



REPUBLIC OF SRPSKA
Government of the Republic of Srpska
Ministry of Finance

**Strategy for Establishing and Building
Public Internal Financial Control
in the Republic of Srpska**

Banja Luka, April 2010

List of acronyms

CAO – Competent Accrediting Officer (an officer within the Ministry of Finance responsible for accreditation in the Republic of Srpska)

CFCU – Central Finance and Contracting Unit (for EU funds for the Republic of Srpska)

CHU – Central Harmonisation Unit

COSO - Committee of Sponsoring Organisations of the Treadway Commission (seeking to improve the quality of financial reporting, business ethics, internal audits and corporate management)

DfID – UK Department for International Development

DG Budget – Directorate-General for Budget

FMC - Financial Management and Control

IFC – Internal Financial Control

INTOSAI – International Organisation of the Supreme Audit Institutions

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IPA - Instrument for Pre-Accession Assistance

IA – Internal audit

NAO - National Authorising Officer (an RS MoF officer)

NF- National Fund (accounts of the RS Treasury to be used for the transfer of EU funds)

NIPAC- National IPA Coordinator

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PIFC - Public Internal Financial Control

SIGMA – Support for Improvement in Governance and Management

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RS AAA – Association of Accountants and Auditors of the Republic of Srpska

USAID – United States Agency for International Development

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1. Introduction

The European Commission ("EC") and Directorate-General for Budget have defined a policy to introduce and develop public internal financial control in EU applicant countries.

According to these EC policies, PIFC should be based on well-established international principles of control management and standards, the implementation of which should lead to the verification by the concerned country's administration that the consumed public funds have been used in an efficient, effective, transparent and accountable manner.

Introducing a new model of managing public financing is a long-term process calling for significant changes in the current management systems, which basically rests on a model that ensures the implementation of activities according to the adopted budget.

According to the EC concept, the process of introducing and developing IFC starts with a strategic IFC document, which should help the Republic of Srpska ("RS") institutions to become familiar with the fundamental elements of internationally recognised management and control standards, weaknesses of the existing management and control model, as well as activities to be implemented with a view to shifting to the required financial management and control model.

The RS Strategy for Establishing and Developing Public Internal Financial Control ("RS PIFC Strategy") has been drafted by a working group of the RS Ministry of Finance with the expert support of the SIGMA and DG Budget.

Analysis of the weaknesses of the current RS PIFC system has been based on the applicable regulations governing FMC and IA; reports on the appraisal of the existing management system conducted by international experts hired by the EC; World Bank's reports on systemic reviews of general capacities; and findings and recommendations contained in the reports of the RS Supreme Audit Institution.

There are no strict EU requirements in respect of a specific budgetary model an SAA or candidate country must adopt. This implies that the RS Government and its Ministry of Finance needs to align the adopted management models and control standards as applicable in EU institutions and Member States with the existing structure of the RS institutions and financial systems.

The countries are bound to implement a reform of public internal control in such a way so as to implement international standards and best practices.

The management principles and control standards to be defined and introduced into the RS public institutions by virtue of the PIFC Strategy and action plans arising therefrom will apply to EU assistance instruments and funds (and funds of other international financial institutions) the Republic of Srpska will be using.

Article 90 of the Stabilisation and Association Agreement, concluded between BiH and the European Communities (EC), stipulates that internal financial control should be set up in the manner developed by the EC.

The European partnership with BiH also refers to establishing IFC as a requirement. The PIFC Strategy will be adopted by the Government of the Republic of Srpska. However, this Document will be developed on a continuing basis and periodic updating, the purpose of which will be to align the activities and goals as contained in the Implementation Plan with the activities actually implemented, as well as to establish a link with the impact of reforms of other horizontal systems and sub-systems on the PIFC area.

The Implementation Plan, as well as the IFC Strategy as necessary, will be updated by the Ministry of Finance in the manner in which the initial text of the Strategy was prepared. The Ministry of Finance will report to the RS Government on the progress of the plan implementation from time to time as well as proposed measures to remove any obstacles to attaining the activities and goals as planned.

Based on the PIFC Strategy, the EC will define terms of reference and initiate a procurement procedure and contract a consultant who will be providing technical assistance in the course of the implementation and monitoring of the adopted Strategy. Currently, a procedure to select a consultant to work on the implementation of the RS PIFC Strategy is ongoing.

