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# Romanian Minimum Income Provision as a Mechanism to Promote Social Inclusion

Simona Ilie, Simona Vonica \*

Romania has inherited a social welfare system from the 80s providing good coverage for different types of risks specific to that type of society. Meanwhile, intervention forms have been diversified under the pressure of both economic changes and international tendencies. A brief overview of these, presented forthwith in order to fix the framework within the adequacy of the welfare state system in Romania, will be discussed. The third way is focused on the characteristic of the minimum income guarantee benefit (MIG) with special attention paid to it as a mechanism of promoting social inclusion.

## A. International context

Within a post-industrial context, European countries have experienced the transition from a Keynesian welfare state model to a Schumpeterian workfare one. Gradually the previous 'passive' measures supporting the unemployed were retrenched in favour of 'active' ones based on education and training. Simultaneously, the American model prescribed the practice of providing social assistance benefits under the condition of work requirement aimed at individuals. (Benner, Barbier, 2001) The end of the "golden era" of the welfare state was accompanied by an enforcement of liberal values. A more restrictive access to social benefits in both financial terms and eligibility criteria has been advocated. In this context, the idea of activating recipients' attitudes has become more and more pronounced. Both increasing participation in community life and social investment strategies have been promoted. The welfare state implies a national responsibility for all citizens' welfare as well as a clear option for moving the weight point from welfare to workfare.

National economies faced new rules to be followed within the globalization framework,

which has become a reality. The realistic approach concerning the globalization process is that of both resource and risk. Genov (1999) describes it as a resource by focusing on the opportunity to share successful institutional, economic and cultural patterns. The risk emerges from the rapid spread of technology, which is going to make people compete with both "machines" and lower cost workers on the labour market. An increasing level of inequality in the world is a likely consequence of the globalization process.

A third way economic model was designed advocating both locally and globally focused politics. Within a general enforcement of civil society objectives, the third way theory counts among its values the protection of the vulnerable as well as no rights without responsibilities (Giddens, 1998, 2001). Individuals are going to move to a space where what was seen as done, by nature or by tradition, is now a subject of change. Equality remains a value, but in a sense of inclusion, as the opportunity to be active within the community. It refers to both individual's rights and participation on the labour market and an active approach of the individual concerning its own life. Welfare state systems should, consequently, support the formation of human capital (Kurtz). Besides avoiding the dependency trap, it involves strengthening individual motivation to self-adaptation in a changing labour force market. Giddens also points out the erosion of the traditional family model, in both the roles played by its members and the meaning assigned to the concept.

The inherent welfare state reforms impose the need to redefine concepts. Pierson (2001) named three dimensions of the reform process: re-commodification, cost containment and recalibration. In different forms, these are aimed at enforcing individual responsibility for well being. This is to be made by emphasizing the link between welfare and

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labour market participation (re-commodification), and between social exclusion and high government social expenditure and taxation (cost containment), as well as by updating the benefits system to both new social risks and new ideas about how to achieve the goals of social provision. (Pierson, 2001 Kurtz).

## B. National context

### B.1. Economic downward trends

Restructuring the economy meant wage-paid job loss and insecurity for individuals, long term unemployment, and the alternative of early retirement in order to avoid unemployment or black work to supplement incomes. After the first half of the transition period, dominated by galloping inflation and the collapse of all incomes in real terms, the 1996 – 2000 government adopted the strategy of a total sacrifice hoping to boost the economy. Its social preoccupations were rather focused on settling the potential social explosions generated by what was seen as a priority – the sharp economic restructuring.

The average wage depreciated in real terms and dropped to less than 60% of the value registered in 1989, while the minimum wage fell to 26% of its 1989 value. As they were not subject to tripartite negotiations, social transfers showed a higher inertia to indexation. Significant differences were also registered between the dynamics of insurance and social assistance rights.

Since 1996, the number of pensioners has exceeded that of wage earners. The average unemployment rate at the national level didn't register any values higher than 13%, but is significantly higher in regional areas, where it exceeded 30%. By applying the ILO condition of "actively seeking a job," the resultant values were lower than the unemployment rate by approx. 2 percentage points until 1998, and then levelled to around 4% after that. In parallel, attempts to estimate the size of the informal sector highlighted a trend of widening it to reach values closer to 50% of the GDP. Governance started in 2001 aimed at stressing the social protection function of the minimum wage. The underlying idea was to stimulate people to enter the formal economy and to stress personal effort at the same time.

### B. 2. Welfare system reform

The transition from a planned economy to a market economy has been accompanied by a social disintegration process which has opened various ways of losing the coverage of the safety net system for different groups.

Until 1990, the *contributory scheme* was a comprehensive one, integrally covering the area of risk but only for the employed. Despite changes that have taken place, a global overview of the social policy shape at the end of 90s revealed a system still structured mainly on the protection of the wage class. Pensions assure a minimal security for the former employees. The deficit of the Social Insurances Budget (SIB) is notorious. Private pension schemes were hoped to offer a solution, but small steps were made in this direction. The undivided attention paid to the unemployed in the early transition has diminished as the phenomenon increased in size and in gravity. In spite of some regulations encouraging support for the inclusion of the unemployed in the labour market, the passive character of the Unemployment Fund expenditures has prevailed, while its in-flows have exceeded the out-flows.

The *non-contributive* assistance system has remained basically unchanged in terms of structure. It has been developed slowly, especially around some explosive problems, like abandoned children or disabled persons. NGOs have been very active around child and youth problems, but much less visible in other fields. The access of the eligible individuals to the state support varies due to different reasons. The public system is still focused on residential institutions, practically ignoring the services afforded families and communities. Within the financial intervention forms, different support forms have been developed more than others.

#### B. 2. a. The beneficiaries

Children have been a group almost permanent in the attention of the authorities (child benefits, supplementary aid and allowances for families with many children). Consequently, the financial benefits addressed to them, regularly with extensive addressability, are prevalent. During 1993 – 1994, there were discussions regarding the opportunity to

universalize the child allowance. Such discussions reached an end when deciding upon the child allowance definition as a right and not as aid, hence its implicit universal character. The child benefit was also used as an instrument to ensure a minimum education level to the younger generation with failure to attend the compulsory education forms (primary school, completion of the 8<sup>th</sup> grade) cancelling the right to receive the child benefit. The experience of extremely poor families reveals, according to field researches, that for this share of the population the child benefits and the other associated rights are, if not the only income, at least the central element in the household budget.

Alongside this, social aid for families with insufficient incomes which are well targeted, but which cover a small segment of the population, can be identified. Disabled people received increasing attention from the state, which made them more and more visible in social statistics: their number increased by almost 20 times during this period. The elderly people, as well as the unemployed, have been supported mainly through contributory schemes, and less by other means.

The responsibility of financing social benefits was shared between local and state budgets. The segment of population these

social transfers were provided for rose from 25.2% 1990 to 30.3% in 2000.

Despite all this, the prevention of child neglect and domestic abuse, shelters for victims of domestic violence and for homeless, support for one-parent families, the perspective of institutionalized children after 18, the “street children” phenomenon, provision of social houses, and at-home special services for elderly are still far from being accomplished. The increasing cost of pre-school services, in both private and state financed units, trimmed down after 1989, explains why those services represent more a source of impoverishment than a real option for parents.

### **B. 2. b. Financing the social welfare system**

Despite efforts on the part of the authorities to adjust the welfare system according to the both socio-economic reality in Romania and international tendencies, the data measuring the state effort in supporting people in need does not reflect this (Table 1). The financial effort Romania made in the 90s was less than other neighbouring transition countries did, where this effort was measured over 20%. During the last 13 years, Romania has experienced not just low economic performances, but also marginal attention paid to social policies. The data reveal an approach of the welfare state rather close to the minimal intervention model.

**Table 1**  
**Social expenditure, % of GDP**

1989	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000
14.2	16.6	17.0	16.5	15.2	15.5	16.0	15.7	15.9	17.7	18.2	17.2

Source: I. Marginean (coord.), *Analiza comparativa a finantarii politicilor sociale: Romania-tari in tranzitie-tarile UE*, (Comparative analyze of financing social policies in Romanian- countries in transition - EU countries) 2001

The strong point of the Romanian social welfare system reform over the last 13 years has been the development of a modern legal and institutional framework, as well as resistance to the adverse disintegration process. The weak points have been the lack of a global strategy, the rather reactive and punctual measures under domestic or international pressures, an orientation which is rather passive and not active active, and the temptation

of reducing social policies only to financial transfers (Zamfir, 2001).

Within this general context, poverty in Romania is rather a result of a social disintegration process, a progressive rupture of the relationships between an increased number of groups of individuals and community. The public was exposed to the long lasting action of various combinations of impoverishment mechanisms. One of the dominant factors has been the long term absence of a safe (not per-

manent) job and the breaks in housing policy: this combination has led to the occurrence/maintenance of severe poverty areas – poverty enclaves within small or big towns, and urban or rural communities alike. This ends by breaking the traditional social ties between individuals and the community they used to belong to. At the same time, one can see an increased solidarity within those who lost their place in the formal labour market. This has increased the gap between rich and poor.

Poverty risk differs by residential area. The risk of being poor in rural areas is twice that of urban areas. Geographical poverty distribution follows the traditional NS – EW axes. In the NE region, the most vulnerable area, almost 1 out of every 5 households is affected by severe poverty. (Table 2) The lowest poverty rate is specific to the region of Bucharest, which enjoys the most active labour market. A high risk of poverty is assigned to children, especially when they are numerous in a family.

**Table 2**  
**Poverty size<sup>1</sup> by different groups, %**

	Severe poverty rate %		Population of the group as % of total poor	
	1995	2001	1995	2001
Total	12.2	11.9	100.0	100.0
1 person	8.7	6.6	4.6	4.1
2 people	8.0	6.5	11.4	9.5
3 people	7.2	7.0	12.4	13.2
4 people	8.7	9.0	18.3	20.0
5 people	15.4	15.2	17.3	16.2
>6 people	27.6	31.8	35.9	37.1
1 person 65 years old and over	12.3	7.9	3.5	2.8
single parent with children	7.7	8.6	0.7	0.7
2 parents with > 3 children	17.0	25.1	6.7	6.5
Urban	7.1	8.6	31.8	39.3
Rural	18.2	15.8	68.2	60.8
North East	18.9	19.7	26.1	27.4
South East	12.5	13.6	13.4	15.7
South	13.4	11.3	17.1	13.9
South West	12.6	13.7	11.2	12.5
West	7.1	8.6	5.3	6.6
North West	10.9	10.5	11.3	10.8
Centre	12.4	9.6	11.9	10.3
Bucharest area	4.4	2.4	3.7	3.0

Source: APSIPC data

<sup>1</sup> The poverty rate measurement is developed by a group of the Romanian experts, from different institution. The methodology is developed around a normative methodology, in two steps. A minimum food expenditure is determined based on foods consumption structure of those in the

expenditures deciles 2 and 3 and a target of 2550 calories / day. The amount of the non-food expenditures results from the volume of these expenditures of the households for which the total expenditures equalize the minimum food expenditure needed.



