final considerations, whereas chapter 6 refers to a proposed timescale of next activities concerning the PIFC development, pertaining to the achievement of objectives of this development stage.

## 1. Summary

Public Internal Financial Control (hereinafter PIFC) encompasses the part of principles of the “*Acquis Communautaire*” that the European Union has established as a coherent system of internal financial controls and sound management of public funds, irrespective of the sources of such funds.

The candidate countries, including also the Republic of Croatia, are recommended to adhere to the said principles and to adapt or develop their respective legal regulations for implementing all measures and mechanisms required for the compliance with the above-mentioned principles and shared best practices.

The COMMISSION OF THE EUROPEAN COMMUNITIES published the “Opinion on Croatia's Application for Membership of the European Union” on 20 April 2004. The present PIFC Policy Paper is in line with the requirements expressed in the part of this Opinion document related to Chapter 28 – Financial Control quoted hereunder:

“[...] As regards **public internal financial control** (PIFC), Croatia has not yet set up a comprehensive control structure based on managerial accountability and functionally independent internal audit. The primary legislation defining the concept of Internal Audit is the Budget Act. Ex-ante control is performed through the implementation regulations of the State Treasury System (Single Treasury Account). The current situation is characterised by a certain compartmentalisation of responsibilities, weaknesses in communication and reporting, lack of obligatory ex-ante financial control inside income and spending centres and by the lack of harmonised legislation relating to control and audit competencies. The Directorate for Internal Audit and Control within the Ministry of Finance is responsible for the development and the harmonisation of PIFC concepts. The establishment of functionally independent and operational internal audit units will be the major administrative challenge in this field.[...]”

As regards **control over EU funds**, efficient mechanisms for monitoring, controlling and auditing EU-funds will need to be developed. A system to deal with securities, debts and recoveries has not yet been set up.

Croatia is also in an early stage of legislative and administrative preparations with regard to the **protection of the EC's financial interests**. The existing procedures and the division of competencies between the different bodies involved mainly cover criminal-law procedures for the treatment of cases of (suspected) fraud, and to a lesser extent other irregularities. No specific institution or body exists for the investigation and/or treatment of irregularities but several existing bodies have responsibilities in this respect. There will be a need to establish and implement properly effective procedures for the detection, treatment, as well as for the financial and administrative/judicial follow-up of irregularities, and to establish the necessary coordination methods to this end.

### **Conclusion**

Croatia needs to develop general policies and a coherent legislative framework in this field. Administrative capacities, including functionally independent internal audit units in State institutions, have to be established or reinforced and relevant staff trained. The State Audit Office has the legal and organisational basis to develop further into an appropriate external audit body but needs to be strengthened. In the area of control over EU funds, efficient mechanism for monitoring, controlling and auditing of EU funds will need to be developed. In addition, Croatia's administrative capacity to give effective and equivalent protection to the EC's financial interests will need to be ensured.

Provided Croatia makes further efforts to reorganise and strengthen its public internal financial control, external audit and anti-fraud capacities, it should be able to meet EU requirements in this field in the medium term.”

\*  
\* \*

In order for components of PIFC to become recognisable and sustainable in the state administration bodies in the Republic of Croatia, it is primarily necessary to complement the Croatian legal framework by a Framework law on PIFC which will provide a strong legal status to the implementation of PIFC in both the financial management and control and internal audit fields.

Although the obligation of establishing the internal audit units was stipulated by the Budget Law<sup>1</sup>, the regulatory orientation of FMC was not defined by this Law. Still, there are also other regulations (rulebooks, decrees and other) which define the course of establishing the financial controls.

In addition to the Framework Law on PIFC which is expected to be passed by the end of 2005, it is also necessary to make a series of other rulebooks, guidelines and clarifications, i.e. regulations which would better describe the role and importance of all elements encompassed in PIFC.

First of all, it is necessary to clarify the definitions, interrelations and necessary segregation for major elements of the PIFC system. Furthermore, management's awareness concerning the need for introducing PIFC and its functioning in the state administration bodies will have to be developed. Then Managers will be held accountable for their decisions and the use of public funds as it has to be in a modern public administration.

Moreover, it is necessary to further establish the functionally independent Internal Audit Units, i.e. internal audit divisions in the state administration bodies, which will be employing internal auditors, members of a new profession amongst civil servants. It is planned to dispose of a hundred of properly trained Public Internal Auditors by the end of 2005. 80 internal auditors (out of which 20 are already trained by the training capacity handled within the CHU) are completing their education curricula in accordance with the training programme of CARDS 2002 project "Development of PIFC and Internal Audit" (hereinafter CARDS 2002 Project), and it is necessary to continue with trainings of future generations of internal auditors, i.e. to ensure sustainability of the training programme within the framework of the Central Harmonisation Unit, and in keeping with the existing training programme which will be upgraded and further developed as needed.

These efforts in terms of initial staffing and training will have to be completed by complementary appointments of Internal Auditors and adequately trained public servants involved in the Process of FMC. A new evaluation of the real needs in that respect will be carried out by the end of 2005 when a better awareness of PIFC functions will be disseminated amongst decision makers. The Central Harmonisation Unit will coordinate drafting of a staffing strategy which will present the overall needs in terms of recruitment, reallocation of human resources and training in the State Administration of the Republic of Croatia.

For strengthening the Functional Independence of the newly created profession of Public Internal Auditors in the Republic of Croatia, a Public Internal Auditor's charter in full compliance with

---

<sup>1</sup> Republic of Croatia's Official Gazette *Narodne novine* 96/03.

international standards as published by the International Institute of Internal Audit (IIA)<sup>2</sup> will be included in the second version of the Rulebook on Budget Users' Internal Audit which will be issued by the Minister of Finance by end-June 2005.

\*  
\* \*

In line with the aforesaid, it is necessary to enhance the qualification structure of the Central Harmonisation Unit by hiring quality professionals and to ensure the necessary financial means which will enable the development of methodology, coordination, training and harmonising the PIFC system in state administration bodies. The Central Harmonisation Unit must establish a proper reporting system towards the Republic of Croatia's Government, which will enable it to have an overview of the activities taken and those needed for the purpose of further development of the PIFC system.

\*  
\* \*

The current Policy Paper abrogates the document called „Development Strategy of Public Internal Financial Control (PIFC) in the Republic of Croatia“.

---

<sup>2</sup> IIA – <http://www.theiia.org>

## 2. Definition of Public Internal Financial Control

Based on the internationally accepted standards, the practice developed in the European Commission, Member States and the EU recommendations, the term “Public Internal Financial Control“ describes the overall, consolidated system established by the Ministries and State Administration Bodies (SAB) for controlling, auditing and reporting on the use of national budgetary and EU means.

### ***2.1. Managerial accountability for the collection and spending of public funds, including the responsibility for establishing and maintaining effective Financial Management and Control (FMC) systems***

The establishment and implementation of FMC systems, including the establishment of a set of rules aimed at achieving efficient, effective and economic use of available funds (including foreign funds), falls under the responsibility of the heads and officials of each institution (Ministries or SABs). The Head is in charge of functioning, efficiency and development of financial management and control system. The officials also assume the responsibility for financial management and control system supervision, development and financial accountability. The FMC system consists of:

a) **independent functions of ex ante<sup>3</sup> and ex post<sup>4</sup> financial control**

**Ex-ante financial control** is a set of control activities indispensable for making financial decisions referring to the use of budgetary means, commitments, public procurement procedures, contracts and related disbursements as well as refunds of the amounts paid without justification.

**Ex-post financial control** checks if the budgetary means were used in a legal, timely and purposeful manner.

b) **function of accountability and financial reporting**

c) **procedures for preparation, processing and storage of financial and other documents**

The principle of segregation of duties is obligatory for efficient functioning of the FMC system.

The system has to comply with relevant legislation, especially with the provisions contained in the Budget Law and the principles of sound financial management, i.e. the principles of transparency, efficiency, effectiveness and economy. The FMC system comprises all measures to control and manage overall government revenue/receipt, expense/expenditure, assets and commitments. It covers all internal control systems and procedures in the public sector. The Heads introduce ex-ante controls to ensure that public funds (including foreign funds) are spent in such manner so as to achieve the set goals.

The primary objectives of FMC are to ensure:

- successful accomplishment of ministries/SAB tasks;
- reliability and integrity of information, particularly financial information;
- compliance with policies, plans, procedures, laws and regulations;

---

<sup>3</sup> The term “ex ante control” is translated as “prior control” in Croatian with the same meaning of the original term.

<sup>4</sup> The term “ex post control” is translated as “posterior control” in Croatian with the same meaning of the original term.

- safeguarding of assets;
- economical, efficient and effective use of resources.

An independent Internal Audit Unit in each ministry and public institution provides assurance and gives recommendations so that the overall system of internal controls is in place and functions efficiently.

## ***2.2. A functionally independent Internal Audit, capable of performing systems-based and performance internal audit***

Internal auditing is an independent, objective assurance 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 the evaluation and improvement of the efficiency of risk management, control and governance processes.

Internal Audit is in charge of giving assurance and advice that management and control systems are established in accordance with the rules and standards and with the principles of sound financial management. It covers compliance and substantive tests, systems audits, performance audits, IT audits and any other kind of ex post verification that is considered necessary to ensure compliance of management with the financial rules and regulations of the organisation. The internal audit process should establish an adequate feedback mechanism of internal audit findings and recommendations into the financial rules and regulations.

Internal audit is organized in the manner that it does not constitute a part of any business process i.e. organisational part and is directly responsible in its work to the Head.

Internal auditors are independent in planning their work they carry out on the basis of strategic and annual plans approved by the Head of the institution as well as in performing internal audit and reporting on the results. The Head of the institution is in charge of internal auditor's recommendations implementation.

## ***2.3. Central harmonisation and co-ordination for Financial Management and Control as well as for Internal Audit***

According to the practices in the EU and other countries, a Central Harmonisation Unit has to be established for harmonising the FMC and the Internal Audit methodologies for all ministries/SABs and as quality and independence assurance of all PIFC functions in the Republic of Croatia. .