2. Executive Summary

The PIFC Strategy defines the basic components of developing IFC based on international well-established principles and management and control standards used by EU institutions and Member States.

Introducing, developing and applying PIFC in RS will evolve through a synchronised and coordinated development of PIFC, IA function and Central Harmonisation Unit ("CHU").

This implies the need to adopt the missing FMC legislation as a binding framework for internal control standards and other regulations to serve as legal grounds for setting up relevant structures within public institutions. The adopted regulations and established structures will be responsible or delegate responsibility for introducing the IFC system depending on the complexity of the activities to be implemented by each institution and the risk assessed in any given activity area.

Training programmes for managers and staff working on IFC issues, along with the legislation currently missing, will be prerequisite for complying with the principle of delegating authority and responsibility on the basis of clear written procedures, which will *inter alia* include the following: approval, verification and authorisation for all significant activities.

Creating an adequate control environment for strategic planning, programme budgeting, mid-term expenditure framework ("MTEF") and budgetary framework paper ("BFP") with an assessment of risks at a given level of responsibility will serve as a basis for setting up efficient ex ante and ex post controls, which will safeguard the implementation of the goals as set in terms of the efficiency and effectiveness of consumed resources and transaction appropriateness.

The PIFC Strategy, IA legislation and currently missing bylaws pertinent to the IA area, methodology and guidelines for the work of internal auditors, internationally accepted IA standards and code of ethics for internal auditors will enable establishing an adequate structure of internal audit units and internal auditors in the RS public sector.

The adopted training programmes, training of internal auditors, curricula and examination to be taken by auditors in order to acquire a licence of the Ministry of Finance required for the work in the RS public sector will be an opportunity for internal auditors to acquire the necessary knowledge and skills to add value to the activities of the institutions they audit, particularly with regard to establishing a relevant management and control system, risk assessment and institution management.

The management and control system as established needs to enable bottom-up reporting and thus ensure that the higher-level budgetary users verify the goals as defined and attained by respective management and control models of lower-level budgetary users.

Reporting on the FMC system will be standardised and made transparent, while the findings of the conducted control procedures will be available to all interested parties in the respective management and control system.

A management and control model thus established, with efficient internal audit and annual consolidated reports on efficiency and effectiveness of the management and control model as set will enable the RS Government to report to the public and RS Parliament not only as to the correct, lawful and regular performance of financial activities but also the efficient and effective use of resources and quality of the transactions made.

As the third IFC component, a CHU will be established. The CHU will be organised and operate in accordance with the Rules on the Organisation and Staff Specification of the Ministry of Finance, RS Public Sector Internal Audit Act and other regulations that will enable efficient CHU operations. The CHU will be a change agent for RS PIFC.

The operability of internal audit units will be coordinated by the CHU on the basis of the requirements as provided for in the Internal Audit Act and other regulations to be adopted by the RS Ministry of Finance.

Coordination of work will enable setting up functionally independent IA units that will implement IA activities according to the level of knowledge and skills of the recruited internal auditors and adopted regulations, standards, methodology and guidelines issued by the Ministry of Finance.

The CHU will also coordinate and guide IA activities with regard to the level of sophistication of the FMC system in such a way that the IA function develops from a review of correspondence through a review of system efficiency and effectiveness to the assessment of the FMC system. The foundation for coordination and guidance of the IA function will be enabled by the analysis of strategic and annual plans as well as annual reports on audits conducted by IA units.

Internal financial control seeks to establish a comprehensive and robust management and control system, which will be integrated into all significant financial processes within the RS institutions.

The financial management and control will take into account the features of the financial systems (sub-systems) operating within the RS institutions, as well as the difficulty and complexity of the institutions in which the relevant processes take place while observing the cost-benefit principle.

The objectives and activity areas as listed in the Action Plan of the PIFC Strategy are interrelated and interdependent in such a way that the attainment of an objective in one activity area will enhance the progress in attaining the objectives and activities in another area.

The proposed approach will also assist all RS public institutions in implementing multi-annual recommendations of the Supreme Audit Institution related to the obligation to establish a system of internal controls based on risk assessment, a relevant control environment, monitoring and introduction of other FMC components.

External evaluation of the IFC system will be conducted through a review of the quality control by IA units and CHU once in five years as stipulated by the Internal Audit Act and adopted methodology for the evaluation of CHU performance.

