STRATEGY
FOR DEVELOPING PUBLIC INTERNAL FINANCIAL CONTROL
IN REPUBLIC OF MACEDONIA

Developed in cooperation with the EAR Project - "Technical Assistance to the Ministry of Finance for developing internal audit in the public sector"

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1. INTRODUCTION

It is an assessment and recommendation of EU that:

“Republic of Macedonia has a functional democracy, with stabile institutions, which guarantee the rule of law. The general progress in the reforms is a good way of fulfilling the political and other criteria for future membership of the Republic of Macedonia in EU.

Republic of Macedonia has undertaken important steps to establish market economy. Although it may not be able to deal with the pressure from the competitiveness and the market forces in the EU in the mid term, it has started the economic reforms, which if energetically pursued, will enable the country to achieve its goal in future.

The efforts in implementing the reforms should be enhanced, so Republic of Macedonia could in the mid term meet the requirements of the acquis in the field of free movement of goods, intellectual property rights, competitiveness policy and FINANCIAL CONTROL.”

Meeting the requirements of the acquis reference financial control requires a global approach in developing modern internal control systems in the public sector, which would lead to a combination of management accountability and functionally independent internal audit. Because of this it is necessary for Republic of Macedonia to adopt and implement coherent legislation that will be implemented in the whole area of public internal financial control, covering all important aspects of management accountability, independent internal audit, central harmonization of internal audit and financial management and control, as well as fraud prevention.

As well, Republic of Macedonia should even more improve the operational and functional independence of the State Audit Office and to provide for appropriate follow up of the findings in its reports.

In the area of managing and controlling EU funds, it is necessary for the Republic of Macedonia to develop efficient systems for managing, monitoring, control and audit, in order to create conditions for decentralized management and implementation of the new pre-accession instrument IPA. Besides this, the country needs to provide for administrative capacity that will enable efficient protection of the financial interests of the European Commission.

For successful implementation of the above mentioned objectives the Ministry of Finance in the Government Program for 2006 proposed the development of a Strategy for developing PIFC in Republic of Macedonia.

The Ministry of Finance developed this document in cooperation with the Project “Technical Assistance to the Ministry of Finance for Developing Internal Audit in the Public Sector”, financed by the EU and managed by EAR.

The PIFC system will be developed continuously, while the Government of Republic of Macedonia will upgrade this document upon proposals developed or coordinated by the Ministry of Finance.

The establishment and the general development of comprehensive and effective PIFC system is part of the Public Administration Reform in Republic of Macedonia.

The objective of this document is to provide the basic elements of the PIFC concept, to provide analysis of the current situation with the PIFC system in the Republic of Macedonia.
Macedonia, to present the future steps that will be undertaken in order to develop the PIFC system, as well as to set the time frame for their implementation.

This document is developed in accordance to the recommendations given by the EC in relation to Chapter 32: Financial Control in the Commission Opinion on the Application from the Republic of Macedonia for Membership of the European Union, the Council Decision on the Principles, Priorities and Conditions in the European Partnership with the Republic of Macedonia and the Analytical Report for the Opinion on the Application from the Republic of Macedonia for EU Membership.

The Government of Republic of Macedonia and the Ministry of Finance appreciate the broad support given by the EC in the area of PIFC development and are convinced that this cooperation will continue.
2. BASIC ELEMENTS OF THE PIFC CONCEPT

The term Public Internal Financial Control (PIFC), (as it is being used by the EC within the negotiations for Chapter 32), presents a comprehensively consolidated system, established by the Government for managing, monitoring, controlling and auditing national and EU funds. It consists of the following basic elements:

a. Financial Management and Control System (FMC),

b. Functionally Independent Internal Audit (IA), and

c. Central Harmonization of FMC and IA methodologies.

2.1 THE FINANCIAL MANAGEMENT AND CONTROL SYSTEM

The establishment, the implementation and the development of a sound financial management and control system in the institution, including the establishment of rules for efficient, effective and economic use of available resources is a responsibility of the Head of the Institution. The Head of Institution delegates authorizations and tasks for establishing and functioning of the FMC system, but his overall responsibility cannot be delegated.

The Head of Institution is responsible, by establishing appropriate organizational structure, to provide for the segregation of duties and to give necessary authorization to senior officials in the institution. He/she is responsible for ensuring efficient information and communication system in order to achieve effective internal control and to accomplish the institution's objectives.

The internal control system helps to mitigate the risks that threaten the institution and provides reasonable assurance that it will achieve its objectives in a legal, transparent, economic, efficient and effective way. The Head of the Institution should ensure the internal controls to be implemented on the basis of appropriate risk analysis, taking into consideration the specifics of the relevant institution.

The implementation of internal controls is a responsibility of each employee in that institution in accordance with the established working processes and operations, as well as with the job description for each position.