### C. minimum Income provision

As more and more groups have been exposed to social exclusion risk, the Ministry of Labour and Social Solidarity (MLSS) decided in 1995 to implement a social aid benefit which was supposed to cover all those struggling from severe income insufficiency. The Social Aid Law (1995) created the legal framework for financial support addressed to the poor, as a means-tested benefit. The idea of means-tested benefit was not particularly new, but it was the first time the principle was explicitly formulated. The SA benefit was granted upon request.

This social aid (SA) came to replace several state transfers offered periodically to small segments of the population and to support at minimum those with low incomes, especially the elderly. This threshold was not conceived as poverty, but rather as a limit imposed by budgetary constraints: 10% of the Romanian households were expected to benefit from SA. Few other eligibility criteria were set in addition to household income. At the end of 1995, some 655, 178 beneficiaries were registered. This decreased constantly in the next 5 years to 25% (2001) of those originally registered in 1995. The assignment of financing SA to local budgets was the underlining cause of the decrease. The poor areas were the most affected by the financial decentralization: these accounted for the most households fitting the theoretical coverage and the decreased financial resources. On the other hand, the on-coming local election in 1996 was responsible for slackening the eligibility criteria. Over inclusion was identified as a result of privileged access to the entitlement, too.

In 1997, social justice requirements claimed for strengthen the eligibility criteria for SA system. Under local authority empowerment, more responsibilities were assigned to it. Based on the general living standard of the community, the local authorities were to decide upon the recipients' eligibility, under general criteria set by law. Again, arbitrary decisions were found out, as well as efforts

of local authorities to set additional eligibility criteria. The households' assets evaluation aimed at taking into account the counter value of durable goods, art objects, and jewellery possessed by them. 5 days community work per month was also imposed to the working age claimants.

The marginal attention paid to poverty issues by the 1996 Government led to a constant decrease in the real value of the SA benefit. (Table 3) Added to the delay of the payments due to the financial constraints at local communities, the disincentives for applying for SA have gained weight.

**Table 3**  
**Social aid - real value, % of 1995**

1995	1996	1997	1998	1999	2000	2001
100	72.0	61.8	51.6	43.0	31.0	23.0

*Source: Authors' computations based on NISES data*

Probably the project most explicitly linked to government started in 2000 and aimed at promoting social inclusion by incomes policy is the regulation concerning the unemployment benefit. This was set at a flat amount, equalizing 75% of the minimum wage, regardless of the length of the contributory period and the amount paid in. The difference is made by the length of the contribution period (at least one year), which marks out the length of the period for which the unemployment benefit is paid: between 6 and 12 months.

In this context, the Minimum Income Guaranteed Law (2001) replaced the Social Aid Law (1995). The MIG aims at coping with severe poverty in accordance with EU regulations. It is also a means-tested social benefit, based on the social solidarity principle. The maximum amount of MIG for a single member family was designed to be 45% of the national minimum gross wage, 25% less than the unemployment benefit respectively, in 2002. It was foreseen that the necessary funds represent 0.4% of GDP, and is going to be directed towards 10% of the Romanian households (estimated to be some 750, 000 families) in 2002.

## C.1. MIG procedure

Those considering themselves entitled for MIG benefits have to prove their financial status. Based on a general background defined by law, the eligibility criteria are set by the Local Councils. Proof includes, among the official request, all those certifying income levels and the status declared for each family member. These are provided by different institutions. Part of the documents must be renewed quarterly. A social survey is carried out by local authorities and a response to the applicant is given in 30 days. The equivalent income per capita resulted from individual declarations and the survey is subtracted from the threshold set for a correspondent family size. The result represents the MIG benefit to be paid monthly.

If the applicant does not present the complete file or does not renew it he loses the entitlement right. He is also obliged to announce any changes that occur in his family status, no later than 30 days afterwards. Even though the list of these documents can be half a page long, the local authorities consider

them absolutely necessary, at least at this stage of system implementation. The beneficiaries' opinion concerning the file size is split between this one and that of considering them too many or too time consuming. The needed time for obtaining all these documents is proportional to both the family size and socio-economic structure.

## C.2. MIG implementation

At the end of 2002, a total of 635, 402 applications for MIG were filed, meaning almost 85% of what was estimated. The application distribution by family size is the following:

- 24.8% by single people;
- 19.0% by families with 2 members;
- 18.8% by families with 3 members;
- 17.5% by families with 4 members;
- 10.0% by families with 5 members; and
- 9.8% by families with more than 5 members.

The total number of beneficiaries was 1, 132, 540 people, representing 5.4% of the population in the country. The comparative analyse of both the poverty rate and MIG benefit dis-

**Table 4 Poverty rates (% , 2001) and MIG benefit distribution (2002)**

	Severe poverty rate	Absolute poverty rate <sup>1</sup>	% of the beneficiaries (families)	% of the total population in the area	% of total amount spent
North East	19.7	10.9	15.0	7.4	21.6
South East	13.6	6.0	17.1	5.8	14.7
South	11.3	4.6	18.5	4.4	17.6
South West	13.7	4.9	13.0	6.1	12.0
West	8.6	4.2	8.2	3.4	8.6
North West	10.5	5.3	12.6	4.4	10.9
Centre	9.6	4.3	13.9	5.0	13.0
Bucharest area	2.4	1.0	1.6	0.6	1.8
Total	11.8	5.6	100	5.4	100

Source: APSIPC and author's computation based on NISES and MLSS data

<sup>2</sup> Absolute poverty rate refers to people of which total expenditures are at most equal to minimum food expenditures identified by the above mentioned methodology



tribution reveals that the latter target are those living in absolute poverty. (Table 4) Besides this, distribution by region is also very similar. One fifth of the total amount spent for MIG benefits went to the NE region.

**The beneficiaries of MIG benefit** are old people living alone, people without work, young people who have never had a formal job (especially in rural areas or those coming from orphanages), and numerous families with large number of dependent people. It is not so rare when they are living in improper conditions in houses without enough room according to the family size, electricity, heating system, running water, if not precisely having a house, but a cover against wind and rain.

The beneficiaries have at most finished 10th grade, and could be hired at most in low skilled jobs. The younger ones with few children in care are still making efforts to send them to school. The child allowance for 7 years and older is granted just to those in school (up to 18 years old). School grants for pupils in need could be offered to them as well as supplies (notebooks, and so on, in 2002). Field research<sup>2</sup> also revealed families which stopped to send their children to school. Social canteens represent a fortunate opportunity for these families. Meat is provided once a day, hot or canned. The subjects of our interviews identified it as an opportunity to diversify children's daily food. Cases of tak-

ing the packed food and selling it elsewhere were, however, mentioned by local authorities interviewed. Compulsory hot meat in the canteen for the children was seen as a punishment measure. Unfortunately, these canteens are absent in rural area. Not even all urban communities have the benefit of such services. The field research revealed cases when these were stopped in order to financially support the MIG benefit system, even if there is consensus regarding in-kind aid as the most efficient means of support.

**Jobs offered** to the recipients by the local authorities on the account of 9 days of community work envisaged mostly cleaning public areas, such as roads, parks, lawns, and so on, and more rarely cleaning and repairing activities in schools, hospitals, retirement homes or other things. A 2 – 3 month delay of payment was also noticed during 2002. Generally, the in-kind payment did not represent an attractive alternative for the local authorities.

Around 171, 000 suspended benefits and 101, 000 leaving payments were registered during the whole year. If the first way of exit is temporary in character, until the recipient fulfil its periodical obligation to up-dates its documents, the second exit type is definitive, and could be caused either by voluntarily leaving or as a result of not fulfilling the responsibility the person has within this contract.

### C.3. Similarities and Differences between SAL (1995) and MIGL (2001)

a. Both are based on the principle of solidarity

b. identification 1995      2001

Total income per capita less than a threshold, including potential income from properties	Total income per capita less than a threshold, including potential income from properties Homeless included
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c. income considered 1995      2001

Various sorts of monetary income, <i>except</i> school grants and soldiers wives benefits	Various sorts of monetary incomes
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<sup>3</sup> The interviews where part of field research – “Local strategies for poverty alleviation,” focused on “Aspects of MIG Implementation,” 2002. The research was carried out by the Life Quality Research Institute and was financed by the

Romanian Ministry Of Education and Research. Newspaper interviews with local authorities are also supporting the research findings.

## d. general eligibility criteria 1995 2001

<ul style="list-style-type: none"> <li>- Upon request</li> <li>- Total income per capita less than a threshold, including potential income from properties</li> <li>- Proof of official registration as unemployed (if the case), followed vocational courses offered and did not refuse a job, proven every 3 months except :                             <ul style="list-style-type: none"> <li>- parent / foster parent with children under 7</li> <li>- people in school under 25</li> <li>- pensioners</li> </ul> </li> <li>- 5 day community service after 1997, promoted by local authorities</li> <li>- social survey is permitted if necessary</li> </ul>	<ul style="list-style-type: none"> <li>- Upon request</li> <li>- Total income per capita less than a threshold, including potential income from properties</li> <li>- Proof of official registration as unemployed (if the case), followed vocational courses offered and did not refuse a job, proven every 3 months except :                             <ul style="list-style-type: none"> <li>- parent / foster parent with children under 7</li> <li>- people in school under 25</li> <li>- pensioners</li> <li>- inadequate work capacity (to be proven)</li> </ul> </li> <li>- 9 day community service at most, generally designed</li> <li>- social survey compulsory</li> </ul>
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## e.1. benefit amount

Amount for 1 member family	% of minimum wage	
SAL, 1995 = 100%	1995 - 60%	2001 - 11.8%
MIGL, 2001 = 66% of SA 1995	2002, January - 45%, since March - 36%	2003, January 26.8%

## e.2. SA increase by size of the households (compared to the benefit of inferior group)

	1995	2002
1 person	100%	100%
2 people	80%	80%
3 people	39%	39%
4 people	26%	24%
5 people	19%	19%
6 people	55% of that for 1 person for each person beyond the 5 <sup>th</sup>	25% of that for 1 person for each person beyond the 5 <sup>th</sup>

## f. funding 1995 2001

<p>Local Budget. The state finance depends on the number of recipients. 1995 the first 3 months State Budget in its entirety After 1996 mostly Local Budget</p>	<p>Local Budget. The state finance depends on the number of recipients. 0% - 100% Local Budget</p>
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## g. means of payment 1995 2001

Money only	Money and in-kind
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h. associated benefits

1995

2001

	Heating subsistence, during winter, added to the corresponding MIG amount Free social health services
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i. incentives

1995

2001

11% increase of benefit for each family member formally employed in 1995	15% increase of benefit for each family member formally employed
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#### C.4. MIG System adequacy

A brief overview of both system regulations points out that MIG Law did not significantly change the framework of minimum income provision. It seems rather to take over and generalize the good local practices with the background of the international tendencies. It is a definite, at least in intention, a step forward towards enhancing individual effort to get his/her own welfare. It appears to be the most clearly articulated in setting the benefit level.