### **2.3.1. Coordination and harmonisation of methodology and standards**

CHU is responsible for developing and implementing **methodology and standards for FMC and Internal Audit**. In particular, this unit pays attention to developing financial management and control **procedures and audit trails as well as manuals, templates of Internal Audit Charters, Code of Ethics** for civil servants involved in IA. The unit also develops **risk assessment methodology** to be used by all public institutions, gives a methodological guidance in financial control and internal audit matters, performs the **assessment of internal audit and FMC services' activities**, oversees the enforcement of the established requirements and analyses the internal audit units' functions in the ministries/SABs.

### **2.3.2. Coordination and harmonisation of professional training and certification of Public Internal Auditors**

The Central Harmonisation Unit is in charge of the **certification** of Public Internal Auditors. This means that the head of this department proposes to the Minister of Finance the list of Public servants to be “certified internal auditors” upon the completion of their training. The certification testifies to their ability to apply professional standards and methodology developed for the performance of Internal Audit in public institutions. This certification will be granted on the basis a proved assessment of professional skills and experience in Public Internal Audit.

Furthermore, the Central Harmonisation Unit is a competent body for training, organisation, introduction, maintenance and sustainability of the Public Internal Auditors’ profession. Therefore, this department has the responsibility of keeping and, as necessary, developing the training material left at the end of the ongoing 2002 CARDS Project for “Development of PIFC and Internal Audit”. Training sessions will be periodically organised by the CHU for new future auditors or for the continuous training of already appointed and certified Public Internal Auditors. Trainers might be Public Internal Auditors or any relevant profile in accordance with the content of the certification scheme in force.

As such the CHU takes the role a Professional Body for Government Internal Auditors and it is relevant to envisage the creation of a professional association of Government Internal Auditors under the auspices of the Ministry of Finance for the promotion of standards and best practices in the public sector, development and publishing of manuals and other guides as well as possible and more flexible undertaking of the training needs and facilities.

### **2.3.3. Guaranty of the independence of the overall Internal Audit function**

#### **2.3.3.1. In respect of plans and annual report on the performance of Internal Audit Units**

The Central Harmonisation Unit collects analyses and consolidates strategic and annual plans of all internal audit units.

The Central Harmonisation Unit also submits to the Government of the Republic of Croatia an annual report on internal audit, which is based on consolidation and analysis of annual reports submitted by various internal audit units. These reports provide information on operations of all internal audit units and execution of plans.

#### **2.3.3.2. In respect of the functional Independence of Internal Auditors and internal audit units**

Internal Audits are exclusively performed by certified internal auditors duly appointed as such in an internal Audit Unit located at the highest level of the organisation. An “Internal Auditor’s Charter” explicitly describes rights and duties during the performance of internal audits.

Accurate and complete application of standards and manuals is an important element of the functional independence.

The profession of internal auditors and their jurisdiction will be provided for in the organisational decrees of individual SABs, whereas the specifics related to the profession will be defined by the new Civil Service Law, which is currently in the passage procedure.

#### **2.3.4. Coordination and harmonisation role in terms of FMC**

The Central Harmonisation Unit provides the Government with **an Annual Report on FMC** based on the consolidation and analysis of the annual reports submitted by various Ministries and SABs.

It also provides all Ministries and SABs with necessary methodology and guidance for the establishment and functioning of a proper FMC.

So far, the Central Harmonisation Unit did not become a member in any internal auditors' association, since its status was not resolved in terms of regulation. Since the unit was established in terms of its status, it has an obligation to cooperate and become a member of the Institute of Internal Auditors as well as with other domestic and international professional associations.

The cooperation with the State Audit Office is and has to continue developing in order to define a common approach in significant audit issues, but having autonomy and independence of state and internal auditors in mind.

#### **2.3.5. Segregation of duties within the Central Harmonisation Unit**

Given the necessary segregation of duties between internal audit and FMC tasks, two different divisions are created within the Department acting as the Central Harmonisation Unit. These two units are staffed with personnel who carry out their respective duties without mutual interference.

The same segregation of duties is maintained between the CHU and the Internal Audit Unit of the Ministry of Finance in charge of planning internal audits for the Ministry, performing the internal audits and reporting directly to the Minister. Any confusion between the tasks assigned to these organisational units discredit the role of the Central Harmonisation Unit in the Ministry of Finance and disseminates confusion amongst other ministries/SABs.

No member of the Central Harmonisation Unit may be involved in any tasks to be performed by any Internal Audit Unit.

#### ***2.4. An adequate structure aimed at taking actions against irregularities***

This particular issue concerning irregularities could be considered as a part of the PIFC scope but a specific later EU-funded project will deal with it.

### 3. Existing structures encompassed in the scope of PIFC in the Croatian State Administration Bodies

#### 3.1. Institutional and Legal Framework

##### 3.1.1. Institutions

The systems of “*internal financial controls*” in the Republic of Croatia are established within the framework of various institutions in the state administration bodies, where financial controls cover the procedures from the scope of competence of certain state and other bodies.

Major institutions within which financial and other forms of controls are being exercised are as follows:

- **the Croatian Parliament** is a representative body of citizens and the holder of the legislative branch in the Republic of Croatia, which, amongst other, passes laws and the State Budget; carries out election, makes appointments and removals in accordance with the Constitution and laws and **supervises the work of the Government of the Republic of Croatia and other holders of public duties** responsible to the Croatian Parliament, in keeping with the Constitution and law. The State Audit Office submits its annual report to the Croatian Parliament on the audits carried out and its work in general. During the sessions of individual committees of the Croatian Parliament, discussions are being held on the findings of the state audit, after which a discussion is held at the plenary session of the Croatian Parliament, followed by the passage of certain conclusions. The sessions of the Croatian Parliament are public, i.e. they are being transmitted in the media (television, radio, press). In the described way, the supreme state authority body is made aware of the procedures and findings of the state audit.
- **the Government of the Republic of Croatia**, amongst other, proposes laws and other enactments to the Croatian Parliament; proposes the State Budgets; implements laws and other decisions of the Croatian Parliament; passes laws execution decrees; runs foreign and internal policies; **directs and supervises the work of the state administration**; cares about the economic development of the country; directs the actions and development of public services; carries out other tasks defined by the Constitution and law. The Central Harmonisation Unit will submit an **annual report on the status of PIFC in the Republic of Croatia** to the Government of the Republic of Croatia.
- **the State Audit Office**, as external audit, audits all government revenues/receipts, expenses/expenditure, assets and liabilities and financial transaction of the public authority bodies, as well as the use of the European Union funds and those of other international institutions. It reports the Croatian Parliament at least once a year on its work and the audits carried out. A twining<sup>5</sup> Project currently in progress with the National Audit Office of United Kingdom is, among other objectives, aimed at

---

<sup>5</sup> An EU project which offers a framework for partnership in the accession to the EU between state administrations of EU member-states on one side and a state administration of an EU candidate country on the other.

improving the capacity of the State Audit Office to perform performance audits and take into consideration development of PIFC in the audited institutions.

- **Line ministries, including the Ministry of Finance and other state administration bodies**, implement the policies and programs by using public means in an *accountable* manner, and by efficient provision of services from their respective jurisdictions.

Within the framework of individual line ministries, i.e. state administration bodies, inspection services were organised and made operational, performing inspection supervision works (posterior control functions) in accordance with the provisions contained in the State Administration System Law<sup>6</sup> and other special regulations.

In implementation of inspection supervision, in keeping with special laws, a direct insight is being carried out in general and specific acts, conditions and the manner of work of the supervised legal and natural persons, and take legally prescribed and otherwise regulated envisaged measures for the purpose of harmonising the identified status and operations with the law and other regulations.

The inspection supervision is carried out by inspectors and other civil servants authorised for carrying out the supervision, when so is prescribed in a special law. This refers to carrying out a classical inspection supervision, which may be regarded as subsequent controls in individual matters.

Hence, inspection services were established within the Ministry of Finance for carrying out affairs from the field of taxes, customs duties and other public revenues, as well as foreign currency and foreign trade operations. Inspection services also were established in most of the ministries for carrying out affairs from their respective scopes.

Establishment of internal audit was stipulated for all budget users in the provisions contained in articles 137 and 138 of the Budget Law<sup>7</sup>. The decrees on internal organisation and internal organisation rulebooks for the purpose of creating an appropriate structure for internal audit have been or are being passed.

Functions of Authorising Officer, Accounting officer and financial controller are indicated in the provisions contained in articles 112 and 113 of the Budget Law, but implementing regulations have not been passed yet to allow the establishment of these tasks and jobs with each budget user.

- **the Ministry of Finance**, on the basis of the Law on Organisation and Scope of Work of the Ministries and State Administrative Organisations<sup>8</sup>, amongst others carries out all affairs connected with the planning, development and passage, implementation and execution of the State Budget, government accounting affairs, Republic of Croatia's borrowing in the domestic and foreign markets, affairs related with the customs and tax systems and policies, administrative and expert affairs related to the evaluation of companies' operations.

---

<sup>6</sup> *Narodne novine* 75/93, 92/96, 48/99, 15/00, 59/01, 190/03 – official version and 199/03

<sup>7</sup> *Narodne novine* 96/03

<sup>8</sup> *Narodne novine* 199/03, 30/04, 136/04 and 22/05

Similarly, the scope of competence of the Ministry of Finance also includes contracting, payments, accounting and financial reporting within the framework of the decentralised system of implementation of European Community assistance to the Republic of Croatia. These affairs run within the framework of the National Fund and the Department for Financing the European Union Aid Programmes and Projects.

The broad scope of competencies and tasks also include work concerning the development of public internal financial control (PIFC) and internal audit in accordance with International Standards. The Decree on Ministry of Finance's Internal Organisation<sup>9</sup> passed in April 2005 established the Department for Harmonisation of Internal Audit and Financial Control, i.e. the Central Harmonisation Unit.