In order to be efficient, the internal controls need to satisfy three basic criteria:

- Appropriateness - right control on the right place and in accordance with the assessed risk
- Continuity - to function as planned
- Cost effectiveness - that is, the costs for the control itself not to be higher than the benefit from that control.

The primary objective of the FMC is to ensure:

- Successful achievement of the objectives and tasks of the institution;
- Reliability, truthfulness, timeliness and integrity of information, especially financial information;
- Compliance with the rules, plans, procedures, laws and regulations;
- Safeguarding the property;
- Economic, efficient and effective use of resources.

The FMC system comprises of:

1 Head of Institution shall also mean the official managing government administration body
a) Mid term and short term planning and programming, budgeting and execution of the budget, planning of cash flow and liquidity;
b) Functions of ex ante and ex post financial control;
c) Accounting and financial reporting function;
d) Procedures for developing, processing and storage of financial and other documentation.
e) other procedures, as well as appropriate working documentation (flowcharts, job descriptions, working manuals and guidelines and other).

Ex ante financial control

Ex ante financial control checks and assures the compliance of the activities with the laws, by laws and internal acts, decisions and contracts prior to their execution. Ex ante financial control is a set of preventive control activities necessary for making financial decisions which relate to collection and use of public funds, undertaking commitments, execution of public procurement procedures, concluding contracts and related payments and refunds of unduly paid amounts.

Ex post financial control

Ex post financial control checks whether the funds were used in legal, efficient and timely manner and for the purpose they were intended for.

The ex post control is done after the activities were executed, it aims towards detecting potential errors, deviations or irregularities and leads to investigating the process or possible sanctions.

The specific ex post controls (as on the spot checks) are executed by internal controllers appointed by the Heads of Public Sector Institutions (PSIs) where selected staff should have appropriate qualifications, education and experience.

The sound FMC system should ensure a division between the functions:

The Function of Authorizing undertaken commitments and payments should be based on preventive, detective and corrective controls created and established in a way to provide sound financial management. The controls of the purposefulness of requests, justification of the expenditures and actual deliver of goods and services need to be fully completed before authorization of the commitments and payments.

The Financial Function should provide lawful execution of the authorized orders in accordance with the financial / accounting and other appropriate regulations. Financial controls should ensure that all transactions are appropriately approved and in accordance with the commitments, contracts and financial regulations. The financial function should be based on preventive, detective and corrective controls; they check, prior to the final payment, whether all controls are done, all approvals given and if all necessary signatures are there. This function gives assurance that each activity is in accordance with the laws and regulations and that all necessary documents and evidence of preceding controls are available.

The Accounting Function should provide reliability of all accounting and other data related to financial reporting. This function should provide evidence of all commitments and other accounting transactions, as well as accuracy and reliability of financial reports.
Besides this the accounting function should provide ex ante control, among which one of the most important is to check whether there are appropriated funds in the budget before making a commitment, to check the credibility of documents, signatures, amounts, etc.

2.2 FUNCTIONALLY INDEPENDENT INTERNAL AUDIT

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

Internal Audit brings independent, professional and systematic assessment of the systems of financial management and control, which comprises revising of all the functions and working processes and their internal controls.

The internal auditor should not be involved in any management functions. He/She is independent in the planning of his work, in the performance of internal audit and in reporting its results, although the Head of the Institution should endorse his/her planning. The Head of the Institution is responsible for implementing the recommendations of the internal auditor, or for undertaking the risk for not doing so.

In accordance with the Law on Internal Audit in the Public Sector, the internal audit unit is independent organizational unit, which is directly responsible to the Head of the Institution. The internal auditors are not responsible for establishing, functioning and developing of the FMC system, but they are responsible for assessing the functioning of the system, emphasizing the weaknesses, deficiencies and irregularities, and for giving recommendations for its improvement and/or for the corrective actions.

2.3 CENTRAL HARMONIZATION UNITS (CHUs) FOR FMC AND IA

The Central Harmonization Units are responsible for harmonization of FMC and IA standards and methodologies in the public sector, as well as for reviewing, analysis, promoting, development and support of those functions in the PSIs. The Central Harmonization Units should, on annual basis, emphasize the development and the common weaknesses and forward this information to the Ministry of Finance and the Government of the Republic of Macedonia. They focus on assisting the development of procedures and guidance for FMC, audit trails, templates for internal Audit Charters etc. They also develop methodology for risk analysis which should be used in all public institutions and supervise the internal audit units and their activities.

The aim of the CHUs is to provide harmonization of the approach, interpretation, record keeping, accounting and handling of all financial and audit operations in the public sector.