First of all, there are taken into account all sort of other welfare benefits (as above c). Secondly, initially set at a lower level than the SA benefit, compared to the minimum wage, it fell to a bit over a quarter of that. Following the same aim, it was designed to be 25% smaller than the unemployment benefit during 2002, respectively 10 – 15% until 2004. It follows the same increase rate by family size as the SA, but the marginal increase for each person over 6 is significantly lower.

The idea of decentralizing responsibilities is based not only on the current tendency of enforcing the local autonomy, but on the hypothesis that they know at best the socio-economic conditions of the area equally. It refers firstly to local authority competences in establishing the value of assets evaluation. In rural areas, the main subject of value evaluation is the land people possess and animal products obtained by the households. This assumption is based on the difference in land fertility by different areas. In urban areas, local authorities have focused on durable goods and the house or building owned. The possession of an automobile as well as of different durable goods in double (TV set, refrigerator,

etc) and, definitely, houses makes people not eligible for MIG benefit.

The permanent imposed contact with Labour Force Offices, as an active attitude toward formal job opportunities, even though not new being necessary for the unemployment benefit too, points out the very core of the law. As the Minister of Labour and Social Solidarity foresaw, in the beginning of 2002 the registered unemployment rate rose from 8% to 12%. The exceptions to this provision are in harmony with social justice criteria, human capital investment direction to aim at, and the increased social exclusion risk of single parent families with underage children, naming here a new vulnerable group that has arisen.

Based on the “no rights without responsibilities” principle, the model of 72 hours per month community service generalizes a good practice set at the local level and enhances it. The MIG increase with 15% is hardly an incentive as long as a minimum wage in the family budget cancels the eligibility to the benefit. On the other scale, the MIG amount is so low that 15% of that does not represent an incentive, but rather a bonus.

#### C.5. Downward exclusion

MIG Law set by its general regulation a broader coverage of the potential beneficiaries. However, downward exclusion paths were to be noticed.

- a. Both *eligibility criteria* types named above could create debatable topics. Definitely, the land in plains and mountain regions has different productivity rates, but it is not likely to be the case for small neighbouring communities belonging to the same administrative council. When this is related to disposable financial

resources, the eligibility criteria can be strengthened more in some communities than in others. Consequently, people with comparable situations but living in different communities could be entitled to MIG benefits or not.

Another risk situation arises from elderly people. The previous work history of those in rural areas links many of them to former agricultural associations. Due to pension benefit computation in such cases, their income is extremely low. As a result of the land restitution process after 1989, it is part of the benefit of a potential income, and because of this it is likely to be excluded from MIG benefits.

In urban areas, the main risk situation is related to extra rooms. The hypothesis behind is that of a potential income source. The idea is not to replace the house with a smaller one, but to rent it. Theoretically it is a solution, but in practice it is still a problem to be solved. In the meantime, the income of people living in houses with extra rooms is computed by adding to their monetary income an amount per square meter in surplus. The resulting (theoretical) income takes them off of the eligible list. It is particularly the case of elderly people living alone. One more reason stresses the importance of solving this problem. When elderly people living in such conditions get severe health problems and would need permanent care, they do not accept someone unknown to share the apartment. If the social worker does not find someone known to the applicant, the people would rather be put in a retirement home. The solution involves not just the development of a special services network, in terms of increasing specialized people in this respect, but also to rebuild people's trust in people nearby.

The value evaluation of other durable goods makes less problems, even though this condition is more subject to be "instantly changed" in order to be fulfilled: durable goods in double could be temporally "damaged" or hidden when a social survey is carried out at the applicant's residence.

b. **Rural area disadvantage.** Some documents proving applicant status are provided by state institutions with no offices in the claimant's community. Sometimes the cost procurement in terms of money or time spent to get them is high enough to discourage people and to make the effort worthless compared to the amount of MIG they would benefit from.

Living in a small community, like most of the rural areas, does not mean just stronger relationships between members, but also a better awareness of others' situation. So, a woman of 50, living in a rural area, taking care of her 90-year-old war handicapped father, benefiting from pension and having land in property (belonging to another far away community) is not eligible for MIG benefits, while a 32-year-old woman, living in an urban area, taking care of her 60-year-old mother, benefiting from pension was considered eligible.

c. **Lack of financial resources.** It has already been proven by the previous SA Law that the eligibility criteria have to be analyzed in accordance with the disposable budget. In 1996, when the funds were no longer provided by the State Budget, the number of recipients decreased to 50% of those registered in the first 4 months of SA implementation in 1995. The financial collapse of local budgets simply stopped the payments. Thus, even though people are entitled for the benefit, they get nothing. This can last from one month to an indefinite period.

## C.6. Reasons for self exclusion

Refusal to do the 9-day community service automatically cancels the right to this benefit. Interviews with local authorities revealed different reasons behind this:

a. **Psychological reasons: stigma, selfish, self-esteem.** People feel shame at being seen in what they define to be marginal jobs. They do not think that they have any moral obligation towards society as long as it fails to get them work opportunities. They are poor because they do not have (anymore) a job on the local market, which the state is supposed to assure. Consequently they have nothing to be in debt to. The logic sur-

passes the communist tradition: the state does not necessarily have to offer jobs to its citizens, but responsibility of developing appropriate economic policies in order to create work opportunities definitely belongs to it.

On the other side, when it is possible, they prefer to use their personal network performing occasional small services for others, instead of fulfilling the required community work.

b. *Financial reasons*, based on the balance between what they pay and what they earn. It is considered that 72 hours of community service is too much for the amount they benefit from. The local authorities' solution to this was to decrease the number of imposed working hours proportionally to the amount to be paid to the family compared to the maximum possible amount. Even this way, a simple efficiency analysis weighing on one side the MIG amount and on the other the income earned on the informal market will tilt the balance toward the latter. Some of the beneficiaries interviewed brought into discussion the amount received per day when working for the community compared to the bigger amount of money they earned in occasional work. The increase of the benefit with 15% for each person formally employed does not provide enough incentive to give up informal income.

c. *Professional reasons and self-esteem*, based on people's qualification. For a small part of claimants, the jobs offered imply skills beneath their qualification. Due to this, people do not accept work, under the conditions offered, which do not make use of their educational/professional skills and experience.

Family life experience could also play a role in the equation. According to the law, the benefit is granted to nuclear families. In Romania, poverty brings together, in the same household, extended families. These share the resources gained by all members, no matter if they belong to the same nuclear family or not. The total household income excludes the claimant, but its total nuclear family income does not. When it is about the family of the parents and their

children and when the parents have a long work history, neither they nor their children would accept the community work offered.

The reason for self-exclusion is likely a mix of those mentioned above. Anyway, one could notice that the frequency of voluntary leaving is higher before and during religious holidays (Easter and Christmas) and at the beginning of the agricultural season. That links the refusals to the informal working opportunities. Some local authorities added the potential amount gained from such occasional activities and reconsidered the entitlement right. Some others thought about this and took it further and saw it as a potential financial resource: those offering daily work should pay the appropriate money to the local authority, which is going to pay back the workers.

A way of escaping the community work duty but continuing to benefit from MIG grants is the medical exemption. Local authorities suspected some of them to be false, but they do not have any competence in expressing doubt regarding a medical decision. The topic needs to have more attention paid to it.

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As a legal framework, the newly promoted MIG Law better fits the current tendency to strengthen local authority power in designing social protection measures, and the individual effort towards their own well-being. As a mechanism, MIG is properly designed to reach these goals. Its implementation revealed that good intentions did not always have the expected results. The voluntary and non-voluntary exclusion paths explain this in part.

The general low income level together with the poor labour supply has pushed particular segments of the population into a hopeless situation. The even less social state benefit level does not keep people in a dependency trap, but rather helps them to survive. In terms of money offered, it is almost improper to speak about MIG as an efficient social inclusion mechanism. The present sharp income policy ought to be accompanied by appropriate economic policy measures in order to activate labour force supply. The decentralization process also needs closer attention: the rate of delegate responsibilities has to



be articulated with the rate of identifying new resources, so as to avoid financial collapse at the local level, as well as to allow the design of local development plans and correspondent resources for it.

Quality of Life, United Nations Development Country Office Romania,

*Social exclusion and anti-poverty strategy*, quoting Silver H. in Rodgers et al, 1995 [www.ilo.org/public/english/bureau/inst/papers/synth/socex](http://www.ilo.org/public/english/bureau/inst/papers/synth/socex)

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# How the Supreme Audit Institution Should Perform and is to Be Managed for External Audit

## Independent SAI as a Precondition for Four Pillars

Neva Maher \*

The purpose of this paper is to describe why the Supreme Audit Institution (SAI) and its independence are important for implementing four pillars. The Four Pillars should function for good governance: responsibility, transparency, predictability and participation. Four pillars support for sustainable development of a country in global competition is indispensable for them to function and management controls in the public sector and the supreme audit institution are how they are put into action. Audit and management controls are also elements of the budget execution cycle.

This article exposes the importance of institutionalisation of external audits to understand why it is a precondition for public expenditure management to function. Public expenditure management, PEM, deals with the allocation and use of resources responsibly, efficiently and effectively. The article also introduces a basic glossary, context and background linked to issues connected to an external audit.

**Key words:** Supreme audit institution, financial audit, performance audit, public expenditure management, managing public money, responsibility, transparency, predictability and participation.

### Context

External audit refers to an audit carried out by a body that is external to, and independent of, the organisation being audited, the purpose being to give an opinion and report on the organisation's accounts and financial statements, the legality and regularity of its operations, and its financial management procedures and financial performance. Organisations responsible for external audit of government activities most often report directly to parliament, and are often referred to as supreme audit institutions (SAIs). In the

modern society, there is no independent audit without its institutionalisation as SAI.

SAI is a public organisation, normally independent of government and accountable to the legislature; that is, it is responsible for auditing the government's financial operations. The SAI may carry out different types of audit activity: financial, compliance and regularity. The first type is a financial audit (standard INTOSAI<sup>1</sup>, 39). Performance audits are the second type (standard INTOSAI, 40). The purpose of any financial audit is to give a discharge for accountability for using public finances. The purpose of a performance audit is an analysis of the economy, efficiency and/or effectiveness of the use of public money and as an independent study that can be used for further discussion or treatment, as for example in the U. K., for a discussion in a Parliament.

As first, running an external audit can be more or less an independent undertaking. Historical development of state and civil society requests its independence more and more. Also, the context of functioning in the European Union brings a request for institution building, and capacity and administration management building.

For SAI, institutionalisation means the existence of an independent institution whose existence stands by and supports its external auditor to function independently. Institutional units are entities with their own resources (means); they accept obligations and do economic and financial matters in their own name.

There are three different kinds of units:

- administrative units of central government, state or local administration, and also non-budgetary funds;

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<sup>1</sup> INTOSAI standards can be found at: <http://www.oecd.org/puma/sigmaweb/act/audit/>

- social security funds; and
- non-market, unprofitable subjects, financed and controlled by the government.