- **the Financial Police** is an administrative organisation within the Ministry of Finance, established in late 2004 by the Financial Police Law<sup>10</sup>. The core task of the Financial Police revolve around financial supervision aimed at strengthening financial discipline of the budget contributors (citizens, craftsmen, companies) the prevention of unrecorded (unofficial) economy and the prevention of evasion of budget liabilities settlement for the purpose of acquiring budget revenues.

The term budget contributors implies every person defined by law providing for individual types of budget revenues, i.e. either natural or legal persons which assumed a commitment in relation to the budget by the conclusion of a contract.

The financial supervision carried out by the Financial Police is a procedure of supervising legality, regularity and timeliness of the application of law, which defines individual types of budget revenues and the supervision of implementing contractual obligations in relation to the budget. The supervision encompasses the legality, regularity and timeliness of the calculation, declaration and payment of budget revenues and fees as prescribed by laws.

Within the framework of its competence, it specifically supervises:

- Production and sales of oil derivatives, tobacco products, beer, alcohol, coffee and non-alcoholic beverages aimed at identifying the regularity of calculation and timeliness of payment of special taxes;
- Meeting the obligation of calculation and payment of contributions for mandatory insurance;
- Meeting obligations towards the budget assumed by a concession or lease agreements.

The above-indicated clearly shows that the Financial Police was established for the purpose of carrying out subsequent financial controls (supervision) for an ever better generation of budget revenues, and this part presents no overlap with the internal audit affairs.

Since the work of the Financial Police is organised through its Head Office and Financial Police Stations, the joint points with the internal audit work potentially exist in the provision of item 5 of Article 8 of the Financial Police Law, which prescribes that the Financial Police Head Office performs affairs of organising, harmonising, directing

---

<sup>9</sup> *Narodne novine* 43/05

<sup>10</sup> *Narodne novine* 177/04

and supervising the work of the Financial Police Stations. This implies that the Head Office organises, harmonises and directs the work of the stations and supervises, i.e. it controls the way the financial inspectors distributed to respective stations perform their work. Therefore, these affairs cannot be equalised, i.e. they do not overlap with the internal audit affairs.

As a part of the Ministry of Finance, the Financial Police is in the jurisdiction of the Internal Audit Unit of the Ministry of Finance and will be included in the scope of work covered by strategic and annual plans. The head of the Financial Police is accountable of the public means used for the performance of the activities assigned to this entity and therefore has to establish a proper FMC.

- **the Budget Supervision Division in the State Treasury of the Ministry of Finance**, in keeping with the Budget Law and the Budget Supervision Rulebook, performs the supervision of legality, purposefulness and timeliness of the use of budget funds with budgetary and extra-budgetary users as well as with other budgetary and extra-budgetary users, coupled with the stipulated supervision of local and regional self-government units. One of the objectives of budget supervision laid down in the Budget Supervision Rulebook revolves around improvement activities and operations of an entity in which supervision is being carried out, which is seen as an internal audit task. The performed audit of the budget supervision control functions efficiency assessment brought a recommendation to remove the said objective from the tasks of the Budget Supervision Division, whereby overlaps will be avoided concerning the respective jurisdictions of budget supervision and internal audit.
- **the Public Procurement Office**, as per the Public Procurement Law<sup>11</sup>, is a Republic of Croatia's Government expert service authorised for the implementation, supervision and application of this Law and bylaws from the field of procurement, which gives a previous consent, guidelines and opinions to the users concerning the application of the Public Procurement Law; it collects, records, processes and analyzes procurement data, it files with the misdemeanour court requests for the initiation of misdemeanour proceedings, i.e. criminal charges with the Attorney General's, it participates in drafting laws and bylaws on general terms and conditions, rules and procedures for procurement, it prepares and implements a training programme for entities and the promotion of law, it participates in the work of international institutions concerning procurement and performs other tasks from its scope of work.
- **the State Commission for Control of Public Procurement Procedures**, on the basis of the Public Procurement Law and the Law on the State Commission for Control of Public Procurement Procedures<sup>12</sup>, is an autonomous and independent body, reporting to the Croatian Parliament, which performs the affairs revolving around the protection of rights of bidders and competitors in a public procurement procedures, which in case of irregularities can file complaints to a selection decision. The objections filed within the prescribed term suspend the conclusion of a procurement contract. The purchaser deals with the objection, and in case of his negative response, the bidder is entitled to file a written complaint to the State Commission for Control of Public Procurement Procedures, which in turn is obliged to make a resolution within 15 days after the receipt

---

<sup>11</sup> *Narodne novine* 117/01 and 197/03

<sup>12</sup> *Narodne novine* 117/03

of a complaint, i.e. the documentation submitted. The resolution of the State Commission is final and a copy is submitted to the purchaser, the filer of a complaint, the State Audit Office and the Public Procurement Office, respectively. The purchaser must proceed in accordance with the resolution of the State Commission. There is an option to initiate an administrative procedure before the Republic of Croatia's Administrative Court against a State Commission's resolution.

- **the Republic of Croatia's Government Office for Internal Control** was established in January 2001 on the basis of the Decree on the Republic of Croatia's Government Office for Internal Control (hereinafter the Office) in keeping with the then effective Budget Law<sup>13</sup> for the purpose of checking financial and material operations of the state administration bodies and the expert services of the Government of the Republic of Croatia. This Law prescribed an obligation of establishing internal control with each budget user, and the Office was therefore established for carrying out internal control affairs in offices and expert services of the Government of the Republic of Croatia, and to serve as a coordinator of the internal control services within the state administration bodies and was vested with powers of performing direct control in such bodies. The tasks of the Office partly overlap with a part of the tasks assigned to the Budget Supervision Division in the State Treasury within the Ministry of Finance.
- With the passage of the new Budget Law<sup>14</sup> in mid-2003, and in accordance with the assumed obligation of harmonising Republic of Croatia's legal regulations with those of the European Union, an obligation of establishing internal audit with all budget users was also introduced.
- On the basis of legal provisions on the establishment of internal audit and on the basis of the Strategy of Development of Public Internal Financial Control (PIFC) in the Republic of Croatia passed by Republic of Croatia's Government in September 2003, the Government Office for Internal Control begun a transformation process whereby it is being reorganised to constitute the Republic of Croatia's Government Office for Internal Audit (GOIA).
- Currently underway is the procedure of passing the amendments to the existing Decree which changes the name of the Office to the Republic of Croatia's Government Office for Internal Audit. This transformation was achieved due to the efforts of the Ministry of Finance and CARDS 2002 Projects, coupled with Republic of Croatia's Government understanding of the need for establishing internal audit. In this way, the new Office for Internal Audit will **exclusively** carry out internal audit affairs for the Government Offices and other Public Institutions pertaining to the State Administration level but considered as too small for establishing their own Internal Audit Units. The said is founded upon the fact that establishment of internal audit with each of the Government offices, services and bodies at the State Administration level, given the financial amounts made available to them and the number of staff, would not be rational. A government decree will stipulate the list of the institutions encompassed by the role of the GOIA for the fulfilment of their Internal Audit obligations.
- This way, the role and tasks of the Republic of Croatia's Government Office for Internal Audit (GOIA) was made fully clear and defined. The Office carries out internal audits within the said offices and bodies independently and objectively, identifies the accomplishment of the overall tasks and functions of the said offices and bodies on the basis of analyses and assessment of internal control systems.

---

<sup>13</sup> *Narodne novine* 92/94

<sup>14</sup> *Narodne novine* 96/03

- In order for internal audits carried out in Government Offices to keep the characteristics of independent internal audit as per International Standards, the following is necessary:
- The Heads of individual offices and other institutions provide information to the Head of the GOIA necessary for the preparation and execution of strategic and annual internal audit plans;
- The Head of the GOIA is responsible for a timely performance of internal audits according to the plans and agreements;
- For each individual audit, the subject matter and internal auditors team are defined by the head of the GOIA with the consent of the head of office or other institution in which internal audit will be carried out;
- Internal auditors will report directly to the Head of the Institution within which they carry out the audit on the content of the audit and to the Head of the GOIA on the audit performance;
- The Head of the GOIA provides the CHU with consolidated strategic and annual plan for internal audits. He also sends an annual report on the performance of internal audit on audits carried out in government offices and other institutions from its scope.
- The Office alerts the Government to irregularities and incompliance with legal and other regulations providing for the operations of the offices and public authority bodies, proposes measures for their elimination and measures for improvement of operations aimed at improving the overall operations.
- The Office is managed by the Office Head who was appointed in mid-2004, and a total of 12 staff was planned for the Office, of which 8 are internal auditors.
- Currently, four internal auditors undergo internal auditors' training within CARDS 2002 Project, who will be performing the internal audit affairs in accordance with international standards and the Professional Code of Ethics of Internal Auditors.
- The Republic of Croatia's Government Office for Internal Audit will perform its affairs on the basis of a three-year strategic plan and an annual plan, which is compiled and adopted on the basis of the strategic plan.
- The Role of the GOIA has to be clearly understood as the Internal Audit Function at the State Administration level for those of institutions for which it is not rational to establish an autonomous Internal Audit Unit. Therefore, the GOIA shall fulfil all obligations of an Internal Audit Unit towards the Central Harmonisation Unit.
  
- **the Central Government Assets Management Office** carries out administrative and professional assignments pertaining to management of movable and immovable assets and stakes in companies owned by the Republic of Croatia, proposes the appointment of members of supervisory boards, unless this is set forth in a special law, and keeps records on government assets entrusted by a special law to different state administration bodies for management, establishes and keeps records on the overall assets owned by the Republic of Croatia, carries out tasks concerning maintenance of assets owned by the Republic of Croatia, unless a deed on submitting such an asset for utilisation, use, management or maintenance assigns this task to the Office, carries out professional and technical assignments related to the preparation and implementation of decisions of the Government of the Republic of Croatia in relation to the development and maintenance of state-owned facilities, change of purpose of state-owned facilities, planning the necessary funds, and monitoring their realisation.
  