The CHUs will also be responsible for coordinating and directing the PIFC training of all heads of institutions and other civil servants in the public sector, as well as for continuous professional development in the accounting, internal controls and internal audit in the public sector.
3. CURRENT SITUATION AND DIRECTIONS FOR FUTURE DEVELOPMENT OF PIFC SYSTEM IN REPUBLIC OF MACEDONIA

3.1 INSTITUTIONAL AND LEGAL FRAMEWORK

The internal financial control system in Republic of Macedonia is established in a way that internal control activities fall within the competence of different public and other institutions.

Main institutions which implement financial and other forms of controls are:

*The Assembly of Republic of Macedonia*, representative body of the citizens and main legislative power in Republic of Macedonia, which among other passes the laws and the budget of Republic of Macedonia; performs elections, appoints and dismisses officials and supervises the performance of the Government of Republic of Macedonia, as well as the performance of other public functions which are responsible to the Assembly, to the Constitution and the Law and reviews the Annual Report of Audits and the work of the State Audit Office. The State Audit Office submits to the Assembly an annual report on executed audits and its performance. Different assembly committees discuss the findings of the state audit, and than on plenary session of the Assembly certain conclusions are adopted. The sessions of the Assembly are public, that is they are broadcasted in the media providing in this way transparency of the findings and recommendations of the State Audit Office.

*The Government of Republic of Macedonia*, among other, proposes laws and other regulations to the Assembly of the Republic of Macedonia; it proposes the budget of Republic of Macedonia and the annual statements of accounts; implements laws and other decisions of the Assembly; adopts decisions for the execution of the laws; leads foreign and internal policy; gives guidelines and supervises the work of the ministries and other bodies of the state administration; takes care of the economic development of the country; directs public service activities and development and performs other issues established in the Constitution and the Law.

*The State Audit Office*, carries out the external audit of the financial statements of the public sector institutions and the compliance, efficiency and effectiveness of the public expenditures usage. In regard to its performance and the executed audits, at least once a year, it reports directly to the Assembly of the Republic of Macedonia. In the SAO ongoing are several projects which purpose is to increase its capability in the area of audit performance.

*The Ministry of Finance* on the basis of the Law on Organization and Function of the State Administration, among other, executes all functions related to planning, developing, adoption, implementation and execution of the state budget; state accounting; borrowings of Republic of Macedonia on national and foreign markets; and affairs related to customs and tax systems and policies. Through the Treasury Department, the Ministry of Finance performs control over the spending of the State Budget.

*The Line Ministries* and the other state administration bodies implement the policies and the programs for the use of public funds and thus they give useful services within their
competencies. In the ministries and other state administration bodies financial management and control systems operates, and internal audit function is established in compliance with the legislation and by-laws.

Inspection services, in line ministries and state administration bodies carry out the task of inspection supervision (additional control function) in accordance with the Law on Organization and Function of the Public Administration and other special laws. The performance of inspection means direct insight in the general and specific documents, the conditions and methods of work of supervised legal and physical entities, on the basis of law and other regulations, and undertaking prescribed measures in order the established situation and the work to be made in compliance with the laws and other regulations. The inspection is performed by inspectors and other civil servants authorized by special law to perform supervision. So within the Ministry of Finance, that is within its bodies, inspection services are established to perform inspection in the area of taxes, customs and other public revenues, as well as foreign currency and foreign trade related work. Also in several other ministries there are inspection services that inspect affairs within their competence. This is a classical inspection supervision that can be considered as additional control for separate operations and can not be seen as identical with the function of internal audit. The inspection services are also subject of the Internal Audit.

3.2 FINANCIAL MANAGEMENT AND CONTROL

The FMC system in Republic of Macedonia is regulated by the respective legal framework / laws and bylaws / and by internal acts. The established control environment presents a basis for the whole internal control system which creates discipline and climate that affects the quality of internal control. In the public sector there are clearly defined organizational structures which show who is responsible for which sector in the institutions. Still, job descriptions in the systematization acts are quite generic, because of which they need to be improved in order to present clear duties, responsibilities and expected specific results from each employee, as well as to clearly establish the responsibility of each manager in the institution. This will create conditions for overcoming the situation where the relevant laws and bylaws, are the only criteria for an employee in performing his/her control activities.

Besides this, there is a need that for all processes where internal controls are performed, written guidelines and procedures, which would clearly define the execution of the process and the accountability of managers and employees, are developed. With this every employee should get a clear message from top management that the control responsibility should be taken seriously and to understand their own role in the entire internal control system. When doing this, care should be taken that control activities are introduced in a way to provide value added, i.e. to be introduced adequately to the risks that are to be reduced. This way the verifications on all levels of control activities will be enhanced, especially in the execution of financial transactions and other important processes.

Taking in consideration that risk identification and assessment generally is not performed in the public sector institutions it is necessary to introduce risk assessment in order to establish effective controls. For this purpose additional training in risk assessment is needed, above all, for managers on all levels and for internal auditors. Effective controls
based upon risk assessment will provide for successful achievement of the objectives of the institution.