As public expenditure management, PEM, deals with allocation and use of resources responsibly, efficiently and effectively (Managing Public Expenditure, SIGMA<sup>2</sup>, 2002, p. 2), “it is necessary to make a distinction between the expenditure policy question of what is to be done, and the expenditure management question of how it is to be done. It is true that attempts to set over rigid boundaries between policy and implementation tend eventually to unrealistic policies, ad hoc implementation and, over time, both bad policy and bad implementation. However, the distinction between the soundness of PEM procedures and processes and the goals that they are meant to achieve remains very important (ibid, p. 2).”

Independence appeared when it became obvious that the public sector is a part of society and also that the public sector is a complex system. In democracy there are three sectors: public, business and the civil service. Also the EU Regulation on Structural funds 1260/99<sup>3</sup>, Article 8, expands its partnership definition on all three sectors and partnership

<sup>2</sup> SIGMA (the OECD organisation for Support in Governance and Management in Central and Eastern Europe) supported reforms of public administration in 13 transition countries: details at <http://www.oecd.org/puma/sigmaweb>.

<sup>3</sup> Structural Funds are the EU main instruments for supporting social and economic restructuring across the Union. They account for over a third of the European Union budget. A region may have access to one or more of the four structural funds, depending whether it has objective 1, 2 or 3 status; all regions have objective 3 status.

The aims of the funds are:

The European Regional Development Fund (ERDF) aims to improve economic prosperity and social inclusion by investing in projects to promote development and encourage the diversification of industry into other sectors in areas lagging behind. This fund is available in areas of objective 1 and 2.

The European Social Fund (ESF) enables training, human resources and equal opportunities.

The guidance section of the European Agricultural Guidance and Guarantee Fund (EAGGF) is in rural Objective 1 areas to encourage the restructuring and diversification of rural areas, to promote economic prosperity and social inclusion, whilst protecting and maintaining the environment and rural heritage.

The Financial Instrument for Fisheries Guidance (FIG) projects modernise the structure of the fisheries sector and related industries and encourage diversification of the workforce and fisheries industry into other sectors. It also aims to ensure the future of the industry through achieving a balance between fisheries resources and their exploitation.

subject relations among and within them. The public sector functions on four levels: Parliament, government, ministries and the technical sector as agencies, etc. In such a mix of different institutions, organisations or subjects, it is obvious that new challenges and more risks arise. It is, in fact, very difficult to be perfect and to obtain total excellence. But it is a must to confront risk: including non-transparency and unpredictability.

Council Regulation (EC) No 1260/1999 lays down general provisions on the Structural Funds exposed management and controls. The Managing Authority for structure funds in a country verifies the delivery of the products and services co-financed and the reality of expenditure declared by the intermediate bodies. The managing authority and the ministry have its own internal audit to verify that management and internal control systems are in compliance with community requirements. In addition, it is authorised to co-ordinate the submission of payment claims and to co-ordinate, if any, irregularity reports.

With regard to structural funds, the member states and local authorities are bound by the following obligations, including control:

- to designate an agency to check the validity of requests for payment;
- to provide the Commission with a description of the management and control system used;
- to make audit reports and control documents concerning the management of funds available to the Commission.

The SAI should endeavour to have the widest possible remit to carry out its work throughout the entire public sector. The SAI could consider carrying out audit work in the following areas:

- \* Central national funds and accounts;
- \* EU and related resources;
- \* Other development and international funds;
- \* Other state and public funds and accounts;
- \* Revenue and tax accounts;
- \* Fees, charges, rents and other revenues;
- \* Annual public sector departmental accounts and any associated trading and/or commercial accounts;

- \* State owned or controlled private sector companies;
- \* State agencies;
- \* State properties;
- \* All state assets and liabilities;
- \* State grants and subventions;
- \* All other public sector and statutory bodies;
- \* Stock and store accounts;
- \* Other assets, investments, guaranties, loans, concessions, subsidies and liabilities;
- \* The national bank;
- \* Public debt;
- \* Audit of local and regional government authorities institutions and other bodies;
- \* Parliament; and
- \* Social security funds and health issues (Recommendations, 1998, annex 4).

“The great importance of the Lima declaration lies in the fact that it contains a complete list of all the objectives, problems and possible guarantees that SAI have to confront in the interest of public auditing (Fidler, EUROSAI, 2000, p. 6).” Special emphasis can be granted to the importance of the independence of SAI, which the Lima Declaration highlights on several occasions. It also demands an adequate legal guarantee by means of the appropriate legal instruments in the event of the independence of those institutions coming under attack. “So, the Lima declaration is characterised by an attitude that is profoundly democratic and state –juridical which, for members of INTOSAI, signifies the obligation to promote this attitude. The implementation of the Declaration at the world level is one of the challenges of globalisation for INTOSAI and its members (Fidler, EUROSAI, 2000, p. 7).”

By definition of UNDP, the United Nations Programme for Development, good governance should be accountable, transparent and should involve citizens to participate.

## Background

In the accession process, the candidate countries are preparing their institutional capacity. The central institution which is indispensable in realising its institution, organising and subject accountability is a supreme audit institution with its instrument – audit programmes and auditing processes – to carry out audits.

Audits bring findings and recommendations to five basic norms or standards which are: integrity, legality, economy, efficiency and effectiveness. In most cases, financial audits are concerned with the first and second norms, whereas the performance audit is concerned with the 3E’s (economy, efficiency and effectiveness). For SAI, the strategic concept means to put down who audits and what, including risks and materiality. It states auditees and the purpose of the audit: whether it be a financial audit for the need of discharge, or a performance audit. When speaking about the concept of SAI, it is basic to put down the scope of audit.

INTOSAI is the International Organization of Supreme Audit Institutions. This is a UN organisation founded in the fifties. In 1977 the INTOSAI congress accepted norms and standards and made the Lima declaration. These standards were prepared very carefully and in detail. Practical needs, theory and future development needs were brought together so well that up to now there have been no changes. Even the EU in 1998 based its standards on INTOSAI and declared the European guidelines on auditing standards INTOSAI. Fifteen “European Implementing Guidelines” are broken up into five groups:

- Group 1 - three guidelines relevant to audit preparation;
- Group 2 - six guidelines relevant to obtaining audit evidence;
- Group 3 - two guidelines relevant to audit completion;
- Group 4 - one guideline on performance audits; and
- Group 5 - three guidelines dealing with other matters.

In 1998, INTOSAI declared the guidelines for privatisation purposes and issued the INTOSAI Code of Ethic. In 1991, INTOSAI launched standards for internal auditing and in May of 2004 a conference on performance audits will be held in Budapest. When facing the new millennium with globalisation problems, the president of INTOSAI, Dr. Fidler, commented “For such preliminary tasks, INTOSAI auditing standards proved and are still of huge importance. The need arose that SAI and INTOSAI combat negative issues of

globalisation (Public auditing and globalisation, 2000, page 9).”

Today, there are 191 members of International Organization of Supreme Audit Institutions, INTOSAI, among them are all important countries in the world (EU member countries and new 10, USA, Canada etc.), as INTOSAI is a United Nation organization. Standards INTOSAI are not only standards of auditing. They are also norms and postulates for SAI as an institution and its capacity building. They are even not only for SAI but also for building up public management capacity. INTOSAI meant this issue under terms management controls and that SAI could be of help to put management controls to work.

INTOSAI auditing standards put down the frame for four basic groups of norms:

- basic postulates;
- general standards;
- field standards; and
- reporting standards.

Postulates as basic principles to support accountability for responsibility, transparency, predictability and participation. These postulates function when SAI implement them through its work, through discharges that function and public officials are accountable and there is a debate among stakeholders and partners about 3E. Basic economic questions, limited resources and value for money obtained for them are crucial questions of survival.

Following INTOSAI standards basic postulates are many important issues to be aware of and to take into account:

- applicability of standards;
- unbiased judgement;
- public accountability;
- management responsibility;
- promulgation standards;
- consistency of standards;
- internal controls;
- access to data;
- activities to be audited;
- improving audit techniques; and
- conflict of interest.

They upgrade rule of law with qualitative use of resources. They serve as standards for heads of SAI to prepare the strategic concept for SAI. Their task is to audit important issues

i. e., materiality in the language of auditors and issues which are specially risky (public procurement, e. g.) or challenges (privatisation, e. g.).

Principles of INTOSAI are the precondition to take into account when using EU resources. Also european guidelines are based on them and in the process of convergency they are to be built in management, for public sector management of public expenditure. The principles are not just formal commitments. They are preconditions for efficient auditing of public money and for accountability in the use of resources.

They support:

- quality of public services;
- efficiency and effectiveness;
- continuity;
- following the objective needs;
- acknowledgement of certain needs by the authorities; and
- trend following.

## Sai and its Independence

In the EU we can say we have four types of functioning institutions:

- the Westminster model;
- the Napoleon type;
- the German; and
- a transition type.

Cour des Comptes of France should serve as an example of Napoleon’s court model. Rechnungshof of Germany is an office model, and the National Audit Office, the NAO, of the United Kingdom represents Westminster’s model.

The European Court of Auditors, ECA, a 15-member independent entity based in Luxembourg, performs an external auditing function for all of the budgets of European institutions. In contrast to what is often the case in the Member States, the Court has no jurisdictional power. ECA performs audits and most financial audit types: all budgetary and financial operations concerning revenue and expenditure alike, and it has broad powers to inspect documents and perform onsite investigations. Its analysis and conclusions are conveyed in an annual report which is circulated to all Community institutions.



Audit departments and institutions operate in various auditing operations and procedures; they converge to perform financial audits following European guidelines; they more and more rely upon management controls to work. That means those internal auditors are responsible for reliable statements, use of classifications, etc.

In 1314 in England, posting the Comptroller of the Exchequer meant the beginning of an era of auditing. In France in 1318, King Philip V founded a Chamber of Accounts; in 1807 Napoleon transformed it into the “Cour des Comptes (Court of Accounts).” 1761 was very important for the Habsburgs – Austria and Hungary – when main and territorial/local audit offices

**Table 1**  
**SAI of EU countries by organisation type and year of commencement**  
*(INCOSAI, 1995, p. 317).*

EU, audit offices	EU countries, SAI as courts	CEE countries
United Kingdom, 1314	France, 1318	Romania, 1864
The Netherlands, 1447 <sup>1</sup>	Spain, 1436 - 1442	Poland, 1919
Sweden, 1651	Portugal, 1933	Latvia, 1919
Germany, 1714	Luxemburg, 1840	Estonia, 1990
Austria, 1761	Belgium, 1830-1831	Hungary, 1990
Norway, 1814	Greece, 1862	Russia, 1992
Finland, 1824	Italy, 1882 <sup>2</sup>	Czech republic, 1993
Switzerland, 1877		Slovakia, 1993
Malta, 1885		Slovenia, 1994
Ireland, 1923		

were found in what is today Slovenia, Croatia, Hungary, Slovakia and the Czech Republic.