- **the State Inspectorate** is a government administrative organisation which is, on the basis of the Law on Organisation and Scope of Work of the Ministries and Government

Administrative Organisations<sup>15</sup> in charge of carrying out administrative and other affairs pertaining to supervision, i.e. the inspection over the affairs concerning the turnover of goods, the application of labour and safety at work regulations, electricity, mining, research and exploitation of mineral raw materials, pressure vessels and supervision over the performance of catering and tourism activities.

From the indicated institutions and state administration bodies, it is clear that there are various organisational forms within which various controlling and inspection systems were established. One of the tasks of the Central Harmonisation Unit should also pertain to the check of legal regulations providing for the control functions in order to avoid overlaps of individual control, i.e. inspection affairs with those of internal audit.

### **3.1.2. Legal framework and activities to date in the development of the PIFC system**

The activities concerning the development of the existing public internal financial control commenced in 2002 within the framework of the Fiscal Reform Project in the Republic of Croatia under the auspices of USAID, i.e. within the framework of an EU/SIGMA project. The following tasks were performed:

- The Budget Law passed in June 2003 introduces the term and tasks of internal audit and orders the establishment of internal auditors with budget users.
- In July 2003 the Minister of Finance passed the Document "Policy and Vision of Internal Audit" which presented the main internal audit principles. This document will be replaced with the passage of the new PIFC strategic document, as well as with the passage of the PIFC Framework Law. Therefore, the document „Policy and Vision of Internal Audit“ will no longer be amended or upgraded.
- In March 2004, the Law on Organisation and Scope of Work of the Central State Administration Bodies was amended, whereby the Ministry of Finance became responsible for the development of public internal financial control in compliance with international standards and best European practices.
- by amendments to the aforesaid law, the Central Harmonisation Unit, in collaboration with CARDS 2002 Project „Development of PIFC and Internal Audit“, carries out assignments of the Central Harmonisation unit, develops the PIFC concept, compiles the Internal Audit Rulebook with the basic provisions for the introduction of internal audit and certification of internal auditors in the overall public administration of the Republic of Croatia, carries out training of internal auditors (80 civil servants currently underway is the forth stream), develops the internal audit methodology, coordinates implementation of internal audit at the Ministry of Finance and line ministries, presentations or discussions have been held with the heads of practically all ministries and individual state administration bodies aimed at establishing PIFC in their respective environments. The result of this collaboration is training of internal auditors in all ministries except one, and a total of seven ministries determined the role and importance of internal audit units in accordance with the PIFC requirements.
- In late March 2005, the Government passed the Decree on Internal Organisation of the Ministry of Finance which also includes the Department for Harmonisation of Internal

---

<sup>15</sup> *Narodne novine* 199/03, 30/04 and 136/04

Audit and Financial Control<sup>16</sup>, the Autonomous Division for Internal Audit, which reports directly to the Ministry of Finance, and the Autonomous Division for Financial Management, Internal Supervision and Controls. The Central Harmonisation Unit was set up and consists of two independent divisions, one in charge of internal audit and the other one for financial management and internal control. The Autonomous Division for Internal Audit is in charge of carrying out audits in the entire Ministry of Finance i.e. in its all organisational units which consists of: Customs Administration, Tax Administration and Financial Police. However, establishment of FMC is an obligation of each of these individually. A proposal for determining the titles of working posts and internal auditors' coefficients on the basis of which Internal Auditors' work will be valued and salaries defined, was submitted to the Government of the Republic of Croatia. Internal Auditors would therefore be appraised equally in every SAB.

- A second version of the Internal Audit Manual was prepared, and still will be upgraded and modified on the basis of the experience gained when performing pilot audits. It will soon be supplemented with two new areas pertaining to audit and specificity of risk assessment when auditing EU funds.
- The Financial Management and Control Manual is being prepared, and several presentations and workshops were held for improving awareness of officials and financial controllers on the purpose of FMC.
- The Republic of Croatia's Government Public Procurement Office and the State Commission for Control of Public Procurement Procedures currently prepare amendments to the Public Procurement Law in order to make it fully compliant with the EU Directives.
- The Central Government Office for Administration is currently preparing the new Law on civil service which is required to be passed for the purpose of harmonising our legislation with the so-called Madrid criterion relating to the obligation of building sufficient institutional and administrative capacity for the implementation of the obligations assumed during integration process to the European Union. In this fashion, state administration reform and modernisation will be realised, public costs reduced and public sector management strengthened.

In addition to the regulations indicated, there are also other regulations that also pertain to this field, and the list of those is provided in this document's annex 1.

### **3.1.3. Funds for the Preparation of Republic of Croatia's Accession to the European Union (NATIONAL FUNDS, PHARE, ISPA AND SAPARD PROGRAMMES)**

The **PHARE, ISPA and SAPARD** programmes represent three instruments for preparing the Republic of Croatia for the accession to the European Union. The programmes are fully financed or co-financed by the European Union in order to assist the Republic of Croatia and other central and Eastern European countries in their preparations for entering the European Union. These funds are not only intended for the development and strengthening the economy but also have the role of institutional capacity for harmonisation with those in existence in the European Community.

**PHARE** – programme for assisting the adaptation of the legal framework in compliance with the

---

<sup>16</sup> Called Central Harmonisation Unit (CHU) in the present document

“*Acquis Communautaire*” and for strengthening or enhancing the state administration and institutions;

**ISPA** - programme for financial assistance to projects influencing the transportation infrastructure and environmental protection;

**SAPARD** - programme for financial assistance to agriculture and rural development.

**The National Fund** was established as a separate unit within the Ministry of Finance's State Treasury for channelling the European Union funds, i.e. for the concept of financial management of the funds made available from the European Union for financing of all indicated and approved programmes. Through the National Funds, all funds approved from the pre-accession programmes (PHARE, ISPA and SAPARD) and, in accordance with the European Union rules, will be received and disposed of and forwarded to end beneficiaries, i.e. the agencies for implementation of such programmes.

The core objective of the National Funds is to manage the European Union funds through an efficient and careful use of the funds, and to establish fiscal discipline. The objectives that are to be set up through this Fund relate to a clear and legal process for executing the aforesaid programmes, financing expenses in accordance with the European Commission's requirements, a responsible and efficient use of the assistance funds, integrity of information on increasing the value of assets and achieved results and improvements in strategic decision making.

**The National Authorising Officer (NAO)** is responsible for the work of the National Fund and his/her most important role, amongst other, refers to responsibility for financial management of financial means from the pre-accession programmes and his/her responsibility to ensure the adherence to the rules, regulations and procedures of the European Community pertaining to the procurement, reporting and financial management, and to establish and develop a proper project reporting and information systems. His/her obligation is to establish and manage the procedures for inter-functional linkage between the National Fund and implementing agencies, as well as control of such agencies and end beneficiary of the funds.

The scope of competences of the National Fund and the National Authorising Officer are defined in the Memorandum of Understanding on the Establishment of the National Fund, which will be concluded between the European Community and the Government of the Republic of Croatia in April 2005.

**The Central Finance and Contracting Unit (CFCU)** established as an organisational Department of the Ministry of Finance, is in charge of executing tendering procedures, concluding contracts and executing payments for projects, strengthening institutions and other projects within the decentralised implementation system framework. It is also in charge of reporting in accordance with the rules and procedures of the European Union.

This unit at the same time is an implementing agency for projects from ISPA and PHARE programmes, whereas a separate SAPARD implementing agency was established for projects belonging to the SAPARD programmes.

The competent ministries will be responsible for the preparation of sector-related attachments in the programming process as well as for the technical implementation of the European Union aid programmes, and within them a project implementation units will be established.

For implementation of these projects, it is necessary to establish in all indicated bodies a sound **control environment and control activities** which represent a series of policies and procedures designed for the purpose of detecting risks and achieving objectives. This may be implemented by

establishing good quality prior and subsequent controls, as well as through systems assessment.

\*  
\* \*

The role of **internal audit** is to give an independent assurance on systems and processes with possible recommendations and advice for their improvement and achieving greater efficiency. It also alters to irregularities and incompliance with laws and other regulations, it carer about accuracy and purposefulness of all activities encompassed by audit processes.

Therefore, internal audit will play a significant role in the process of establishing and developing organisational form, i.e. the bodies in charge of receiving and distributing, i.e. spending the pre-accession funds.

As part of the Ministry of Finance, National Fund and CFCU pertain to the jurisdiction of the Ministry of Finance's Autonomous Internal Audit Division.

Given the currently insufficient number of internal auditors in this division, it is intended to assign internal auditors pertaining to an "internal auditors' capacity" for the internal audit within the National Fund and the CFCU. This Capacity is built from the identification of internal auditors duly trained for auditing EU funds and made partly available by the institution to which they belong. Their availability for the performance of internal audit within the National Fund and the CFCU will be stipulated by an agreement between the Ministry of Finance and Institutions from which auditors are originate. The size of the capacity will be permanently adjusted to the needs expressed by the strategic and annual plans of the National Fund and the CFCU.

Internal Auditors will be specifically assigned by the National Authorising Officer for the performance of each audit and will report to him/her about irregularities and recommendations.

The SAPARD agency will have its own internal audit unit, and its auditors are involved in the training process.

After training and establishment of a sufficient number of internal auditors and after a transitional period, there will be an option for each of the implementing agencies (ISPA, PHARE), as in SAPARD, to dispose of own internal auditors. Until then, the described "internal auditors' capacity" will be available.

## 4. Development of adequate PIFC in the Republic of Croatia

### 4.1. General principles

Development of PIFC will fully comply with the principle of accountability at all levels of the use of public means. It will therefore cover the entire scope of all activities carried out for the execution of administrative tasks as well as for the implementation of policies and programs.

It will encompass the permanent verification of the legality, purposefulness and efficiency of the use of any type of public means **prior to making decisions** as well as the ex-post control aimed at verifying on the spot and in the fields if public means were used on a proper manner. PIFC will also comprise Internal audit fully compliant with international internal audit standards<sup>17</sup> as published by the IIA, the best practices in that respect applied in the EU member State countries as well as a code of ethic directly inspired by the above mentioned sources. The existing inspection and supervision bodies will complete the frame work after having been adapted as mentioned in the chapter above.