**Adequate segregation of duties** is not practiced in public sector institutions. It is necessary that approval of financial transaction documents is not done by one person only, but to implement four eye principle (control being done by two employees on the same level). Also in the PSI it is necessary that financial transactions are not approved only by the head of the institution or the head of the financial department, but that responsibility and authority is delegated to lower levels in the hierarchy. The duties and responsibilities should be systematically segregated to several employees in order to have efficient and balanced verifications. This should contribute to decreasing the risk of abuse and errors that would provoke loss of assets and irregularities.

In all PSIs measures should be undertaken for documenting the procedures for **authorization and approval**, while the managers and the employees of the institutions should be clearly informed about this. The authority limits should be clearly defined especially in relation to procurement and financial transactions, by which the power of approval will not be concentrated solely with the head of the institution. Also it is necessary to undertake additional measures which will balance control activities at the end as well as during the process.

In all PSIs it is necessary to enhance **control over access to assets and data, as well as to improve their safeguarding**, by developing lists of authorized personnel and prescribing procedures for their storing and utilization.

In all PSIs it is necessary to start developing **appropriate integrated IT systems** (modern management information systems) which will decrease the load of manual work. The introduction of IT will facilitate the process of **reconciliation** at all levels of activities and will mitigate the risk of errors. Effective IT systems should produce accurate reports that contain operational, financial and non financial information which would facilitate business processes and its controlling. In order to be able to make the right decisions the managers need appropriate, timely, up to date, accurate and available information.

All PSIs should start to develop **effective IT systems for mutual communication** having in mind that that is the basis for executing control activities, and that their introduction will contribute to elimination of paper communication and the possibilities of errors. The reliability and the security of the IT systems and data should be mainly the concern of the management and the internal auditors. When using IT systems it is necessary to introduce stronger access control, as well data protection and disaster recovery capacities. It is necessary to develop audit capacities for auditing of IT systems.

All PSIs should improve their **performance review** procedures by developing internal documents which will clearly define who is doing what and in what way in the institution, and every activity will be controlled from the aspect of its compliance with the existing legal framework and accepted standards in order to determine the need of improving the processes. The internal auditors will have a special role in this.

It is also necessary that internal control systems are supervised, through routine management activities and reviewed by the internal audit, in order to assess the quality of their functioning and to provide sustainable development. Besides the assessment of the internal controls by internal auditing, the management should provide for regular supervision activities based on reception of the necessary information.
3.3 INTERNAL AUDIT

The activities related to the development of internal audit system started in 2000, by changing and amending the Law on Budgets, which regulated the performance of internal audit. The Central Internal Audit Unit was established within the Treasury Department in the MoF.

In 2004 within the World Bank Project "Development Policy of Republic of Macedonia in internal audit and training", financed by the Dutch Government, 10 day training for internal auditors from 17 budget institutions was organized and the Internal Audit Manual was updated.

Also in October 2004 the Law on Internal Audit in the Public Sector was passed which stipulates that all public sector institutions are obliged to establish internal audit units or provide for the function of internal audit and to implement it in accordance to this law, the bylaws and the accepted international internal audit standards.

The Government of Republic of Macedonia in January 2004, adopted the Information for Developing Internal Audit and Enhancing Financial Control in budget users and funds, a document that is the basis for the implementation of mid term priorities related to internal audit and control in the public sector. In accordance with this document it was planned by April 2005 to establish IAUs in additional 15 budget institutions on the central level, as well as by March 2006 to have IAUs established and internal auditors trained in 42 municipalities that have more than 15,000 inhabitants.

So far in the central level institutions 24 IAUs are established and the auditors have been trained. Also, IAUs are established in 12 municipalities, while 25 auditors from the local level have completed the beginners training.

With the trainings organized in 2004 and 2005, the internal auditors are trained to do compliance audits. In order to improve the operationality of the IAUs, it is indispensable to provide additional training for internal auditors on risk assessment and performance review as well as additional staffing of IAUs.

3.4 MANAGEMENT AND CONTROL OF EU FUNDS

Regarding foreign funds, RM will treat them equally as the domestic budget funds, except in cases of special requirements by the donors/creditors. The same principles and standards for the management, control and internal audit system will be applied. As far as pre-accession (IPA) funds are concerned, RM established central bodies necessary for usage of these funds, applying the principles of a decentralized implementation system.

Republic of Macedonia started to establish effective mechanisms for monitoring, control and audit of the utilization of pre accession funds (IPA) of the EU, as well as to build institutions and public administration which would have effective and balanced capacities to protect the EU financial interests.

In the Ministry of Finance the Department for managing the EU funds (National Fund) is established, responsible for managing the EU assistance in compliance with the EC requirements, providing information for monitoring of their usage and informing the EC.