In many countries, the constitution or legislation gives the SAI the right to undertake some form of performance audit. In some countries, the SAI has an obligation in certain circumstances to carry out some performance audit or to reach an opinion upon the reliability of performance indicators published by audited entities in their annual reports or similar. Even in countries where the constitution or legislation do not require the SAI to carry out audits of economy, efficiency and effectiveness, present practice shows a tendency to include this sort of work as part of financial and regularity audits (“comprehensive/integrated audits”). These audits often require the auditor to assess systems resulting in professional judgements relating to the efficiency and effectiveness of organisational structures and procedures, and to the economy with which actions were undertaken.

Jurisdiction and competence of the Court of Portugal, for example, are very broad; sanctions for responsibility are being implemented in the Courts of Italy, Spain, Greece, Luxembourg, Belgium, France and Romania as well. They give discharge or form judgments.

Central and East European countries are implementing and building the capacity of external controls and their SAI, following recommendations accepted by their presidents in October 1999 in Prague. “EU legislation allows the SAI of a new Member State considerable freedom to decide how active role it wished to play in the control and audit of EC funds (SIG-MA paper no. 20, 1997, p. 12).”

### Management

Management must implement a number of different functions and be accountable to them. Management must not be confused with leadership: management has to organise, to coordinate, to plan and programme implementation of strategy of owners with resources it has to take care about, specially to manage

<sup>4</sup> In 1814 there was a reorganisation to a Court of audit.

<sup>5</sup> Start to work 1882, constitution by law in 1862.

human resources and to have issues under control. This latter function means, in the language of auditors, management controls to function.

“A sound system of public expenditure management needs to take into account the wider values and requirements of society. Accountability, transparency, predictability and participation are important instruments for sound budget management, but also have an intrinsic value, and are generally seen as four pillars of good governance” (Allen, Tomasi, *ibid.* p. 35)... “Corruption, which is the misuse of public or private office for direct or indirect personal gain, poses moral and legal problems and is a major source of inefficiency in PEM (*ibid.* p. 35).” That is why the author suggests “effective systems of procurement, management control and audits to limit opportunities for corruption (*ibid.* p. 36).”

As there are great changes in development, society and culture, in mutual relations between legal and natural entities, in organizations and between individual bodies, management in public sector must also implement processes to be efficient and make outcomes, results and impacts efficient and state policies effective. This is also in a transition country management capacity in which the public sector is building and following the “bible” of structural funds – it is already mentioned in Regulation 1260/99 – public sector management is a “must” and use of structural funds needs management capacity and management systems to work.

Management responsibility systems are policies and measures which function efficiently and can be traced: financially and physically. So an audit trail which was primarily based on tracing money spent in accordance to law and regulation is upgraded to a physical trail. This means that should any risk appear, it is easy and immediately possible to find out where a subject is located or where an issue comes from. Events such as the recent SARS outbreak are typical examples of this: the world has become a global village with more and more free movement of people, services and capital. It brings more and more risks that have to be overcome. If systems are settled and if they are transparent, then processes are predictable. People, organisations

and institutions must perform accountably as responsibility enables participation in decisions for sustainable development in survival for all partners.

In the background of last decade’s events, an audit is an expert examination of legal and financial compliance or performance, carried out to satisfy the requirements about management. It deals with fulfilling its mandate, if management meets not only statutory obligations. Audit findings emerge as a process of comparing “what should be” with “what is.”

Management controls are in fact organisation, its structure and process and control of these to provide public services that function in accordance with law to be effective and efficient. The term “management controls” stresses that it has to do with controls inside the organisation and not outside it. Separation of duties, autonomy and responsibility is different following hierarchical levels starting from parliament, government, ministries, right down to civil servants. Management control (internal control) follow INTOSAI standards defined as “the organisation, policies and procedures used to help ensure that government programmes achieve their intended results; that the resources used to deliver these programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision-making (INTOSAI auditing standards).”

The term management control emphasizes that planning and controlling are the responsibility of the management of organization and not the responsibility of auditors or external inspectors. “Management controls are succession of policies and procedures which help government organizations to achieve planned results: resources should be used according to the planned objectives and purposes of established organizations, resources for programme implementation should be spent usefully, there is no place for fraud and bad management, information must be reliable and timely and used for decision-making.” (SIGMA, *Anatomy of the Expenditure Budget*, 1997, p. 7).



In practice, management control systems embrace a wide range of specific procedures, including, for example, controls on accounting, processes, procurement, separation of duties and financial reporting. Management control systems require effective communications within an organisation and need to be supported by sound internal audit procedures.

Internal audit refers to audits carried out by a department or unit within a ministry or another (government) organisation, entrusted by its management with carrying out checks and assessing the organisation's systems and procedures in order to minimise the likelihood of errors, fraud and inefficient practices. Also, internal audit units must be functionally independent within the organisation they audit and report directly to the consumable stores and supplies, but not including depreciable assets.

It is established the internal audit to carry out financial audits in order to discharge federal government with regard to budgetary and property accounts.

Management responsibilities are the legal and administrative systems and procedures put in place to permit government ministries and agencies to conduct their activities so as to ensure correct usage of public funds that meets defined standards of probity, regularity, efficiency and effectiveness. In this context, financial management also includes the raising of revenue; the management and control of public expenditure; financial accounting and reporting; cash management; and, in some cases, asset management. SAI is not only accountable for financial management, but for PEM audits. The financial control and audit are in most cases in the countries based on a legal framework consisting of the Court of Audit Act dealing with external control and the Public Finance Act in most cases represents the base for the public internal financial control.

Management is responsible to programme and to plan. It should be able to answer the following questions:

- Are activities defined?
- Are selected activities also organized according to time?

- Were critical items found, dates determined and critical activities stated?
- Can phases be distinguished one from another?
- Is a liquidity plan in accordance with planned activities?
- Does the programme have a financial control?
- Are there any clearly identified project objectives, inputs, outputs, impacts and results?
- Are there any planned solutions in advance if a problem appears?

Management – in the context of the European environment – not only manages public expenditure, but actively implements planning, organising and coordination, human resource management and control.

By definition, assessing effectiveness requires comparing measures of outcome or output with the programme objectives. In practice, to assess whether results are good, bad or indifferent, every performance measure should be compared against some base or standard. Many theoreticians even say that performance is only a relative concept.

Thus, performance is often measured against:

- What has been achieved in the past? Time series statistics are very useful, but do not take into account changes in efficiency or productivity due to technological factors.
- What other comparable programmes or organisations are achieving or what the national/international standards are in the field. The activities of other organisations provide useful benchmarks. Targets set in the budget or other policy statements by the government.

Although they have a useful role to play, performance measures and indicators need to be handled with care. Their meaning and interpretation must be systematically questioned and, if not used carefully, they may seriously distort the behaviour of institutions, organisations, managers and employers. For example, a rigid focus on a small range of performance measures, with no provision for dialogue on their interpretation, may successfully achieve certain targets, whilst distracting attention from the attainment of broader organisational goals and objectives. Don't

forget: there could be different points of view, different stakeholders and different users of information.

## Scope of Audit

For SAI to prepare formal or informal discharge, it has to perform a financial audit. The budget is also submitted to discharge. A subject or institution which is accountable postpones accounts to be given a discharge: a formal (e. g., in France an accountant officer is under suspicion until he is given a formal discharge) or an informal one.

**A Financial audit** (regularity audit) comprises:

- Attestation of financial accountability of entities involving examination and evaluation of financial records and expression of opinions of financial statements.
- Attestation of financial accountability of the government administration as a whole.
- Audit of financial systems and transactions including an evaluation of compliance with applicable statutes and regulations.
- Audit of internal control and internal audit functions.
- Audit of the probity and propriety of administrative decisions taken within the audited entity.
- Reporting of any other matters arising from or relating to the audit that the SAI considers should be disclosed.

Financial reporting is the communication on financial information by an entity (e. g., the government or a line ministry) first of all to interested parties (e. g., parliament, the Ministry of Finance). It encompasses all reports that contain financial information based on data generally found in the financial accounting and reporting system. Allen and Tomasi specially stress that “budget management and control is not the exclusive responsibility of the Ministry of Finance (Managing Public Expenditure, 2002, p. 75).”

It is important to stress that financial control means all aspects of management (or internal) control that relate to financial issues and performance. Financial statements are the accounting statements prepared by a reporting entity to communicate information about its financial performance and position. Finan-

ing means all transactions in financial assets and liabilities that balance the fiscal deficit or surplus. Broadly speaking, this is the means by which a government obtains financial resources to implement its policies, programmes and projects.

The global objectives of a performance audit vary in different countries. They may be defined in the SAI basic legislation or be a matter for internal decision within the SAI. In general, most SAIs set themselves to achieving one or more of the following global objectives:

- a. to provide the legislature or discharge authority with independent assurance as to the economic, efficient and/or effective implementation of policy;
- b. to provide the legislature or discharge authority with independent assurance as to the reliability of indicators of or statements about performance that are published by the audited entity;
- c. to identify areas where performance is poor and thus to help the audited entity, or government more generally, to improve their economy, efficiency and/or effectiveness; and
- d. to identify examples of “best practice” and draw these to the attention of government and/or audited entities.

**Performance audit** comprises:

- Audit of the economy of administrative activities in accordance with sound administrative principles and practices, and management policies.
- Audit of the efficiency of utilisation of human, financial and other resources, including examination of information systems, performance measures and monitoring arrangements and procedures followed by audited entities for remedying identified deficiencies.
- Audit of the effectiveness of performance in relation to the achievement of the objectives of the audited entity and audit of the actual impact of activities compared with the intended impact.

The performance concept raises questions as performance audits and evaluations have a useful role to play, they are more and more frequent. Confusion exists: what is a performance audit, what is evaluation, what

is difference to a value for money audit, etc. Around the world, national auditing agencies are moving away from the financial audit based on traditional standards of legality, regularity and compliance and moving towards a more comprehensive audit that looks at questions like 3E as well (New Approaches to Public Sector Auditing, 1994, p. 12).

In the U. K. National Audit Office, NAO implements value for money audits with the aim of determining whether public money has been spent wisely or not. It is not an auditor and neither is the NAO that decides upon it. This analysis or study with many evaluation elements is sent to the Parliament to discuss and the NAO and its auditor must defend their findings.

What is important is to make a difference between measurement economy and efficiency of management and efficiency and effectiveness of programme results.

## Responsibility and Accountability

Accountability must be seen as a government policy concept and a management concept. Accountability means that politicians and public officials have to be held responsible for the exercise of the authority provided to them.

More than 80% of information comes from accounting – the theory and systems of organising and summarising information about financial and economic activities. So, good accounting systems are essential for budget management, financial accountability and efficient decision-making. For effective accountability, clear lines of responsibility must be firmly established and consistently maintained. In the public sector, accountability of individual officials, within their organisation and to external controlling bodies, is applied most often to spending money wisely and achieving programmed results effectively and efficiently.