The RS PIFC Strategy Plan will be implemented through the RS Ministry of Finance as an owner of this strategic document, and with the financial and technical assistance to be provided by the EC and selected consultant.

It is estimated that the implementation period for the PIFC Strategy's Plan will be at least 5 – 7 years. The following risks will considerably affect the attainment of the defined objectives and activities in the said period:

- The manner of implementing any support to be provided through a defined project document. This primarily implies relevant project and financial documents to be signed by and between the RS Ministry of Finance as a direct assistance beneficiary, as well as the involvement and commitment of a foreign consultant to the planned activities and Strategy objectives.
- Insufficient commitment to the changes in the RS public administration,
- Inability to ensure the full staffing (including the CHU), inadequate training and scarce financial resources can also constitute potential risks that might adversely affect the implementation of the planned activities and objectives set forth in the PIFC Strategy.

In order to define framework standards, guidelines, methodologies and training programmes in the IFC area properly tailored to each level of governance in BiH, the managers of the CHUs within the BH Ministry of Finance and Treasury and entity ministries of finance will set up a CHU coordinating board.

The authority and functioning of the CHU Coordinating Board will be set forth in the Rules on the Work of the Coordinating Board. The Board will also be responsible for coordinating the delivery of expert assistance to all levels of governance in BiH in line with the adopted IFC strategies and project document.

3. Basic elements of the PIFC concept - IFC

According to the accepted EC concept, public internal financial control refers to a comprehensive system of processes and principles of financial management and control and internal audit functions, which are integrated into all financial systems of public sector institutions. PIFC systems aim to provide adequate and transparent methods and organisations to provide reasonable assurance that public funds are being used for the objectives of public institutions.

PIFC systems are put in place by governments to ensure accountable planning, use, control, audit and reporting on the spending of public funds from domestic sources and EU funds (and other IFI funds).

According to the adopted EC concept, a PIFC system is defined as having three pillars:

- a) financial management and control (FMC),
- b) functionally independent internal audit (IA) and
- c) a central harmonisation unit (CHU) for harmonisation and coordination of the PIFC system and internal audit function.

PIFC aims to reform traditional national control systems.

3.1. Managerial accountability

Establishing a PIFC system rests on the principle of managerial accountability. According to the principle of managerial accountability, managers hold the ultimate accountability for the entire management and development of the organisation in a lawful, efficient and effective manner.

This primarily includes the accountability for defining strategic, programme and operational goals of the organisation in accordance with the respective legislation, as well as identifying, evaluating and managing risks in order to attain the organisation's goals as defined.

In order to attain the goals as set, the manager is accountable for developing and implementing a PIFC system to ensure the attainment of such goals.

A public manager is accountable for setting up and developing the IA function to assess whether the PIFC system is adequate and operating efficiently during a period. A public manager is accountable for developing and implementing policies and procedures to ensure transparent and reasonable attainment of the organisation's goals, as well as a PIFC system.

Managerial accountability is not limited only to the financial aspect of the organisation's activity, but includes all operational activities and processes. A public manager is accountable for supervising the implementation of all significant activities and processes as well as reporting to responsible bodies on the adequacy and effectiveness of financial management and controls and internal audit. An IA unit manager can notify the competent authorities (such as the prosecutor's office of any irregularity even without a prior consent of

the organisation's manager if s/he believes it would contribute to the transparency of the organisation's work.

3.2. Financial management and control

The PIFC system encompasses all types of processes, policies and procedures used in an organisation for financial planning, execution, control and reporting in the area of the organisation's strategic, programme and operational activities.

All staff is responsible for implementing a PIFC system in line with the organisation's goals and business processes as defined earlier. The public manager is accountable for ensuring the development and application of written instructions and procedures for all processes for which control activities are being introduced.

A PIFC system ensures reasonable assurance that the organisation's objectives will be attained in terms of the following:

1. Executing cost-effective, effective and efficient operations to attain the organisation's objectives,
2. Reliability of financial reports, security and timeliness of financial information,
3. Complying with applicable regulations, plans, policies and procedures, and
4. Safeguarding resources and data.

A PIFC system is an integral component of the organisation's management process and is a component part of the organisation's activity. Organisation management is central to establishing and efficient functioning of internal controls, which are the responsibility of the organisation staff.