National Authorizing Officer – NAO will be the Minister of Finance. He is responsible for the work of the National Fund, for managing financial resources from the pre-accession
assistance programs, as well as for ensuring adherence to EU regulations, laws and procedures that refer to procurement, reporting and financial management. He, at the same time, will be in charge of establishing and managing procedures for functional interrelation between the National Fund and the institutions that will execute and control the use of resources by the end users. For this purpose an appropriate reporting system will be established.

**CFCU – Central Finance and Contracting Unit** is established as a separate unit in the Budget Department in the Ministry of Finance. This body is authorized to perform tender procedures, contracting and paying for projects that strengthen the administrative capacities of Republic of Macedonia and for other projects within the decentralized implementation system. The unit will be responsible for reporting in accordance with the EU rules and procedures.

Related to the obligation to protect the EU financial interests, the MoF will coordinate the activities for the needs of OLAF and will provide instructions for the institutions for purposes of reporting of irregularities.

Internal auditors at CIAD, of MoF will be trained and authorized to perform internal audit in the Department for managing the EU funds (tha National Fund) and the Central Finance and Contracting Unit.

### 4. MEASURES FOR DEVELOPING THE PIFC SYSTEM IN THE REPUBLIC OF MACEDONIA

Priority of Republic of Macedonia is to develop a comprehensive internal financial control system in all the public sector which will enable the introduction of sound financial management with public funds (national and foreign). In this context all the important aspects of management responsibility, internal audit, central harmonization and fraud prevention will be tackled. That comprises development of sound legal basis, establishment of indispensable central bodies, establishment of adequate administrative capacity and adequate training of all the involved parties.

#### 4.1 PASSING A PIFC LAW

In order PIFC elements and concept to become recognizable and sustainable in the public sector in the Republic of Macedonia, at mid 2006 a PIFC Law will be passed. It will present a legal framework which will give the Ministry of Finance a leading role in establishing comprehensive PIFC system in public administration. It, will also regulate the establishment of global approach towards development of modern internal control systems in the public sector which will cover all important aspects of financial management and control and its central harmonization.

By end of 2006, on the basis of the PIFC Law the Minister of Finance will pass the following by-laws: Rule-book for the basic elements of financial management and control
in public sector, Rule-book for the internal control standards, such as Technical Guidelines for implementation and operation of financial management and control system, which will be published on the web site of the MoF, by end of 2007.

4.2 ORGANIZATIONAL CHANGES IN THE MINISTRY OF FINANCE

By end of 2006 the Ministry of Finance will change and amend the Rulebook on Organization and Systematization of the Ministry of Finance, according to which the Central Internal Audit Department will be transformed into PIFC Department. This Department will have the following units: Central Harmonization Unit for Financial Management and Internal Controls, Central Harmonization Unit for Internal Audit, Unit for Central Internal Audit, and Unit for Coordination of Fraud Prevention which will coordinate the prevention of EU financial interests. In accordance to this Act, both harmonization units in this Department will be responsible for developing methodologies and standards and will take care of developing internal audit and FMC procedures and manuals.

The Central Harmonization Unit for Internal Audit will develop Methodology for Audit Risk Assessment, Audit Planning, Audit Techniques and Reporting that will be applied in all public sector institutions, and will also supervise the operation of internal audit units. This Unit will also collaborate with all the internal auditors in the public sector with purpose to review and resolve problems and to introduce cooperation in the frame of the established net of internal auditors.

The Central Harmonization Unit for FMC will work on developing methodologies for documenting the business processes, management risk assessment, standardization of basic internal controls, check lists, sampling methods for the needs of ex-post on-the-spot control and similar issues.

The harmonization units will prepare appropriate annual reports to the Government of Republic of Macedonia containing the undertaken and needed activities for further developing the PIFC System in Republic of Macedonia. They will also provide other methodology manuals and guidelines reference issues related to the development of the PIFC system, and will also ensure continuous training capacity for internal auditors and employees in charge of financial management and control in the public sector.

In accordance with the new Systematization Act, the FMC CHU will be staffed with three employees in 2006 and additional 2 in 2008.

The Unit for Coordination of Fraud Prevention will record the reports for non-compliance, will cooperate with OLAF and will inform on non-compliances and frauds in the usage of EU funds. This Unit will start working by the end of 2007 and will be staffed with two employees.

Central Internal Audit Unit will perform internal audit in public sector institutions where internal audit units have not been established yet, until establishment of such units, and internal audit in the organizations which have established internal audit units, but such units fail to perform internal audit in accordance with this law and with the acts deriving from this law, until such irregularities are eliminated. The auditors from this unit will also audit the use of EU pre-accession IPA funds.
4.3 DEVELOPING MODERN FMC SYSTEMS

4.3.1 Developing the concept for management accountability

Once the Law on PIFC is passed the legal framework for the principles, standards and rules for FMC will be introduced. According to this concept the head of the institution is responsible for establishing, implementation and development of the sound financial management and control system in his/her institution, including the establishment of rules for efficient, effective and economic use of resources available. This responsibility cannot be delegated.