Accounting controls are procedures and documentation concerned with the safeguarding of assets, the conduct and recording of financial transactions and the reliability of financial records. They are frequently based on standards issued by the Ministry of Finance or the supreme audit institution to ensure comparability of accounting practices across all ministries and conformity with national and/

or international conventions. The accounting system is the set of accounting procedures, internal mechanisms of control, books of account, and plan and charts of accounts that are used for administering, recording, and reporting financial transactions. Systems should embody double entry bookkeeping (which is not in cash accounting for budget expenditure in some countries), record all stages of the payments and receipts process needed to recognise accounting transactions, integrate asset and liability accounts with operating accounts, and maintain records in a form that can be audited.

The institution of discharge must not be questionable regarding its independence. A number of cases (e. g., Enron) – also in the public sector – show that this question actually exists. That is why there is often serious discussion about the independence of SAI in its budget and in functional and organisational independence to form its own concept for access in an audit and the programme of audits to assure that all responsible should act as accountable.

That is why one of responsibilities of SAI in pre-accession countries was also to be active in public administration reform. Public administration reform deals with new financial cultures and also a culture of using classifications.

A programme classification of expenditures should be not seen, warn Allen and Tomasi, “as a substitute for an administrative classification, which is an essential foundation of effective administration and accountability... Programme budgeting may create delays in preparing the budget, especially if the programme structure is very different from the administrative structure (Managing Public Expenditure, 2002, p. 136).” “Accountability requires developing proper accounting and financial reporting systems (ibid. p. 139).” This is connected to an important issue, a formal exercise that several transition economies consist of preparing a rolling public investment programme, PIP, as a multi-year program which poses even more awareness towards responsibility and accountability. Allen and Tomasi report that “in aid-dependent countries, current expenditures often account for 30 to 40% of the total cost of the PIP (ibid. p. 185).”

## Participation

“The process of globalisation ought not to be accompanied by unjustified fears of loss of social, national, cultural or economic identity. It should be regarded as a challenge for everyone who is participating in this process in which they can transfer their own identity to others (Fidler, F.: Public Auditing and Globalisation, EUROSAI, 2000, p. 3).” We can say that stakeholders are interested in three kinds of results of auditing which also follows the scope of auditing.

The scope is threefold:

1. financial and legal compliance;
2. economy and efficiency; and
3. programme results (Miyakawa, 1994, p. 16).

There are several groups of stakeholders in a society:

- Parliament
- Government
- Ministries (for culture, for education, etc.)
- Ombudsman
- Mass media
- Taxpayers
- The public

The SAI needs to provide its parliament and the public with objective, relevant, independent, and effective audit reports that are based on audit work carried out in accordance with the best professional (international and EU) auditing standards. To help achieve this, auditing policies and standards should be established and promulgated, including a Code of Ethics.

The division and presentation of results that follows is logical as it is not the same thing to follow efficiency of managing processes or programme efficiency. Also management effectiveness is another subject as policy effectiveness and later is the crucial theme of policy programme evaluation. *A performance audit leads to responsibility, transparency, predictability and participation.* “The performance audit is becoming an active actor in the administrative process descending from the Olympus of financial audit into the market place of whys and wherefores and, as a result, its findings are more controversial, more open to attack and criticism (Studies in State Audit in Israel, Geist, 1995, p. 2).”

Accountability measures should address three questions: accountability by whom; accountability for what; and accountability to whom. To ensure that accountability is properly enforced, there is a need for predictable and meaningful consequences related to performance. In the public sector, accountability of individual officials, within their organisation and to external controlling bodies, is applied most often to how money has been spent and what results have been achieved. Crucial too in democratic systems is the general accountability of ministers to parliament and to the public at large. To put in place management controls is not the duty of an auditor but for management. Efficient management is monitored and audited and policies and programmes are evaluated for the sake of stakeholders.

Performance measurement can be used as an instrument for strengthening managerial accountability. Results-oriented management systems attempt to link the performance of managers to explicit or implicit contracts, which generally include performance targets. In theory, contracts should provide for both penalties and rewards. However, in most cases only rewards are included in the contracts; for example, the possibility for managers to retain some or all of any efficiency savings made; flexibility in resources (e. g., in staffing numbers); or a performance-related element in the pay of senior management and unit heads.

The dimensions of performance to be measured in defining such contracts are necessarily narrower than for programme evaluation. For example, it is possible to hold managers accountable for the output of a vaccination program, and to reward them accordingly. However, it is difficult to hold them responsible for the outcome of improving health, which may depend on factors outside their control, such as the quality of water or changes in tobacco consumption. Performance measures used for the purpose of accountability and control are focused, by necessity, on inputs and outputs rather than on programme outcomes. Even where budget funds are provided on the basis of a contract or a performance agreement, the link between performance and resource allocation remains indirect. In most cases, the release of budget



funds or grants is not conditional upon delivery of agreed performance results.

SAI is accountable to report results to different stakeholders. Therefore, SAI has to be organised. On the other side, it is participation that enables users to have access to audit and evaluation reports that could be useful to them. In these relationships, permanent and intensive co-operation with mass media fulfils three principal functions: education and information, preventive and motivation (EUROSAI, Results of Questionnaire, Report by the NAO, U. K., 2000, p. 22).

Reporting results to different stakeholders about using public money demands that different things be taken into account. A good report is useless if it is not understood, if the person or institution that gets it does not know how to use or apply its findings or does not want to or has intention of reacting to it. It is not only important for stakeholders, but also for civil servants, who prepare information and data and make comments on them.

When speaking about reporting, it is very important to define, first of all, several key starting points: what does financing public services mean and what are public services? Regarding stakeholders it has to be clear about:

- Who stakeholders are or who to report to.
- What their interest is.
- What their attention to react on statements is.
- When to report: before providing services, during the process, at the end of the process, reporting at the end of the calendar year, interim reporting; complete or partial reporting.
- What to report about.

The Parliament is not the only institution to report to; it is also closely connected to administrative controls with laws passed in parliament and with which the administrative controls are connected. They are, in many cases, in a country's financial procedures of ministries to ensure compliance with rules on:

- appointment, promotion, pay, and disciplining of personnel;
- public procurement (bids, tenders, contract management, etc.);
- equal opportunities for minority groups; and

- the handling of information flow.

That means that there is not only information to give, but the information must also be evaluated and considered how it influences better value for money.

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## Transparency

Transparency underpins accountability. Fiscal and financial information, made available on a full, regular and timely basis, is an important ingredient of an informed executive, legislature, and public. A competitive legislative staff and independent public media are essential to processing and disseminating information (p. 33). Among the main requirements for fiscal transparency, the IMF, International Monetary Fund, exposed four points: clarity of roles and responsibilities, public availability of information, open budget preparation, execution and reporting and independent assurances of integrity. Among the latter, the IMF in 1999 stated that "mechanisms should be in place to ensure that external audit findings are reported to the legislature and remedial action is taken. Then, those standards of external audit practice should be consistent with international standards and that the working methods and assumptions used in producing macroeconomic forecasts should be made publicly available (Managing Public Expenditure, 2002, p. 34 – 35)."

There are no efficient management controls if (SIGMA, Anatomy of the Expenditure Budget, 1997, p. 7) what "accountability" means is not defined. Accountability as government policy or management concept means (i) politicians and public officials have

to respond periodically to questions concerning their activities (answerability) and (ii) must be held responsible for the exercise of the authority provided to them.

To guarantee sustainable transparency of a system, countries should have two mechanisms: management controls and external audits for which the supreme audit institution in a country is responsible. Systems for setting and implementing surcharges must be transparent and efficient. That is why Allen and Tomasi suggest implementing:

- Audit and performance evaluation
- Clear legal authority
- Consultation with users
- Determining full stocks
- Equity considerations
- Competitive neutrality
- Effective collection (ibid. p. 61 – 62).

Explicitly they warn: “Government commitments and promises outside the budgetary systems reduce fiscal sustainability (ibid. p. 65).”

## Predictability

The development and implementation of performance measurement should be adapted to local circumstances and concerns as there are numerous risks but also challenges. The substance of performance measures differs according to the responsibilities of those whose performance is being measured and the requirements of those using the information. At the operational level, measures and indicators should be related to issues such as the management of resources and production processes. At a higher management level, the information should be related to issues of programme effectiveness in order to inform decisions on policy formulation and resource allocation.

Performance measurement can be a useful tool for managing programmes. Performance information can help ensure that such programmes are implemented in conformity with their objectives, and in preparing new programmes. For example, in the road sector, performance measures covering issues such as mobility/accessibility, traffic flow, and safety and environmental factors can be useful in both preparing and supervising the implementation of programmes.

## Evaluation

The aim of evaluation is to assess the effectiveness of funds use for policy measures and programmes. Sources have to be used according to the purpose, not only their fair and legal use, but also the aim and the objectives of programmes or projects have to be realized. In order to control the relation between effects and used resources, there is a set of special instruments which is based on programme event cycles and structures combined in what is called a logic frame. Evaluation is part of each programming level, while the criteria depend on the programming period phase. For example, in the programme documents, planning phase evaluation focuses on the suitability and adequacy of the strategies, while the ex-post evaluation examines programme effects. Evaluation “exploded” together with new regulations of structural funds in 1999.

The ex-ante **evaluation** brings conclusion to the reliability of the added value of the programme, the midterm evaluation is the answer to the question whether it should continue. The main purpose of ex post evaluation is – among others – how to be bring even greater added value.

Ex-ante evaluation is the basis for the programming documents preparation and is implemented during the programme planning, namely for the plans, support and programme complements. Evaluation is taken into consideration during document preparation and is also a part of it. Ex-ante evaluation is the responsibility of national authorities, who are also responsible for the planning works, e. g., preparation of these documents.

Ex-ante is an evaluation for the plans and support and includes (contains):

- an exact analysis of strengths and weaknesses of regions or sectors;
- consistency estimates of the strategy and selected objectives with the specific characteristics of the regions;
- foreseen effects (results) of the priorities;
- evaluation results of the previous programming periods;
- possibilities to provide resources; and
- the ability to provide implementation.

Ex-ante evaluations have a task to give an estimation according to four aspects:



- Can the selected strategic approach give a solution to the identified problems?
- What will the results (effects) probably be?
- Have been EU policies taken into consideration? and
- Was the implementation correct and in accordance with the regulations?

Mid-term evaluation measures first results in structural help. It also measures the use of financial resources and a monitoring and implementation course.

The aim of ex-post evaluation is to compare achieved objectives with the planned ones. Considering the actual results of an evaluation, information about the use of resources, impacts, effectiveness of particular help and their impacts, executed actions and achieved results are given.

In order to evaluate, there are three quality criterias: relevance, sustainability, and feasibility.

Relevance means assessment of adequacy and suitability of the strategy or objectives with regard to environmental needs. To what level programme objectives are relevant (adequate, correctly placed) as regards development priorities at the national and EU level. Therefore, it is important to monitor changes which could essentially influence the project (for example, changed conditions – economic, social, environmental, institutional).