Risk assessment and multi-annual planning are the basis of the determination of the priorities assigned to FMC and Internal Audit as well to a certain extend for the performance of activities carried out by other inspection and supervision bodies.

The Internal Control System set up in the frame of the Financial Management and Control (FMC) will be periodically assessed by Internal audit which will provide management with recommendations for its improvement and then complete updates and upgrades generated by the self-assessment permanently performed by the management it-self.

Permanent screening and monitoring of the efficiency of the ongoing activities, elaboration of performance indicators for assessment of the achieved results as well as multi annual budget planning and re-planning are the main priorities assigned to the management of every SAB.

In each SAB a senior official coordinates all actions and measures taken for the implementation and the maintenance of an efficient and comprehensive FMC.

### 4.2. Internal Audit<sup>18</sup>

#### 4.2.1. Existing situation and weaknesses

In accordance with the Budget Law, the budget users are obliged to establish internal audit, unless already established. The establishment of Internal Audit was regulatory provided for in five ministries in accordance with the Budget Law and implementing regulations, whereas this process goes on in other Ministries and SABs. All of the ministries, apart from one, and certain state administration bodies sent their employees to be trained as internal auditors. Given the new internal

---

<sup>17</sup> [http://www.theiaa.org/?doc\\_id=1499](http://www.theiaa.org/?doc_id=1499)

<sup>18</sup> Internal Audit and internal auditors are respectively called, in Croatian language, Internal Revision and internal revisers. These appellations refer clearly to the notion of audit since the same word is also used for External Revision in both cases of the State Audit Office and functions carried out private External Audit institutions.

auditors' profession, amendments to the Decree on Job Titles and Jobs Complexity Coefficients in the state administration were prepared to also include the position and title of internal auditors. Following the amendments to the said Decree, which falls under the jurisdiction of the Republic of Croatia's Government, and the passage of Rulebooks on Internal Organisation, which falls under respective jurisdictions of the ministries/SABs, internal auditors in individual SABs will be appointed.

#### **4.2.2. Development of Internal Audit**

The provisions of the Budget Law indicate the role and meaning of introducing internal audit at the levels of central government, local and regional self-governments. The document titled "Policy and Vision on Internal Audit" passed by the Minister of Finance in July 2003 is replaced with the document titled "Development Strategy of Public Internal Financial Control (PIFC) in the Republic of Croatia" and its current amendment.

By July 2005, a proposal of the Framework Law on Public Internal Financial Control will be prepared and submitted to the Government of the Republic of Croatia with the goal of adopting the Law by the Croatian Parliament by end-2005. This Law will lay down the basic framework of action and the development of internal audit and financial control in the Republic of Croatia. The Law will, amongst other, set forth the basic definitions of internal audit and Financial Management and Control, i.e. it will in detail determine the status, role and jurisdiction of internal audit, coupled with the determination and prescription of the elements concerning independence and expertise of internal auditors, with a reference to their training.

The internal audit activities are currently prescribed through the provisions contained in the Rulebook on Budget Users' Internal Audit<sup>19</sup>, passed by the Minister of Finance in August 2004. The Rulebook provides for the requirements to be met by internal auditors, internal audit standards and methodology of work, as well as internal audit's manner of work. A new version of the Rulebook on Budget Users' Internal Audit will determine criteria for the establishment of joint internal audit units, on the basis of which the budget users will be able to set internal audit, as well as the relationship between the unit and an auditee. There is a need for the establishment of joint internal audit units, as it is not economical, rational and possible to establish own internal audit units with all budget users.

It is also necessary to pass the Internal Audit Charter, which will be applied by all internal audit units at the Ministries/SABs. The Charter will increase the quality of audit mandate, encompassing audit jurisdiction, powers, rights and duties entrusted to each of the audit services, i.e. audit units and to internal auditors.

The Charter will ensure and emphasise internal auditors' independence and will also provide a more detailed explanation of the relationship between internal audit and the auditee.

Internal audit is being carried out in the manner and in accordance with the procedures set forth in Internal Audit International Standards as set by the international Institute of Internal Auditors (IIA)<sup>20</sup> and in keeping with the best practice of the European Union.

---

<sup>19</sup> *Narodne novine* 111/04

<sup>20</sup> <http://www.theiia.org>

Internal audit is organised and carried out on the basis of five fundamental standards:

- **independence (functional),**
- **competence,**
- **scope,**
- **performance (of internal audit),**
- **accountability.**

The Ministry of Finance will specifically publish the international Internal Audit Standards and Internal Auditors Code of Ethics at its official Internet site even though they are already mentioned in the rulebook.. Internal auditors shall apply the Internal Auditors Code of Ethics in their work.

In performing their audits, internal auditors are using the second version of the Internal Auditors' Manual. It is planned to issue a new version of the Manual, which will incorporate experiences gained from the audits carried out, coupled with two new annexes on a) risk assessment and b) European Union funds audit, i.e. the pre-accession funds.

The head of internal audit in the Ministries/SABs, including the Ministry of Finance, is appointed by the Head of the Ministry/SAB and the head of IA reports to him. The heads of internal audit units, in addition to other requirements set forth in the Rulebook on Internal Organisation should also have Minister of Finance's certification for the performance of internal audit work.

A strategic audit plan which will be developed for a three-year period and an annual plan, both based on risk assessment are prepared by the head of internal audit unit and endorsed by the Head of a Ministry/SAB. The passage of strategic and annual internal audit plans is an obligation of all internal audit divisions in the Ministries/SABs and a copy of these has to be sent to the CHU within the Ministry of Finance. These Internal Audit Units will also provide the CHU with an annual report on the performance of Internal Audit and the execution of plans. The Central Harmonisation Unit will then produce a consolidated annual plan and annual report on internal audit, on which the Minister of Finance will inform Republic of Croatia's Government.

### **4.2.3. Training of Internal Auditors**

According to the Budget User's Internal Audit Rulebook<sup>21</sup>, the internal audits are to be carried out by internal auditors possessing a university degree and Minister of Finance's certification, confirming skills, appropriate experience and the application of internal auditors' professional code of ethics.

The certification is being acquired as per the training programme and procedure made in force by the Central Harmonisation Unit.

A certification scheme and procedure for obtaining internal auditor's certification were elaborated in collaboration of the CHU and CARDS Project 2002 "Development of PIFC and Internal Audit". The acquisition of the certification validates the gained knowledge and skills, the capacity of applying international standards and best practices for internal audit performance as well as

---

<sup>21</sup> *Narodne novine* 111/04

adequate experience in Internal Audit.

For the acquisition of this certification, conditions of eligibility are the relevant educational background prescribed in the above mentioned Rulebook i.e. the attendance to a specific programme followed by a knowledge evaluation process and acquisition of the practical experience under coaching by CARDS 2002 Project experts and in the future certified internal auditors.

The certification is the foundation for the creation of the new profession of Public Internal Auditors in the Republic of Croatia and the guarantee of the application of International Standards and best practices of internal audit.

\*  
\* \*

The training itself comprises 6 modules for a total duration of 7 weeks over a period of several months and optional modules, out of which one relates to the EU funds auditing. Practical experience over a period of at least one year starts after the completion of the 3<sup>rd</sup> module and after the acquisition of the 1<sup>st</sup> level certificate validating the first gained abilities.

3 streams of about 20 public servants each were already carried out by experts of CARDS 2002 project and it is foreseen that a large part of the first stream trainees will be certified by the end of the project i.e. by October 2005. Some civil servants are trained as trainers in order to ensure the sustainability of the training capacity under the responsibility of the CHU.

A first stream of about 20 trainees is already being carried out successfully by local trainers monitored by CARDS 2002 project experts. The adaptation of the existing training material was needed for this transfer of know-how. The continuity of the training content and sustainability of its quality is guaranteed by the synopsis describing in details the objectives, content and operating way of each module. The training programme devised in this fashion as well as the training programme for trainers who obtained the certificates, fully guarantee the sustainability of the procedure for acquiring internal auditor's certification as described.

It is foreseen to have trained about 100 internal auditors in 2005 and an equivalent number of public servants in 2006 with more emphasis on the servants who will perform internal audit in the local and regional self-government bodies. The quality and the motivation of applicants are significantly improving with the time and the good name of the training process for the acquisition of internal auditors' certification.

\*  
\* \*

It is also foreseen to periodically update and upgrade internal auditors' skills and awareness through the organisation of periodical conferences, seminars and workshops. A strong emphasis was also put by the CARDS 2002 Project and taken over by the CHU for the creation and the maintenance of a network amongst internal auditors. This could lead in a near future to the constitution of a professional association of Public Internal Auditors under the auspices of the CHU.

### **4.3. Establishment of financial management and control**

The implementation of FMC in the SAB is carried out by:

- An official, the Secretary General or any other person appointed at a sufficient level of authority and responsibility for having a vision of the functioning of all the administrative part of the SAB and a recognised capacity for managing this type of issues. This senior Official coordinates actions of the entire **PIFC** at a “strategic” level and has a pre-eminent role of impulsion during the phase of establishment.
- An official, generally the Head of the directorate for financial affairs (or equivalent). The most frequent envisaged solution consists of the setting up of a division within this department covering as independently as possible the three main functions encompassed in the notion of **FMC**. This Senior Official has an essential role for the operational coordination of all actions pertaining to the scope of FMC in a comprehensive manner:
  - **Ex-ante control**, financial controller(s) are generally appointed in this unit with possibility of decentralisation of this function when the SAB has large size;
  - **Ex-post control**, for the purpose of controlling the legality, efficiency and purposefulness after performance of an action and as close as possible to the end user. It is intended to decrease the number of these controls for benefiting from the implementation of the ex-ante control. The function of financial controller is incompatible with the activities of ex-post control.
  - **Prescription of rules and guidance** for the implementation of FMC at all levels of the organisation as well as for the development of financial reporting.