The system of sound FMC will be established by the management and on the basis of the general directions and recommendations of the CHU for FMC.

4.3.2 Segregation of duties and authorities

By April 2007, in accordance with the principles of sound financial management and control, internal acts of PSIs on central and local level will be changed and amended in a way that appropriate organizational structure will enable segregation of duties and necessary authorizations to the managers in the institutions.

By changing and amending the internal acts in the PSIs the duties and responsibilities will be systematically segregated to several individuals which would provide effective and balanced control, and will mitigate the risk of abuse and errors, loss of resources and irregularities, and will introduce the four eye principle and delegate responsibilities to lower levels in the hierarchy.

The authorization and approval procedures will be documented, and managers and employees will be clearly informed about this. These documents will also contain clear definition of the authorization limits concerning procurements, financial transactions and control activities in the early steps of the processes.

4.3.3 Training

The introduction of modern FMC systems in short term will begin by presenting the PIFC system to the managers of the PSIs. During the first quarter of 2007 a compulsory training in FMC will start for state secretaries, directors of different public institutions, and the secretaries of municipalities. The training will be realized in cooperation with the Twinning Project.

In the mid term FMC training will be organized for all heads of departments, financial services and accountants, and later on for all employees, on lower levels in the hierarchy, on central and local level.

For successful execution of training the FMC CHU will use technical assistance from other countries, and will also cooperate with universities and experts from Macedonia and from abroad who have practical experience in this field. For this purpose in the beginning of 2007, in cooperation with academic institutions, the Program for FMC training will be developed.

4.3.4 Developing effective internal control systems

The intensive development of effective internal control systems will start in 2006 and it will be continually developed and improved.
The PSIs will have the obligation to develop, in a given deadline, written internal procedures in form of internal act (rulebooks) which will define the basic business processes and will contain flow charts, guidelines which will give detailed description of operations, and on the basis of this detailed job descriptions for every position in the Systematization Acts. These documents will enable assessment of the risks that present a threat for achieving the business objectives. Internal controls will be designed based on the risk assessment in order to be appropriate to the type and the scale of the risk.

In this way, it will be clearly determined who does what and in what way, and will at the same time enable control of the performance results.

The PSIs will start building modern MIS which will enable quick and efficient reconciliation of accounting and other data as well as the production of financial and other type of reports.

IT supported control activities will be strengthen on all levels in the public sector, with stricter access control, contingency plans for data protection and also developing IT audit capacities.

4.4 MEASURES RELATED TO INTERNAL AUDIT

By the end of 2007 on central and local level at least 140 internal auditors will be trained, out of whom 98 on central and 42 on local level. The process for establishing IAUs on central level is expected to end in the first quarter of 2006, by when the last 6 units will become functional (currently they are being established).

The IA CHU in the CIAD will be additionally staffed with one employee in 2006, 2 in 2007 and 1 in 2008, while the Unit for Central Internal Audit which is performing internal audits in the institutions that still do not have or do not perform internal audit will be additionally staffed with one IT auditor.

The training of internal auditors will be continuously coordinated by the CIAD, and appropriate technical assistance of the Kingdom of Netherlands is expected during the year 2006.

By the end of 2007, 2 IT internal auditors will be trained out of which one will be in the CIAD and the other in some of the central level institutions.

During 2006, the technical performance of the central level internal auditors is expected to improve by procuring 100 lap top computers and other technical equipment, for which a financial assistance in the amount of 200,000 Euros will be requested from the CARDS Project. In case these funds are not provided, the MoF will issue a recommendation and will make efforts to introduce these funds, divided per institution, in the budget planning for 2007.

Improvement of the efficiency and the effectiveness of the internal auditors will be achieved by the development of the Internal Audit Manual which will be a technical guide for performing internal audit. The Manual will be issued in the beginning of 2006 and it will be published on the web site of the MoF as well as printed in a hard copy.

In the first half of 2006 the Law on Internal Audit will be changed and amended in order to enhance the independence of internal auditors, to regulate their status, rewarding and promoting as civil servants, will regulate the certification process and passing an exam for internal auditor in the public sector, as well as other reconciliations in accordance with the EU standards and best practices for internal audit. By the end of 2006 the Minister of Finance will pass: Rule-book for acquiring the title of state internal auditor which will
regulate the essential elements of the training program for state internal auditors and the exam for becoming state internal auditor, and a Rulebook for the unified arrangement of the status and the salaries of the state internal auditors.