Relevance analysis contains:

- identification of the true problems in the environment, relevant target groups;
- qualitative appraisal of local potentials, interests;
- qualitative appraisal of local potentials implementation;
- description of preparative activities – feasibility studies, together with the financial and economic analysis, activity plans, necessity resources;
- consultations with the local subjects and partners;
- assessment of the activities, which are realizing additionality principle; and
- assessment whether forecasts about conditions and risks are real.

Sustainability of activities and influences should provide continual growth and existence of resources.

To evaluate inputs, processes, outputs (outcomes), impacts and results, performance indicators are used. So it is very important to define in advance what effectiveness is, how it should be measured or whether it should be measured at all. What if effectiveness is a political decision: who is then to decide? Service quality, in its broader sense, “quality of service,” refers to effectiveness. However, it is generally used in a narrower sense, in terms of satisfying the more immediate needs of users, such as the timeliness, accessibility, accuracy and continuity of services. As such, it relates to the quality of service delivery rather than of service outcomes.

Performance can be monitored and assessed through measures or indicators. Measures correspond to direct records of inputs, outputs and outcomes (e. g., the number of police patrols carried out in a given period is an output measure). Indicators are used as a proxy when direct measures are difficult or costly to obtain (e. g., the “street” price of illegal drugs is an indicator of the outcome of an anti-drug programme). In practice, however, the terms “measures” and “indicators” are often used interchangeably.

Programme evaluation is an in-depth examination of the economic, financial, social, etc., effects of a programme or policy initiative. Summary evaluations are carried out when the programme has been in place for some time (ex post evaluation) to study its effectiveness and judge its overall value. Formative evaluations are usually undertaken during the implementation of the programme (intermediate evaluation) in order to improve its effectiveness.

The logic model used to arrive at conclusions about outcomes is an evaluation study. In selecting the evaluation design, the evaluator must simultaneously determine the type of information to be retrieved and the type of analysis this information will be subjected to. Theory and practice differs among several evaluation designs: value for money (VFM), evaluation of attaining the objectives, outputs, performance evaluation and a choice among alternatives. But it should be defined if the reporting is to be good. There could be a model of functioning – system, process of providing public services and reporting – which helps

to define basic things, to define the phase of process we are in. As in the model, there are basic things. We could define the SWOT of a system, of a single activity, or we could even measure implementation more precisely.

## Concept of SAI and Total Quality Process Model

*As we have presented in the context and background of four pillars and the importance of SAI to support four pillars, its time to turn our attention to managing SAI to build up a suitable system, to push this system to work and to prepare access of SAI and programme of audits. All these are crucial tasks for the head of SAI.*

It is a recommendation to have an independent SAI and management control to function. It is the responsibility of the head of SAI to establish management in the public sector to function and monitor its own system and system controls to function and segregation of duties of civil servants and public officials.

The functioning of the concept, the structure and the programme of institution reflect the quality of reporting.

An audit concept is – like every concept of a system – is to assure quality. The model connects all important parts and focuses in

a system, operation quality and activities, as they are:

- management and operation with resources, including financial resources;
- risk management;
- relations with the partners and institutions and relation and contribution of partners to the results;
- implementation time plan; and
- analysis of costs and their eligibility in comparison to the similar activities.

We present all these issues as indispensable issues in a model, based on the EU model of total quality that defines what is basic from five points of view:

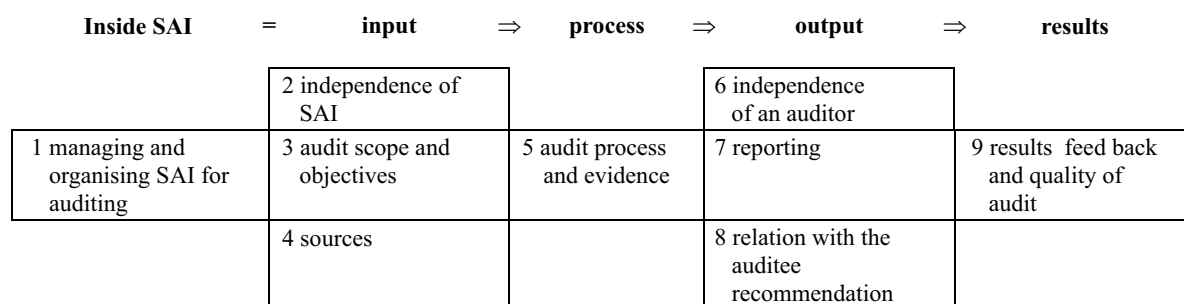
1. Inside SAI – its management controls and managing auditing.
2. Input – managing auditing process, audit scope and objectives and resources.
3. Process.
4. Output – reporting.
5. Results – are long-term and also important feed back.

The model shows that every element must be placed exactly in the programmed place as an input and then there should be an output, impact and results.

Results mostly depend on managing and organising SAI for auditing, on the independ-

### Graphic 1

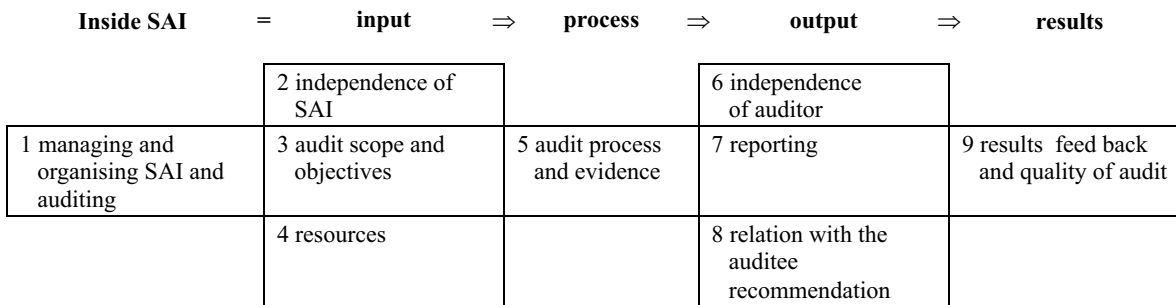
#### Model of functioning SAI applied as a model of total quality management (The process European foundation 1992)



ence of SAI, audit scope and resources: financial, human and material. Input influences processes and output. Output – as its quality – reflects and shows independence of an auditor, quality in reporting and relation with the auditee.

Graphic 2 shows how predictable and structured INTOSAI standards were in fact declared and unchanged from 1977. Basic postulates of standards INTOSAI form all postulates for managing and organising SAI and auditing. General standards are a precondition for the

**Graphic 2.**  
**Interrelation between the EU model of total quality and INTOSAI standards.**



independence of SAI, for audit scope and objectives and resources.

We only have some important issues to add to the partial subsystem: input, processing, output and the subsystem of results.

**Input – managing the auditing process, audit scope and objectives and resources**

Regarding managing auditing there are several issues to settle:

- stability of the legal base (SAI established by Constitution);
- status of SAI;
- audit mandate – what SAI may audit: public funds;
- competence to audit EU funds;
- mandate of the SAI President, members;
- independence from political influence – SAI president;
- independence from executive legislature (covered by Constitution);
- relations SAI with parliament and government;
- clear organisational structure and rules for procedures; and
- audit manuals.

Managing people means to settle the auditor’s status, responsibilities, powers and duties; in essence, all important issues connected with independence. Then comes audit scope and objectives. As mentioned before, the scope of audit could be: financial (regularity) and performance audit. It is important that SAI have the liberty to audit programmes.

Sources are first of all: staff, their qualification, knowledge and experience, SAI has to engage for their training programs and career development plan. Financial independence

of the SAI budget should be established by parliament.

**Process**

Process forms that part of what we are usually thinking about when we are talking about an audit. But as shown, public auditing should start before; there is no accountability if there is no SAI concept. Following the concept of SAI, the plan of audits is arranged, and then auditing proceeds and evidence is collected. Then, the rules for internal auditing procedures (main elements) are, as in an audit of the private sector:

- understand the business;
- risk assessment;
- materiality;
- engagement objectives;
- understand and assess the control environment and accounting system;
- audit strategy (develop planning);
- assess control effectiveness;
- substantive testing; and
- audit completion as specifying, gathering and evaluation of evidence documentation.

The Audit Process involves three main areas:

Planning (audit approach, audit planning, materiality, risk and audit programmes, etc.)

Field work (evaluation of controls, testing, obtaining evidence, documenting, etc.)

Reporting (process, documentation, quality control, etc.)

**Output**

Outputs are services produced directly by a programme or activity. Reporting is a duty to report findings to the auditee and aforementioned users – authorities: parliament, Presi-

dent, government, the public. That is why SAI has a right to shape conclusions and the auditee has the right of appeal against the findings of the audit. In such a context, the right to shape a recommendation appears.

INTOSAI auditing standards with its basic postulates, general standards, field standards and reporting standards within the model of total quality process, which as such is a systematic way of acting, can assure relevant, sustainable and consistent outputs and efficient and effective results.

## Results

Work results appear not only if SAI is efficient but also if there is accountability. Feed back from the result enables the possibility to check recommendations.

However, SAI is a systematic way of functioning. SAI auditors should comment on the absence or adequacy of such systems and in absence of that fact, the quantity and quality

of reporting could suffer and the final result could be hung upon public accountability. The functioning of 3E in part reflects the quality of reporting.

The formal adoption and public dissemination, consistent application and subsequent continuous review and updating of accepted auditing standards will help in the achievement of high quality, effective audit work.

*The model enables SAI to be transparent and enables predictability and participation in society in parallel through the culture of accountability. Last but not least, the model also helps SAI management to be effective.*

*The structure, transparency and logic of the model help to avoid most frequent mistakes connected with effectiveness, which in the EU context, are:*

- Overall objectives are not clearly defined.
- Objectives are defined too broad or weak to be evaluated.

**Graphic 3**  
**Audit on its way towards 3E.**

Basic postulates	General standards	Field standards	Reporting standards
applicability of standards	independence	planning	completeness
unbiased judgment	competence	supervision and review	subject matter
public accountability	due care	internal control	legal basis
promulgation of standards		compliance with laws and regulations	compliance with standards
consistency of standards		evidence	compliance with laws
access to data		analysis of statements	
activities to be audited			
improving audit techniques			
conflict of interest			

- Objectives are defined in such a way that the results of one objective preclude the results of another.
- Neither objectives are clearly quantifiable so monitoring objectives is not possible.
- Information about objectives is not available or management at different levels is not receiving information about them.
- Because reconciliation of work in a decentralized management system or a system with a number of managerial levels is not sufficient, objectives can not be achieved entirely.
- According to the activity, management structure and/or system are insufficient (for example, responsible people or auditors

do not have the required abilities or experience).

- Past experiences are not taken into consideration about evaluating events, or insufficient measures or methods are used.