Some different organisational solutions are envisaged to take account with the specificity of certain SABs but they will comply with this general approach.

An annual report on the performance of the FMC activities is drafted every year under the responsibility of the senior official overarching the FMC functions and sent to the FMC division of the CHU within the Ministry of Finance. This report describes actions and measures taken for ensuring:

- systematic monitoring of revenues/receipts and expenses/expenditures, assets and liabilities
- adequate checking of the following:
  - o Security and safeguard of assets (capital and/or property),
  - o Public procurement procedures,
  - o Projects management,

The Senior Official responsible for FMC ensures that all activities in the field of FMC are taken in accordance with a risk assessment periodically updated.

Financial management and control is being implemented in accordance with the standards of internal control<sup>22</sup> adopted by the European Commission in 2000 and in accordance with COSO<sup>23</sup> model. Internal control standards then comprise the 5 usually recognised components: control environment, risk management, control activities, information and communication as well as monitoring and assessment.

---

<sup>22</sup> [http://europa.eu.int/comm/budget/ic/index\\_en.htm](http://europa.eu.int/comm/budget/ic/index_en.htm)

<sup>23</sup> Committee of Sponsoring Organisations of the Treadway Commission - <http://www.coso.org>

To date emphasis is put on the establishment of the Control environment in order to create the sustainable foundations of a sound Financial Management and Control.

To be efficient, internal controls shall meet three fundamental criteria:

- to be adequate (right control in the right place and proportional to risk),
- to function continuously as planned,
- to be cost effective-which implies that control implementation costs should not exceed benefits it brings.

#### **4.3.1. Ex ante control**

Ex ante control encompasses all controls related to the legality, economy, efficiency and effectiveness prior to the use of public funds and may suspend all decisions with potential financial and other consequences or risks.

By nature these controls are preventive and are implemented together with the performance of business process.

##### 4.3.1.1. Existing situation and weaknesses

In the Republic of Croatia, internal controls are established although not made legally mandatory by internal regulations edicted by the relevant above mentioned law.

Nevertheless, one of the basis for the introduction of control is founded upon the provision of the article 11. of the Rulebook on Budget Accounting and Chart-of-Accounts<sup>24</sup> which provides for control of bookkeeping documents before recording them in the accounts.

Similarly is stipulated a public procurement procedure by the provisions of the Law on Public Procurement<sup>25</sup> and the Decree on procurement procedures for works, goods and services of small value<sup>26</sup> which determine procurement procedures which are necessary to be implemented depending on the value of goods, works or services planned for procurement.

The Law on civil servants and employees<sup>27</sup> provides for the recruitment procedure, as well as rights and duties, responsibilities and the manner of determining salaries.

Apart from e.g. the mentioned laws and decrees, many SABs passed the rulebooks or instructions by which they prescribed particular business processes or activities specific for them. However, some business processes are not prescribed, i.e. the way how to perform them in order to ensure their implementation in compliance with the principles of legality, economy, efficiency and effectiveness, is not prescribed.

The existing system of control is not established taking into account both objectives that the SAB

---

<sup>24</sup> *Narodne novine* 27/05

<sup>25</sup> *Narodne novine* 117/03 and 197/03

<sup>26</sup> *Narodne novine* 14/02

<sup>27</sup> *Narodne novine* 27/01

wants to achieve and risks which influence the achievement of the objectives. Furthermore, the existing controls are directed to the achievement of legality and regularity but not to the economy, efficiency and effectiveness.

The provision of the article 113 of the Budget Law<sup>28</sup> provides for that a budget user's financial controller is responsible for the legal execution of Requisitioner's orders, i.e. the head of SAB in accordance with the financial-accounting regulations.

The Accounting Officer of the budget user is responsible for the legal and purposeful spending of public funds for the purposes defined by the budget and financial plan. He can temporarily suspend the payment if it is contrary to this Law or by the Law which annually provides for the state budget execution.

The functions of Financial Controller and Accounting officer of the budget user are incompatible.

As evident from the provisions of the Budget Law, the functions of Financial Controller and Accounting officer are not clearly distinguished i.e. there is not clear segregation of their competencies. In addition to what was said, the Law uses the notion of Authorising officer and Requisitioner in the same sense i.e. the Authorising officer and Requisitioner is a head of SAB. To that effect, this Strategy should clearly distinguish a role and tasks of all persons involved in FMC.

The existing system of control is not established taking into account both objectives that the SAB wants to achieve and risks which influence the achievement of the objectives. Furthermore, the existing controls are directed to the achievement of legality and regularity but not to the economy, efficiency and effectiveness.

#### 4.3.1.2. Development of Ex-ante control

In compliance with the legislation in force, particularly with the Budget Law, instructions and guidelines issued by the Ministry of Finance and in compliance with the principles of sound financial management, the Ministers or Heads of SABs – and on behalf of them, the Senior Officials in charge of the implementation of FMC – have the responsibility for the collection of the revenue, for the commitments and payments of any expenses. They are also required to ensure the adequate allocation of functions prior to the application of *ex-ante* control as well as the segregation of duties between *ex ante* and *ex post* controls or between authorising officer and financial controller. It will be necessary to compile the job descriptions with an emphasis upon this delegation of authorities and responsibility that is created in this fashion.

As the first step in the development of FMC, the heads of SABs and the persons with delegated authorities, defined today as the authorising officers, shall delegate their authorities at a lower hierarchical level closer to where the action takes place. Since their role nowadays is substantially centralised, the head of SAB is often considered as the only authorising officer, although the real decentralisation represents the conditions of efficiency for the exercise of a sound *ex-ante* control as described here under.

*Ex-ante* and *ex-post* controls of expenses and expenditure shall be performed by experienced and skilled staff.

---

<sup>28</sup> *Narodne novine* 96/03

Moreover, better distinction of nature and consequences will be made between delegations of responsibility and delegation of signature when screening the various responsibilities along the processes of decision making. The development of audit trails<sup>29</sup>, already strongly encouraged and significantly advanced in certain SABs contributes for a large part to clarifying the existing situation and to disseminating of the control environment.

**FMC in its “Ex-ante” component is classically exercised by:**

The Accounting officer, responsible for the reliability of the overall accounting and financial reporting information. He ensures recording of the commitments and all other transactions in accounting as well as the accuracy and reliability of financial reports. Performing the previous control, he checks the availability of budget resources, i.e. he determines if there are ensured resources before creating, that is assuming the commitments. He replies to the question “Are resources ensured i.e. planned within the budget or financial plan? “

The Authorising officer is a head or a person with the delegated authorities. The financial authorisation signature given by the head or the delegated authorising officer should be based on his preventive, detective and corrective controls designed and implemented in a way to ensure sound financial management which implies the legality, and regularity but also the economy, effectiveness and efficiency. He controls the purposefulness of the requests for the creation of commitments.

The Financial controller is responsible for the legal execution of the heads' orders according to the financial-accounting and any other relevant regulations. The Financial controller, with adequate qualifications and experience, is appointed by the head of SAB for the purpose of checking if all transactions are in accordance with the instructions of the Head of SAB and the above mentioned regulations.

The authorisation of the financial controller should be based on his preventive, detective and corrective controls. He also checks, before the final Decision, if all procedures were carried out, all authorisations obtained, if there were all necessary signatures. He finalises gathering of the information necessary for the purpose of decision making. He checks the proposed transactions by controlling whether each participant performed expected controls in a process i.e. that he confirmed that each action is legal and regular and that the file contains the expected evidence. He replies to the question: “Are all necessary authorisations obtained i.e. all envisaged controls performed?”

He has the right to withhold the transaction in a case he considers that financial authorisation made before was not made in accordance with the principles of sound financial management (economy, efficiency and effectiveness), legality and regularity. However, if the final decision is made by the Head of SAB in contradiction with the Financial Controller, the Financial Controller has to report about this fact even though this could not be considered as an irregularity.

The Paying officer is responsible for the payment accuracy and payment system. He accomplishes the payment process by forwarding the payment order to the legal entity/agency which performs the payment operations.

---

<sup>29</sup> Maintenance of records giving the full documentation and justification at all stages of the life of a transaction together with the ability to trace transaction from summarised totals down to the individual details and vice versa.

All above-mentioned persons are responsible for their part of controls in a business process which commences with the expression of the requisite and finishes by the final decision i.e. by the payment. Therefore, strong emphasis is put on the role of requisitionners. These officials, generally heads of departments or main organisational units exercise the first control of purposefulness before validating the requisite expressed for the accomplishment of the activities assigned to the unit they lead. Moreover, they provide authorising officer and potentially financial controller with all justification of the expressed need as well as with all useful relevant for a further appraising the relevance and the quality of the satisfaction of the expressed need. They are the first and essential link of the chain of accountability which is the essence of the implementation of FMC.

For the implementation and development of the previous controls it is necessary to undertake the following activities:

- by drafting audit trails:
  - To identify all existing business processes and activities as well as established controls,
  - To identify main risks and controls required to reduce the negative influence of risks,
  - To identify whether the existing controls match the necessary ones,
  - To identify the differences and to establish missing controls and to eliminate unnecessary controls;
- By issuing organisational decrees and rulebooks
  - To describe in detail the tasks of all state officials, civil servants with reference to their responsibility,
  - To delegate certain responsibilities to lower levels,
- By performing Internal Audits of the Internal Control System
  - To assess the efficiency of the controls in comparison with the control objectives
  - To propose recommendations for adjustment

### **4.3.2. Ex-post controls**

The Ex-post control checks whether the budget resources have been spent in a legal, purposeful and timely manner and in accordance with the assumed commitments (contracts, invoices, etc.). Therefore, it is implemented after the discontinuation of business activity or business process.

#### **4.3.2.1. Existing situation and weaknesses**

In the Republic of Croatia, several bodies perform Ex-post control and at two levels: at the level of State and at the level of particular SABs.