During 2006 amendments and supplements to the Law on financing the self-government units will be passed including its harmonization with the Law on internal audit of the public sector and with the adopted international standards for internal audit. By this change the internal auditors will not have the status of officials appointed by the Municipality Council, they will obtain a position of civil servants responsible directly to the Mayor.

For internal auditors that will be appropriately trained and will have one year of practical experience in internal audit, the MoF will organize the exam for achieving the title of state internal auditor. The Certification curriculum for state internal auditors will be developed by the end of 2007.

The independence and the role of the internal auditors in the IAUs will be enhanced by developing special IA Charters, which will actually present a statute of the IAU signed by the head of the institution and the head of the IAU.

By passing the Law on changing and amending the Law on Public Procurement towards the end of 2006, the public procurement inspection will be transferred from the competence of the CIAD to the Public Procurement Bureau.

In order to deal with the fluctuations of internal auditors and in order to strengthen the IAUs in 2007 the salaries of internal auditors in the public sector will be harmonized with those of the auditors in the State Audit Office.

4.5 MEASURES IN REGARD TO USE OF EU FUNDS

The creation of efficient monitoring, control, and audit mechanisms in utilization of pre-accession (IPA) funds will be supported by employing 12 employees with knowledge of English in the National Fund and the CFCU.

In 2006, 5 internal auditors from CIAD will be trained in auditing the usage of the pre-accession IPA funds, while in 2007, 10 auditors from other PSI will be trained as well.

4.6 MEASURES IN REGARD TO ACCOUNTING

In 2005 Republic of Macedonia started the process of raising the quality of accountants in the public sector in accordance with the international accounting standards in public sector (IPSAS). For this purpose in December 2005 the cash based IPSAS were adopted and published. In cooperation with the Center of Excellence in Finance (CEF) form Slovenia and Charted Institute of Public Finance and Accountancy (CIPFA) from Great Britain the implementation of the Project “Improving the Capacities of Public Accounting” will start. This Project will be implemented in the period between 2006 and 2010. The financing of this project is mainly done by foreign donations.

Under the Project two cycles of training for public accountants will be organized, each lasting two years, with the objective at the end the accountants to receive internationally certified diploma.

In the first training cycle, which will be done in English, in the period between October 2006 and June 2008, 30 to 50 accountants will be trained, and they will be responsible for
future development of accounting profession through their involvement in the future professional accounting body.

The second training cycle which will be held in Macedonian language, will take place in the period between October 2008 and June 2010. In this cycle 50 to 70 accountants will be trained.

In 2008, the appropriate legal regulations will be changed and amended in accordance to which all accountants in the public sector will have to be certified.

In order to continue this process after the Project ending, a national body will be created which will provide training and will promote accounting profession.

4.7 MEASURES IN REGARD TO EXTERNAL AUDIT

The State Audit Office as an external Audit is not part of the PIFC system, however, in many cases it influences the control environment and the financial management of the public funds. The cooperation between the external and internal auditors is extremely important element that can help in strengthening some of the PIFC elements.

In the first quarter of 2006, in order to improve the cooperation between the SAO and the CIAD, a Protocol for Cooperation will be signed by the Minister of Finance and the State Auditor General.

The improvement of the operational and financial independence of the State Audit Office will be provided by the Law on changing and amending the Law on State Audit Office which will be adopted in the first half of 2006.

In order to monitor the actions undertaken upon the recommendations in the SAO reports the Government of Republic of Macedonia will appropriately change and amend the Rulebook on the Function of the Government according to which the reports on implemented recommendations given by the SAO will be reviewed by the appropriate bodies of the Government, and if needed by the Government itself.
5. TIMEFRAME OF ACTIVITIES FOR PIFC DEVELOPMENT