Internal controls ensure reasonable assurance that the organisation's missions and objectives will be accomplished. Reasonable assurance equates to a level of confidence, which implies that the costs of internal controls will not exceed the benefits from the established controls.

According to the internationally recognised internal control standards, internal controls encompass five interrelated elements as follows:

- Control environment,
- Risk management,
- Control activities,
- Information and communication, and
- Oversight / monitoring.

The above elements constitute a framework of internal controls and a starting point that is relevant to all institutions and organisations. The management will make a series of choices regarding the complexity of processes and methodologies deployed to apply the above internal control components.

3.2.1. Control environment

A positive control environment is a foundation of the functioning of any other component of the management and control model. The control environment provides the adequate structure of the organisation, integrity and ethic values, which constitute a basis for efficient internal controls.

An important control environment factor is also the commitment of managers as regards the level of competence (knowledge and skills) each member of the staff should possess in accordance with the authority and responsibilities vested with him/her.

The philosophy and operational style of the management, supportive to internal controls, as well as good employment policies and practices, orientation, training, evaluation and career paths for the staff are a factor that contributes to a positive control environment and efficient management and control system.

3.2.2. Risk management

Another important internal control factor is risk management or risk assessment. Risk management refers to the overall activity of identifying risks related to the attainment of the organisation's goals, risk analysis through impact assessment and likelihood of event occurrence, as well as the management's final decision on actions to be undertaken to ensure efficient risk management.

3.2.3. Control activities

Control activities are an integral part of planning, executing, monitoring and reporting, and rest on written policies and procedures for all significant processes and activities of an organisation.

Control activities occur throughout the organisation, at all levels and in all important functions. They help the organisation attain its defined goals in the manner set forth in its plans. Through defining and establishing control activities within the organisation's processes that are assessed to be at the greatest risk, control activities help address (resolve) adverse effects of some significant risk in the organisation.

Control activities are classified as preliminary (ex ante), ongoing and subsequent (ex post). Ex ante controls aim to prevent the occurrence of adverse events.

Ex ante controls need to be applied prior to carrying out a decision relating to appropriations, commitments, tender procedures, contracts and related disbursements and recovery of unduly paid amounts. Examples of ex ante controls include: identifying duties, written procedures for giving authorisations and approvals in place, access to resource control, verifying accounting documents prior to disbursement.

Ongoing controls are the set of control actions deployed in the course of activity implementation. Ongoing controls include: monitoring activity progress relative to strategic, operative or programme criteria as defined.

Ex post controls take place after a business activity or business process have been carried out. Ex post controls are set to detect the actual adverse events. They are designed to warn the managers as to what has actually happened in order to undertake corrective actions as soon as possible. Control activities that are most frequently deployed include: physical control activities, reconciliation, reviews of completed activities relative to the planned ones. Oversight of the execution of certain activities is also an ex post control of the completed activities.

Ex post control activities, including inspection, are ex post controls set up by the organisation's management and should not be confused with either internal or external audit. In certain situations, a mix of control activities can be used, whereas in others one control activity can substitute another.

In order for the financial management and control system to operate successfully, the principle of adequate segregation of duties is compulsory. The manager is bound to segregate duties and assign the necessary authorisations to the organisation's line managers.

3.2.4. Information and communication#

In order for the financial management and control system to operate efficiently, it is necessary that the organisation should have significant, reliable and timely data. Data are essential to realising all of the organisation's defined objectives. All significant data must be identified, collected and communicated in a required format throughout the organisation (top-down and vice versa).

The manager should ensure that the staff receive and share information and data in an appropriate manner, as well as that such information is timely, sufficient and relevant to their users.

3.2.5. Monitoring / oversight

Monitoring is an overview of the organisation's activities and transactions aimed at assessing the quality of the activities performed over a time period, as well as establishing whether the internal controls have been effective in the given period.

The manager should set up monitoring according to the organisation's internal controls and mission. For monitoring to be effective, all staff should understand the organisation's mission, objectives, levels of acceptable risks, as well as the level of their own responsibility. Monitoring and assessing the efficiency of the financial management and control system will be carried out through ongoing oversight of the execution of significant activities, self-assessment and internal audit activities.

Although internal audit is an integral part of the monitoring of the management and control model as a component recognised at the international level, one of its elements is managerial accountability.

Internal audit is functionally independent.