At the State level, two bodies are in charge of performing ex-post control: Budget Supervision Division in the Ministry of Finance and the Croatia's Government Office for Internal Control as set forth in item 3.1.1. of this Strategy. This role of the Government Office for Internal Control will be abrogated by the decree in progress for its transformation into the Government Office for Internal Audit.

The majority of SABs have the established internal supervision and/or internal control and it is done in various ways. By passing the Rulebook on Budget Supervision<sup>30</sup>, the Rulebook on budget supervision and internal control<sup>31</sup> has been put out of force whereby an obligation of establishing internal control (CRO: nadzor) was annulled. Therefore the background for organising internal supervision or internal control is constituted of special rulebooks and other enactments of some SABs. In addition to, and taking into account the existing unclear issues and insufficient laws and by-laws and the fact that there is not enough awareness on the role and function of internal controllers in relation to internal audit, it is necessary to define clearly their role and their meaning. Although the Budget Law prescribes the establishment of internal audit which does not at the same time imply the removal of internal control/supervision. In certain areas, there is still the need for internal controllers work which will be defined by each head of SAB in accordance with his scope and organisation as well as the rulebooks on internal organisation.

#### 4.3.2.2. Development of ex post control

*Ex-post control* is performed after the implemented action and is directed to the detection of potential mistakes, discrepancies or irregularities and it leads to process re-examination or possible sanctions.

Ex-post control is aimed at the checking of :

- the achievement of expected results by using public funds;
- legality, accuracy and purposefulness of financial decisions as well as the conditions of their implementation;
- Legality, accuracy and purposefulness of the use of delegated public funds on the spot and in the fields.

Ex-post control is performed by internal controllers (inspectors) appointed by the head of SAB selected from amongst the staff with adequate qualifications, training and experience. These controls are performed periodically on the basis of the annual plan but also at requests and on the basis of complaints.

Ex-post control, performed by internal controller (inspector), comprises the following tasks:

- to check, by sampling method and where appropriate, whether the goods/services:
  - are received, in use and in accordance with the specifications, bid and instructions of the head
  - match the goods/service by value of paid amounts
- to check whether the project/program has been performed in accordance with the contract
- to check whether the payments to the users (of pensions, benefits) are in accordance with the regulations
- to investigate the possible irregularities and propose measures for their prevention
- to improve management, particularly financial management of the examined part of operations.
- to take conservative measures if necessary in case of anticipated risk for assets or persons consecutive to the discovery of serious irregularity.

---

<sup>30</sup> Narodne novine 42/04

<sup>31</sup> Narodne novine 92/96

Ex-post controller reports to the Head of the SAB (or to the Irregularity Officer if any exists) in case of suspicion or evidence of serious irregularity or fraud.

#### **4.4. Development of Central Harmonisation Unit**

The Department for Harmonisation of Internal Audit and Financial Control is now established as the Central Harmonisation Unit and is completely in compliance with the model described in Chapter 2.3. The Department is established with two completely independent divisions, what guarantees the segregation of duties between internal audit and FMC. The existence of the common Head of Department additionally strengthens the integration of the overall PIFC concept for both components of PIFC.

The Department develops methodology and standards and cares about the development of procedures and manuals for internal audit and as well as for financial management and control. The Department also develops methodology for risk assessment to be used by all line ministries/SABs. It gives methodological guidance concerning FMC and internal audit issues, evaluates activities of internal audit units, oversees the implementation of the defined requirements and analyses the internal audit units' functions, compiles the annual report used for consolidating activities of internal audit units and officials in charge of FMC in all ministries/SABs.

The CHU is in charge of making amendments to this document as necessary jointly with other Ministries/SABs.

It has been regulatory determined that the Central Harmonisation Unit will ensure the sustainable training capacity for internal auditors and persons in charge of FMC in public sector.

**The Division for Methodology and Coordination of Internal Audit** as a part of the Central Harmonisation Unit, is in charge of :

- publishing internal audit standards and methodology of work,
- organising training for acquiring internal auditors' certification. The training programme is compiled in accordance with the standards. The capacity of internal audit trainers needed for training future auditors is provided for internal audit trainers who gained the needed authorisations. The time distributed to these internal audit trainers for performing training will be clearly segregated from the available capacity of internal audit units to which they belong. Before the commencement of each training, the internal audit trainers will be allocated for the purpose of delivering training by the head of the Central Harmonisation Unit and the heads of the Ministries/SABs to which they belong,
- selecting and training of future trainers for internal audit from amongst the certified internal auditors;
- collecting, analysing and consolidating strategic and annual plans for internal audit unit,
- preparing the consolidated annual report on the activities of internal audit units which has to be submitted to the Government of the Republic of Croatia,
- establishing and maintaining of the internal auditors' network for the purpose of information exchange and improvement of the public internal audit profession;
- the establishment and maintenance of a register of all internal audit charters;
- maintaining of the Ministry of Finance's web-site, through which it informs the public on internal financial control and internal audit in the public sector of the Republic of Croatia as well as on certified internal auditors;
- keeping permanent contacts with other organisations (public, private, national and international) dealing with internal financial control and internal audit and ensuring to be a member of IIA and other similar organisations.

**The Division for Methodology and Coordination of Financial Management and Internal Control**, as a part of the Central Harmonisation Unit, is in charge of:

- definition, development and harmonisation of the methodology of financial management and the system of internal controls in the public sector in accordance with best practices of EU member-states
- preparation and production of a manual for financial management and internal controls;
- giving advice and guidance concerning risk assessment and risk management, as well as internal control self-assessment;
- giving advice and guidance related to implementation of internal audit recommendations;
- compiling and developing procedures related to financial management and control;
- training of the officials and other staff in charge of financial management and control;
- cooperation with the officials and other staff in charge of financial management and control
- development of a consolidated annual report on activities related to financial management and internal controls in the public sector for the needs of the Government of the Republic of Croatia;
- maintenance of the Ministry of Finance's web site through which will be informed the officials and other staff in charge of financial management and control as well as the public on internal financial control in the public sector of the Republic of Croatia;
- cooperation with other state bodies and international institutions and professional associations.

The Central Harmonisation Unit is in charge of establishing cooperation with the State Audit Office in order to have a joint approach concerning the main audit issues and methodologies, simultaneously respecting independence of both institutions and avoiding overlaps in the work

#### ***4.5. Establishing PIFC in local and regional self-government units***

The 2003 Budget Law made also mandatory the establishment of internal audit in the local and regional self-government units (hereinafter: LRSGUs).

Most of them did not establish independent internal audit service, as criteria were not defined yet concerning the location for establishing such service, given the financial strength of local units and their number of employees. In organising internal audit at local levels, it is necessary to take account of economy and the need of establishing those services in some of them.

Therefore, the establishment and development of the overall PIFC at the level of LRSGUs will begin in early 2006 within the framework of CARDS 2004 Project "Further Development of PIFC and Internal Audit".

The Central Harmonisation Unit will be tasked to jointly with expert of CARDS 2004 Project establish and develop financial management and controls and internal audit within the framework of LRSGUs.

Two pilot regional self-governments are already in progress with the attendance in the training programme for internal auditors of three Public servants appointed by the City of Zagreb and the Brodsko-Posavska County.

#### **4.6. Taking actions against significant irregularities and fraud**

Consideration of this field does not fully fall under the PIFC system. A CARDS or PHARE project should in near future be aimed at a comprehensive consideration of this field.

However, Internal Auditors and major actors involved in FMC are aware about the posture when facing strong irregularities or frauds. They directly report about their suspicions or proper findings to the Head of the SAB or to a senior official who will be duly designated in each state administration body as the “Irregularity Officer”.

The Head or the Irregularity officer will take the appropriate measures. A possibility will still be offered to Internal Auditors or Financial controllers to over pass this hierarchical path if no action is taken in a reasonable period of time compatible with the irregularity or the urgency as well as if the Head or the irregularity officers are obviously involved. The exact conditions of the emergency procedure are still being considered.

#### **4.7. Internal Audit Council**

For the purpose of strengthening the development and supervision of internal financial control and internal audit, an Internal Audit Council will be constituted. The Council is an advisory body of the Central Harmonisation Unit and may not assume the role of the Central Harmonisation Unit.

It is convened at least twice a year for the purpose of:

- giving opinion on the consolidated annual report of internal audit before its submission to the Government of the Republic of Croatia,
- advising on the problems which may occur in relation to particular audits, internal auditors or internal audit units,
- advising on the appointment or removals of the heads of internal audit units.

The Internal Audit Council is occasionally convened at a request of the head of the Central Harmonisation Unit or any other minister or head of SAB, no later than within one month time after the submission of such a request. The composition of the Internal Audit Council is defined by the Republic of Croatia's Government Decision.

The composition of the Audit Council will include:

- the Minister of Finance – the chairman,
- head of the Central Harmonisation Unit,
- 3 ministers,
- 2 heads of SABs except the ministries,
- 3 heads of internal audit units from the ministries or SABs whose minister or head is not already represented in the Council,
- 1 professor from the Faculty of Economics specialised in internal audit,
- 1 member of CHU staff as secretary to the Council,
- and the head of a ministry/SAB when the Council discusses his/her organisation.

The Internal Audit Council's members will be appointed by the end of 2005.

## 5. Conclusion

By the achievement of the objectives in compliance with a time schedule of CARDS 2002 project and a document titled "Strategy of Development of Public Internal Financial Control (PIFC)" in the Republic of Croatia, the Central Harmonisation Unit of the Ministry of Finance in cooperation with the project's experts, will strengthen its institutional capacity in this area and provide support to the implementation of PIFC with all users of public funds.

The activities will be directed also toward further strengthening of the responsibilities of the heads and other persons involved in FMC for the purpose of developing the awareness on the necessity and need to establish PIFC in all SABs for better financial and any other public means management.

Thus the development of PIFC will continue through CARDS 2004 project "Further Development of PIFC and Internal Audit" relating to the further development of PIFC in the Republic of Croatia and which is accepted by the European Commission and the project's holder is the Ministry of Finance, the Central Harmonisation Unit.