<table>
<thead>
<tr>
<th>No.</th>
<th>Measure / Activity</th>
<th>Deadline / Year / Quarter</th>
<th>Competent Institution</th>
</tr>
</thead>
<tbody>
<tr>
<td>A) JOINT ACTIVITIES</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td>Passing a Law on PIFC</td>
<td>2006/II</td>
<td>MOF</td>
</tr>
<tr>
<td>2</td>
<td>Passing a Regulation on the basic elements of FMC in the public sector, Regulation on the internal control standards, as well as Technical Guide for the method of implementation and execution of FMC which will be published on the web site of the Ministry of Finance</td>
<td>2007/IV</td>
<td>MOF</td>
</tr>
<tr>
<td>3</td>
<td>Changing and amending the Law on internal audit in the public sector</td>
<td>2006/II</td>
<td>MOF</td>
</tr>
<tr>
<td>4</td>
<td>Passing a Regulation on the basic elements of the curriculum for internal audit training and the exam for acquiring the title state internal auditor and a Regulation on the status and salaries of certified internal auditors.</td>
<td>2006/IV</td>
<td>MOF</td>
</tr>
<tr>
<td>B) ACTIVITIES IN REGARD TO INTERNAL AUDIT</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>5</td>
<td>Establishing IAUs in the the budget user institutions on central level which do not have established one according to plan</td>
<td>2006/I</td>
<td>MOF and the budget users</td>
</tr>
<tr>
<td>6</td>
<td>Establishing IAUs, that is provision of the function of internal audit in 42 of the LSGUs</td>
<td>2006/IV</td>
<td>MOF and LSGUs</td>
</tr>
<tr>
<td>7</td>
<td>Adopting a Plan for completing the staffing in the IAUs (central level)</td>
<td>2006/I</td>
<td>MOF/Government of RM</td>
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<tr>
<td>8</td>
<td>Training for the internal auditors</td>
<td>2007/IV</td>
<td>MOF</td>
</tr>
<tr>
<td>9</td>
<td>Training of IT auditors at the central level budget users</td>
<td>2007/IV</td>
<td>MOF</td>
</tr>
<tr>
<td>10</td>
<td>Procuring IT equipment for IAUs on central level</td>
<td>2006/IV</td>
<td>MOF</td>
</tr>
<tr>
<td>11</td>
<td>Adopting national training curriculum for the state internal auditors</td>
<td>2007/IV</td>
<td>MOF</td>
</tr>
<tr>
<td>12</td>
<td>Developing Technical Guide for performing internal audit</td>
<td>2006/I</td>
<td>MOF</td>
</tr>
<tr>
<td>C) ACTIVITIES RELATED TO PIFC IMPLEMENTATION</td>
<td></td>
<td></td>
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<tr>
<td>13</td>
<td>Amendments and supplements to the Systematization Act of the MoF in order to change the CIAD into PIFC Department in which there will be additionally formed the CHU for FMC (3 employments in 2006 and 2 employments in 2008), and Unit for coordination of fraud prevention (2 employments in 2007). The CHU for IA will be enlarged for 1 employee in 2006, 2 in 2007 and 1 in 2008, and the Central Internal Audit Unit will be enlarged for 1 employee.</td>
<td>2006/II</td>
<td>MOF</td>
</tr>
<tr>
<td>14</td>
<td>Passing a FMC Training Program</td>
<td>2007/I</td>
<td>MoF</td>
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<tr>
<td>15</td>
<td>Starting a continuous FMC training</td>
<td>2007/IV</td>
<td>MOF</td>
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<tr>
<td>16</td>
<td>Establishing and staffing of a Department for Managing EU funds (National Fund)</td>
<td>2006/I</td>
<td>MOF</td>
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<tr>
<td>17</td>
<td>Establishing and staffing of CFCU</td>
<td>2006/I</td>
<td>MOF</td>
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<tr>
<td>18</td>
<td>Training of 15 internal auditors for EU funds Audits (5 from the CIAD at the MOF)</td>
<td>2007/IV</td>
<td>MOF</td>
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<tr>
<td>19</td>
<td>Certification training for public internal auditors</td>
<td>2006/IV</td>
<td>MOF</td>
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<tr>
<td>D) ACTIVITIES RELATED TO THE STATE AUDIT OFFICE</td>
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<tr>
<td>20</td>
<td>Changing and amending the Law on State Audit</td>
<td>2006/II</td>
<td>MOF</td>
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<tr>
<td>21</td>
<td>Amendments and supplements to the Rule-book for the functioning of the Government of RM and appointing a person to monitor the SAO findings</td>
<td>2006/I</td>
<td>Government of Republic of Macedonia</td>
</tr>
<tr>
<td>22</td>
<td>Signing a Protocol for cooperation between the State Audit Office and Public Prosecution, MoI, the Ombudsman and the State Committee for Prevention of Corruption</td>
<td>2006/II</td>
<td></td>
</tr>
<tr>
<td>23</td>
<td>Signing a Protocol for cooperation between the SAO and the MoF</td>
<td>2006/I</td>
<td>MOF</td>
</tr>
<tr>
<td>24</td>
<td>Training state auditors in audit trails, performance audits, IT audits, in EU Funds audit, risk assessment etc.</td>
<td>2007/IV</td>
<td>SAO</td>
</tr>
</tbody>
</table>

### F) PROTECTION OF EU FINANCIAL INTERESTS

| 25 | Additional staffing of Computer Crime and Forgeries Unit which works directly on discovering Euro and other foreign currencies forgeries as well the Crime Investigation Unit | 2007 | MOI |
| 26 | Reinforcing the IT systems of Departments under point 25 | 2007/IV | MOI |
| 27 | Adopting operational procedures for the Unit for Fraud prevention in the PIFC Department | 2007/IV | MOF |
| 28 | Developing a Rulebook on the form and the method of record keeping into the Registry of discovered money forgeries | 2006/IV | MOI |