3.3. Functionally independent internal audit

Internal audit is an independent function designed to objectively collect data, verify, analyse, assess and report the functions and processes of management and control systems. Thus, internal audit adds value to the processes and enhances the organisation's activities.

Internal audit will found its activities on strategic (three-year) and annual internal audit plans. The strategic plan will define processes / systems / functions / activities of the organisation that may be a focus of IA work. The annual priorities and intervals in which certain audits will be carried out will depend on the size of risks assigned to the said systems (processes / activities) and available resources for the planned audits.

In terms of hierarchy, internal auditors will report direct to the highest ranking manager within the organisation, but will be independent from the manager's opinion as to the internal auditor's manner of work. Functionally independent internal audit will not be part of any other process within a public organisation, nor any other organisational unit. The manager may not request an internal auditor to be part of any managerial accountability within the organisation.

The manager is accountable for establishing an efficient financial management and control system. Internal auditors are not responsible for establishing, functioning and developing a financial management and control system. The auditor's role is to assess the efficiency of such systems, their potential weaknesses, deficiencies and irregularities, come up with recommendations for improvement and follow up the corrections made. The manager is accountable for following the auditor's suggestions.

The IA unit will develop a rulebook on internal audit and code of ethics for internal auditors according to the respective statutes and specific situation in the institution.

3.4. Central Harmonisation Unit for financial management and controls and internal audit

The Central Harmonisation Unit (CHU) is an integral part of internal financial controls. The CHU is authorised to manage development and is a prerequisite for a successful approach to establishing and developing public internal financial controls.

The CHU is responsible for developing and promoting financial management principles and framework control standards, as well as the methodology for public internal audit on the basis of internationally recognised standards and good practices of EU institutions and Member States.

In particular, the CHU is focused on developing regulations, procedures and audit traces for financial management and control, as well as preparing IA framework rules, IA manuals and the code of ethics for officers involved in financial management and controls and internal audit.

The CHU monitors the application of the adopted regulations, methodologies and procedures, analyses the findings and reports to the Ministry and Government on the PIFC

development, weaknesses and measures required for improving the financial management and control system and internal audit.

The CHU adopts relevant training programmes for the staff responsible for financial management and controls and internal auditors alike. The training programmes should be based on international standards, principles and best practices in the FMC and IA areas.

The CHU is also responsible for coordinating and organising relevant FMC and IA training of the management and civil servants in the public sector.

EU practices show that the CHU is best placed in the Ministry of Finance.

4. The current situation in IFC in RS

Certain IFC elements in RS public institutions can be recognised in the FMC system governed by the institutional (systemic) and legislative framework as referred to above.

4.1. Institutional framework

The key institutions to develop and implement PIFC in RS are as follows:

The Republic of Srpska National Assembly is a body elected by the citizens of the Republic of Srpska. The National Assembly is the legislator of the Republic of Srpska. It adopts RS legislation and budget, elects, appoints and dismisses, and controls the work of the RS Government. Through its standing **Audit Committee**, it significantly contributes to the efficiency of the managing and controlling the beneficiaries of public funds in RS. The Supreme Audit Institution is accountable to the Audit Committee. The Committee contributes to responsible spending of public funds by the budgetary users by ensuring the implementation of recommendations from audit reports as regards the irregularities observed in financial reporting and FMC in audited budgetary users.

The Government of the Republic of Srpska submits statutes and other regulations to the Republic of Srpska National Assembly, as well as the budget and annual financial statement of the Republic of Srpska; it implements statutes and other acts of the National Assembly, decides on internal policies, guides and supervises the operations of the ministries, administrations and administrative bodies, takes care of the economic development of the Republic of Srpska. It carries out other tasks as defined in the RS Constitution and law.

The RS Supreme Audit Institution operates in accordance with the RS Public Sector Audit Act. It is authorised to audit all institutions of the Republic of Srpska that are funded from public resources (budgets of the Republic of Srpska, municipalities and cities, as well as public enterprises and extrabudgetary funds). Its mandate is to carry out financial audit, performance audit, compliance audit, subsequent audit, management audit and controls as well as other audit related services. Auditing reports are published on the SAI's web page.

Internal audit units within RS public institutions are set up in accordance with the initial criteria as set forth in the Internal Audit Act. Approximately thirty of the RS public institutions have established structures necessary for the IA function. Establishing the IA

function mainly refers to developing and applying the PIFC Strategy, harmonisation of legislation and coordination of activities by CHU.