For the purpose of the above, it is necessary to pass the Law on PIFC which will provide for, amongst other, and explain differences between internal financial control and internal audit, i.e. set the main definitions of both PIFC components, define competence, i.e. independence of internal auditors as well as actions and activities of the Central Harmonisation Unit.

## 6. Proposed timeframe of next activities in the PIFC development

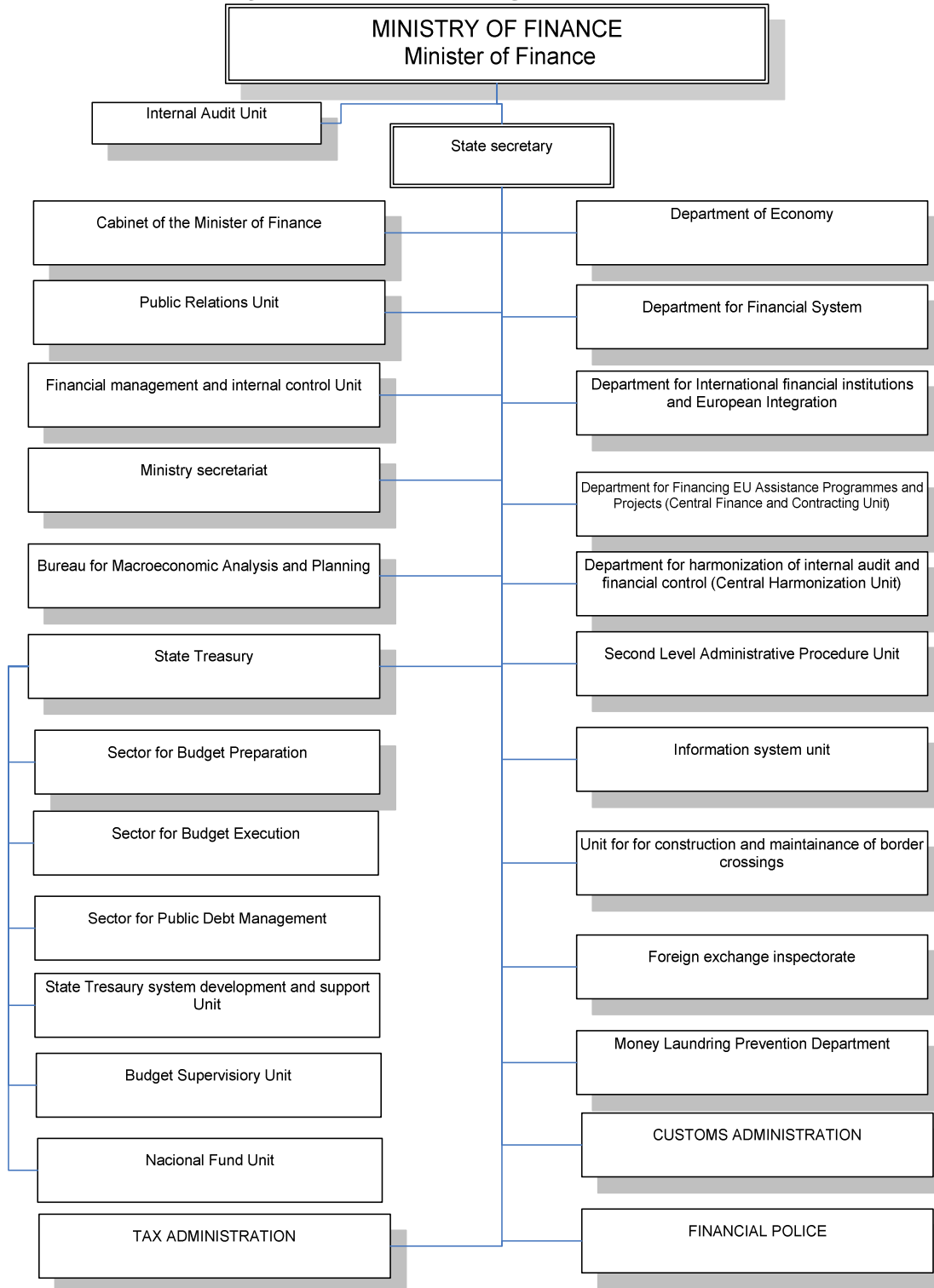
Activities description	Person or institution in charge	Deadline or period of work
<ul style="list-style-type: none"> <li>• Passage of the Framework PIFC Law, which will provide for both of its components, the role and significance of the Central Harmonisation Unit, competence and independence of internal auditors and responsibilities in management of Ministries/SABs.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Croatian Parliament on the proposal of Croatian Government</li> <li>▪ Central Harmonisation Unit in collaboration with CARDS Project</li> </ul>	<ul style="list-style-type: none"> <li>by 31 December 2005</li> <li>By 30 September 2005</li> </ul>
<ul style="list-style-type: none"> <li>• Amendments to the Internal Audit Rulebook, which will determine criteria for establishing internal audit in Ministries/SABs, i.e. the establishment of joint internal audit units for carrying out audits in bodies where this would not be economical, rational and purposeful.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Ministry of Finance on the proposal of the Central Harmonisation Unit and CARDS 2002 project team.</li> </ul>	<ul style="list-style-type: none"> <li>by 30 June 2005</li> </ul>
<ul style="list-style-type: none"> <li>• Passage of the Internal Audit Charter aimed at increasing the quality of audit work, which pertains to audit jurisdiction, powers, rights and duties entrusted to each internal audit units and internal auditors. The Charter will highlight and ensure functional independence of internal auditors and interrelations between an auditee and internal audit unit...</li> </ul>	<ul style="list-style-type: none"> <li>▪ Minister of Finance on the proposal of the Central Harmonisation Unit and CARDS 2002 project team.</li> </ul>	<ul style="list-style-type: none"> <li>by 30 June 2005</li> </ul>
<ul style="list-style-type: none"> <li>• To include additional 20 auditors in the internal auditors training programme, in order to have all 100 auditors certified by end 2005.</li> </ul>	<ul style="list-style-type: none"> <li>▪ Minister of Finance and CHU</li> </ul>	<ul style="list-style-type: none"> <li>by 31 December 2005</li> </ul>
<ul style="list-style-type: none"> <li>• Train 30 internal auditors for carrying out auditors of pre-accession funds and operation.</li> </ul>	<ul style="list-style-type: none"> <li>▪ CARDS PROJECT and CHU</li> </ul>	<ul style="list-style-type: none"> <li>by 30 June 2005</li> </ul>
<ul style="list-style-type: none"> <li>• The Central Harmonisation Unit has to update the internal auditors and training strategy and civil servants involved in the systems of internal controls for the period 1 January 2006 onwards, including: <ul style="list-style-type: none"> <li>- number of staff to undergo training</li> <li>- planning new recruitment or reallocation</li> <li>- train the trainers for the purpose of sustainability of CARDS project training programme</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ CHU with the assistance of the CARDS PROJECT</li> <li>▪ Each ministry/SAB</li> </ul>	<ul style="list-style-type: none"> <li>by 30 November 2005</li> </ul>
<ul style="list-style-type: none"> <li>• In each ministry/SAB, establish and regulate (where not done yet): <ul style="list-style-type: none"> <li>- internal audit units directly reporting to the Minister/Head of SAB</li> <li>- proper structures for FMC</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>▪ Croatian Government</li> <li>▪ Each ministry/SAB</li> <li>▪ CHU</li> </ul>	<ul style="list-style-type: none"> <li>by 31 December 2005</li> </ul>



## Appendix 1. Legislation from the PIFC field

1. Budget Law (*Narodne novine*, 96/03)
2. Law on the Execution of 2005 Republic of Croatia's State Budget (*Narodne novine*, 171/04)
3. Law on State Audit (*Narodne novine*, 49/03-official version and 177/04)
4. Law on Financial Police (*Narodne novine*, 177/04 and 42/05)
5. State Administration System Law (*Narodne novine*, 190/03- official version and 199/03)
6. Law on Organisation and Scope of Central State Administration Bodies (*Narodne novine*, 199/03, 30/04, 136/04 and 22/05)
7. Law on Civil Servants and Employees (*Narodne novine*, 27/01)
8. Public Procurement Law (*Narodne novine*, 117/01 and 197/03)
9. Law on the State Commission for the Control of Public Procurement Procedures (*Narodne novine*, 117/03)
10. Decree on Principles for Internal Organisation of State Administration Bodies (*Narodne novine*, 43/01 and 8/04)
11. Decree on the Procedure for Procurement of Goods, Works and Services of Small Values (*Narodne novine*, 14/02)
12. Budget Accounting Decree (*Narodne novine*, 96/94, 108/96, 119/01 and 74/02)
13. Decree on Job Position Titles and Jobs Complexity Coefficients in the Public Service (*Narodne novine*, 37/01, 38/01- correction, 71/01, 89/01, 112/01, 7/02- correction, 17/03, 197/03, 21/04 and 25/04- correction and 43/05)
14. Decree on the Government Office for Internal Control (*Narodne novine*, 6/01 and 126/02)
15. Decree on Internal Organisation of the Ministry of Finance (*Narodne novine*, 43/05)
16. Decree on the Treasury General Ledger System and the Manner of Keeping the Single Treasury Account (*Narodne novine*, 97/95)
17. Rulebook on Budget Users' Internal Audit (*Narodne novine*, 111/04)
18. Rulebook on Budget Accounting and Chart-of-Accounts (*Narodne novine*, 27/05)
19. Rulebook on Financial Reporting within Budget Accounting (*Narodne novine*, 27/05)
20. Rulebook on Determining the Users of State Budget and Keeping Budget Users' Register (*Narodne novine*, 80/04)
21. Rulebook on Budget Supervision (*Narodne novine*, 42/04)
22. Instruction on the Execution of the State Budget from the Single Treasury Account (*Narodne novine*, 4/01).

## Appendix 2. Ministry of Finance organization scheme<sup>32</sup>



<sup>32</sup> Decree on Internal Organization of the Ministry of Finance, Narodne novine 43/2005