*Strategic product quality namely relates to the objective that the SAI wishes to achieve: to assess and improve the functioning of central government and outside organisations. It is more than just the **quality of a technical product**. It relates to the findings, opinions and recommendations of the audit, which have to meet the following requirements of cogency, consistency, accessibility and objectivity.*

*Cogency means that the findings should be valid and reliable. Measurements must actually have been carried out and the repetition of the audit should lead to the same results. Opinions must not be plucked out of the air, but follow logically from the findings; consistency means that opinions and recommendations within the same audit and between different audits must correlate. An audit satisfies this criterion if the same opinion is given in similar situations and there is a logical connection between the recommendations and the opinions; accessibility means that the message must be formulated clearly and concisely, so that it does not lead to misunderstandings and can be easily understood by the intended reader; objectivity as criterion is satisfied if the findings and opinions are presented separately. It also covers the inclusion of positive opinions arising from the audit.*

As shown in the model, the requirements to be met by the audit process should be as follows:

- *care towards auditees. This means that auditees must be given the fullest possible information on the structure and course of the audit and must be given the opportunity to verify the data. The response of ministers to the draft report, opinions and recommendations should also be incorporated in the publication as accurately and fairly as possible;*
- *efficiency. This criterion is satisfied if the final results tally with what was promised in the audit proposal. In addition, the planned audit costs and turnaround time must not be*

*exceeded unless permission is given during the audit;*

- *auditability. This means that it must be easy for internal or external third parties to reconstruct the audit process afterwards;*
- *optimum quality guarantees. This refers to the contribution of various actors and their impact on the process and product.*

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*As was stated at the outset: there are four pillars of good state management: responsibility, transparency, predictability and participation.*

*Responsibility should be delegated due to competencies and be transparent. The model also enables SAI to be transparent, enables predictability and participation in society in parallel through the culture of accountability.*

*As an emphasis, though trends and approaches to public audits have radically changed and are still changing, the value of this article was to show in a structural way the links to the four pillars of good governance. These links are vital not only as SAI and external audit to support them but for good governance. Public bodies must be aware of these facts and surpass the fear of being watched. They must also help the modern state audit move in the direction of the audit of the facts beyond the figures.*

## Conclusions about External Audits

For the public sector and for the use of public money (which is also more and more in the private sector) the external audit is not just one of many control functions. External audits should also be institutionalised as a supreme audit institution, SAI. Its institutionalisation leads to its independence: independence of its concept and its auditors work.

SAI and its independence also implement four pillars that should function for good governance: responsibility, transparency, predictability and participation. Four pillars support sustainable development. As the 21st Century is characterised by global competition and more and more multi-national investments, small countries are especially vulnerable. Their gross national income could be



less than ten percent of the gross income of a multi-national firm.

The 21st Century is also the time of public expenditure management and corporate governance. As management capacity in the public sector is in progress, there could be conflicts of interest among policy and technical decisions so it is indispensable that supreme audit institution builds its administrative, management and audit capacity. The SAI is also there to support the build up of management controls in the public sector. (It should not be forgotten that audit and management controls are also elements of a budget execution cycle).

This article illustrated the importance of institutionalisation of external audits to understand why SAI is a precondition for public expenditure management to function. Public expenditure management, PEM, deals with how to allocate and use resources responsibly, efficiently and effectively.

Supreme audit institutions not only run financial audits, but more and more performance audits. The purpose of a financial audit is to give a discharge. The institution of discharge should not be questionable regarding the independence of an audit. But a number of cases when discharges were not even attempted to be given show that independence of SAI is somewhere questionable. That is why there is often serious discussion about the independence of SAI: its budget, functional and organisational independence.

The purpose of a performance audit is an analysis of the economy, efficiency and/or effectiveness of public money – an important analysis, report or evaluation from the point of view of different users of public money for their further discussion and also building partnerships between them. The money used for public services and investments is huge and the risks are many: among them there are political risks as well. The expenditure management question is how it is to be done and whether SAI, if it is independent, can survey its efficiency.

These important tasks also demand an adequate legal guarantee by means of the appropriate legal instruments in the event of the independence of those institutions coming under attack. The challenges of globalisation

have already brought the fight to SAI for its independence – independently to prepare an audit access and an audit programme to carry out audits.

Following INTOSAI standards and European guidelines, an audit should bring findings and recommendations to five basic norms or standards which are: integrity, legality, economy, efficiency and effectiveness. In most cases, financial audits are concerned with the first and second norms, while the performance audit is concerned with the 3E's (economy, efficiency and effectiveness). We must conclude that not only quantity but the quality of money used and value for money obtained from the point of view of different stakeholders becomes more and more important.

As there are great changes in development, society and culture, in mutual relations between legal and natural entities, in organizations and between individual bodies, management in the public sector has to implement processes to be efficient, and outcomes, results and impacts efficient and state policies effective. This is also in a transition country management capacity in which the public sector is being built and public sector management is a "must." Structural funds need management capacity and management systems to be in place and to work.

An audit trail was primarily based to trace money spent in accordance with laws and regulations. In the background of last decade's events, an audit is an expert examination of legal and financial compliance or performance. It is carried out to audit the quality of management. It deals with fulfilling its mandate, if management meets – not only – statutory obligations. Audit findings emerge by a process of comparing "what should be" with "what is." By definition, nowadays management has five basic functions (leadership, organisation and coordination, human resource management and planning), and control is one of them. It is logical that a good manager or management would like to have things under control. That is why from the nineties SIGMA wrote several important books about "management controls" in the public sector.

Management controls are in fact structure, process and control of organisation to provide public services the ability to function in accordance with the law and to be effective and efficient. The term “management control” stresses the fact that it has to do with controls inside the organisation and not outside it. Segregation of duties, autonomy and responsibility are different in the different hierarchical levels starting from parliament, government, ministries right on down to civil servants who are, in fact, management in the public sector. The name is given from the point of view of auditors.

Management control (internal control) follows INTOSAI standards defined as “the organisation, policies and procedures used to help ensure that government programmes achieve their intended results; that the resources used to deliver these programmes are consistent with the stated aims and objectives of the organisations concerned; that programmes are protected from waste, fraud and mismanagement; and that reliable and timely information is obtained, maintained, reported and used for decision-making. Management control systems also require effective communications within an organisation and need to be supported by sound internal audit procedures. That is why SAI is not only accountable for financial management, but for audit PEM. Allen and Tomasi specially stressed that “budget management and control is not the exclusive responsibility of the Ministry of Finance (Managing Public Expenditure, 2002, p. 75).” It is always a conflict of interest between the state and the public sector and society.

But, as the resources are limited, right decisions must be taken for social and economic development and its cohesion and the five norms of using resources must be watched. The watch dog is SAI. And a good watch dog also has to manage himself; the crucial elements are shown in the model.

Last but not least, SAI is accountable to report results to different stakeholders. Reporting the results to different stakeholders about using public money demands that different things be taken into account. A good report is useless if it is not understood, if the person or institution that gets it does not know how to use or apply its findings or does

not want or has no intention of acting on it. This means that there is not only information to give, but it must also be evaluated and pondered to see how it might better influence value for money. And again the conclusion is – the institution of the external audit has to be built up.

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## Information for Contributors

The *Occasional Papers* are devoted to public administration and public policy issues based on empirical research carried out in Central and Eastern Europe.

### **Papers**

Decisions about the publication of a manuscript are based on the recommendation of the main editor and an additional review process conducted by two appropriate specialists from a relevant field. The main editor and/or deputy editor selects these specialists.

Submissions should not have been published previously and should not be under consideration for publication elsewhere. Papers presented at a professional conference qualify for consideration. The submission of manuscripts that have undergone substantial revision after having been presented at a professional meeting is encouraged.

### **Components of a Policy Paper**

#### **Presentation of the Issue**

What is the problem that requires action?

#### **Scope of the Problem**

What is the history and current context of the issue? How did it become an issue? Who is affected and how severely?

#### **Consultations**

What are the views or positions of groups who will be significantly affected? What are the concerns of other ministries/agencies who will be affected?

#### **Options for Consideration**

What three or four distinct options should be considered? What are their implications? What are their advantages and disadvantages?

#### **Additional Issues:**

Consistency with the government's priorities; the effectiveness of available options in addressing the issue; the economic cost-benefit; the effects on taxpayers; the impact on the private sector; environmental impacts; the fiscal impact on the government; the disproportionate impact on various groups or regions; the complexity and timing of implementation; public perception; and constraints raised by legal, trade, or jurisdictional issues.

#### **Recommendation (s)**

What is the proposed course of action? Why was it chosen over other possibilities?

#### **Implementation Issues**

What are the financial impacts of the proposed course of action? What are the implications for government operations? Will the proposal require regulatory or legislative changes? What is the proposed means of evaluation?

#### **Communications Analysis**

What is the current public environment? What are the key issues of contention, and how can they be addressed? What is the position of key stakeholders, both inside and outside the government, on the proposal, and what communication vehicles should be used for each? How does the proposal relate to government reform priorities? What is the objective of communication on this issue? What is the key message?

### **Structure of a Paper**

#### **Title**

The title should be a brief phrase adequately describing the content of the paper.

#### **Abstract**

An abstract is a summary of the information in a document. The abstract should not exceed 250 words. It should be designed to clearly define the contents of the paper. The abstract should: (i) state the principal objectives and scope of the research; (ii) describe the methodology employed; (iii) summarise results and findings; and (iv) state the principal conclusions. References to literature, bibliographic information, figures or tables should not be included in the abstract.

#### **Introduction**

The introduction should supply sufficient background information on the topic and also provide the rationale for the present study. Suggested guidelines are as follows: (i) the introduction should first clearly present the nature and scope of the problem that was researched; (ii) it should provide an overview of the pertinent literature used; (iii) it should state the research methodology employed and, if necessary, the reasons for using a particular method; and (iv) the principal results of the investigation should be stated.

#### **Results**

This section should contain an overall description of the topic and present data gathered during the research project. The manuscript should utilise representative data rather than repetitive information. Data that will be referenced several times in the text should be provided in tables or graphs. All data, repetitive or otherwise, should be meaningful. Results must be clearly and simply stated as the section comprises innovative research findings for an international community of academics and practitioners.

#### **Discussion**

This section presents principles, relationships, and generalisations indicated by the researcher's findings. This should not restate information present in the results section, but should: (i) point out any exceptions or lack of correlation; (ii) define unresolved issues; (iii) show how the results and interpretations agree (or contrast) with previously published work; (iv) discuss the theoretical implications of the work, and any possible practical applications; and (v) summarise the evidence for each conclusion. The primary purpose of the discussion section is to show the relationships among facts that have been observed during the course of research. The discussion section should end with a short summary or conclusion regarding the significance of the work.

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#### **References**

Only significant, published references should be cited. References to unpublished data, papers in press, abstracts, theses, and other secondary materials should not be listed in the references section. If such a reference is essential, it may be added parenthetically or as a footnote in the text. Secondly, authors should verify all references against the original publication prior to submitting the manuscript. Stylistically, authors should utilise the in-text parenthetical reference system with complete references alphabetised at the end of the text.

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