The RS Ministry of Finance plays one of the key roles as to developing, implementing and overseeing the PIFC implementation. This importance reflects both in the Ministry's submitting the fundamental bills binding the budgetary users to set up PIFC elements, developing bylaws defining policies and procedures to apply the FMC principle as well as supervising the application of the relevant regulations and reporting thereof. The RS Ministry of Finance is responsible for supervising the operations of the major RS financial systems and sub-systems, which, inter alia, include the following:

The process of preparing the RS budget rests on the mid-term expenditure framework and budget framework paper. The traditional model of economic classification prevails in budget preparation, although programme budgeting based on the MTEF and resource allocation in line with the Government's policies are being introduced through projects funded by the United Kingdom.

Budget execution and cash management. The RS budget is executed in accordance with the Budget Execution Act, which sets forth the budget to be executed and cash management requirements. The Budget Execution Act is implemented through annual and monthly spending plans in accordance with the previously set spending priorities. The automated treasury system ensures that no disbursements are made without a proper budget adopted for the purposes and prior monthly allocation of funds. The budgetary users verify, approve and authorise disbursements, whereas the actual disbursements are made by the Treasury.

Budget execution controls. The ministers and managers of Republican administrations and agencies are accountable for executing the budget in line with the Budget Execution Act. The MoF's budgetary inspection is in charge of ex post control of the legality of the budget execution by the RS budgetary users in accordance with the Budget Execution Act.

Wage computation. Each budgetary spending unit manages its own wage system. However, the treasury system has built-in controls for capping the wage expenditures relative to the budget adopted for the purpose, hence it is impossible to make disbursements that exceed the given ceiling.

The accounting system. The RS has a single accounting system for the public sector. The RS Treasury maintains official accounting records of all budgetary users. The treasury system has significantly improved the availability and quality of financial reporting in the public sector. The MoF is bound to control financial reports submitted by the budgetary users, municipalities and cities as well as public funds. Annual reports on budget execution are submitted to the RS Parliament in a timely manner. The Treasury prepares consolidated annual reports for the Government.

The Fixed Assets Register is maintained by budgetary spending units. The records are conciliated on an annual basis along with inventories carried out by budgetary spending units.

The Tax Administration records all direct tax liabilities and non-tax revenues, and monitors related defaults. The Tax Administration conciliates its records with the records it receives from the Treasury. The Tax Administration also conducts audit of the correctness of assessments and payments of direct taxes and non-tax revenues of the RS.

The Public Procurement Agency is responsible for proper application of the Public Procurement Act. The Agency carries out its functions through setting up a system monitoring the application of the statutory requirements by contracting authorities. Procurement activities are conducted within each public fund user in accordance with a procurement plan and allocated funds.

The Complaints Office is an autonomous administrative organisation set up under the Public Procurement Act, the purpose of which is to deliberate upon and issue second-instance decisions concerning the complaints lodged by suppliers as regards the public procurement procedure conducted by a contracting authority. The Office is a body that carries out ex post control of the implemented procurement procedure.

Ministries, republican administrations and agencies are responsible for operational and material and financial activities. This includes responsibility for budget planning and execution, managing the payment system in line with the relevant law, maintaining the fixed assets register, accounting records, public procurement function, etc.

Towns and municipalities prepare and execute their budgets in accordance with the RS legislation. Accounting and reporting are based on the treasury system of towns and large municipalities. They are responsible for managing and handling property. The Ministry of Administration and Local Self-Governance supervises the operations of local self-governance units.

The Republican Administration for Inspection Affairs (Inspectorate) controls the application of statutes in various areas under the jurisdiction of republican, municipal, town and local authorities. The control includes occupational safety and health related issues, transactions in goods, catering related issues, protection of waters, protection of forests, etc. The Inspectorate's operations are subject to the RS Government's oversight.

4.2. IFC related activities as implemented so far

The recently completed activities that have significantly affected the PIFC development certainly include the activities of international institutions as well. The following international institutions have given the most significant contribution:

- The World Bank has prepared a BiH Financial Management Fiduciary Updating Document, which includes financial management in the Republic of Srpska as well.
- A public administration reform document - project, prepared by the European Commission, also provides for public finance reform, within which the introduction of PIFC in line with EU requirements is separately provided.
- The World Bank has secured significant additional support and conditioned the loan by drafting and adopting an internal audit statute.
- The USAID has financed the setting up of the treasury system at the RS level and prepared an internal audit system framework.

- DFID's technical assistance has focused on supporting the reform of the RS budget planning process and improvement of budgetary systems and procedures.

4.3. Legal framework

The most significant legislation governing the control environment and IFC includes the following:

- Rules of Procedure of the RS National Assembly (RS Official Gazette No. 79/07);
- RS Public Sector Audit Act (Official Gazette No. 98/05);
- RS Government Act (RS Official Gazette No. 118/08);
- RS Public Sector Internal Audit Act (RS Official Gazette No. 17/08);
- RS Budgetary System Act (RS Official Gazette No. 54/08, 126/08, 92/09);
- Republican Administration Act (RS Official Gazette No. 118/08, 11/9)
- Treasury Act (RS Official Gazette No. 16/05, 92/09);
- Budget Execution Act (RS Official Gazette No. 115/09 for the 2010 budget);
- RS Inspections Act (RS Official Gazette No. 113/05, 1/08);
- Rules on Internal Controls and Internal Control Procedures of the Ministry of Finance (RS Official Gazette No. 110/04);
- Instruction on Implementing Internal Control Procedures and Segregation of Accounting and Disbursement Function (RS Official Gazette No. 18/05).

Article 31 of the Rules of Procedure of the RSNA "National Assembly Working Bodies" concerning deliberations of the issues falling within the authority of the National Assembly by commissions and boards, stipulates that the Audit Committee is a standing body of the RS National Assembly.

The RS Government Act is the fundamental statute enabling the Government to coordinate and guide the work of republican bodies of governance and oversee their work, as well as to stay the execution of, abolish and annul individual acts that are contrary to law or Government's acts.

The RS Public Sector Audit Act defines the authority and responsibility of the RSNA's Audit Committee in the area of funding the SAI's operations, audit planning, reporting on the SAI's performance, audit reporting, as well as control of the quality of audits and auditing reports.

The RS Public Sector Internal Audit Act sets up an internal audit function in RS institutions. The Act contains all requisite elements for setting up internal audit units. This refers to the responsibilities, principles and organisation of internal audit, conflict of interests, internal audit procedures and activities, as well as reporting irregularities or potential fraud. The internal audit function in public enterprises is provided for by the Public Enterprises Act.

The RS Budgetary System Act delegates to budgetary users the responsibility to set up internal controls and develop rules on internal control procedures. The Act also sets forth the MoF's responsibilities to control the accounting documentation of the budgetary users, municipalities, towns and extrabudgetary funds

The Treasury Act provides for a broad decentralisation of the responsibility to set up and maintain the management and control system as regards the execution of the adopted budgets, accounting function and accountability for accurate and timely financial reporting. The MoF's budgetary control function carries out ex post controls (inspection) of material and financial operations of the budgetary users. The Minister of Finance has the obligation to issue the rules on the manner of carrying out the management and audit of accounting and other records.

The Republican Administration Act defines the responsibilities of ministers and managers of republican administrations and agencies for lawful and efficient carrying out administrative, operational and material-financial activities within the institutions they represent. This implies the use of funds within the framework of the adopted budget. The ministries are responsible for supervising the operations of republican administrations and agencies that are attached to them in organisational terms.

The Tax Administration Act sets forth supervising the application of the legislation governing the area of direct taxation by the TA. The supervision is carried out through ex post controls (audits) of legality and accuracy of assessed and paid direct tax liabilities. The Act provides for the obligation of the TA to audit taxpayer direct tax liabilities in terms of their assessment and payment.

The Public Procurement Act defines the rights, duties and responsibilities of participants in public procurement procedures, as well as the public procurement control procedure.

The Complaints Office is yet another level of controlling the public procurement process as per complaints lodged by suppliers as regards the actions of contracting authorities in the course of a public procurement procedure.

The RS Inspections Act provides for inspection controls in the RS with a view to ensuring compliance with statutes and other regulations, as well as for other areas pertaining to the organisation, rights and duties of inspectors and other issues relevant to inspection activity.

The Local Self-Governance Act defines the jurisdiction of municipalities as regards inspection controls under the RS Inspections Act, as well as managing and handling the municipality's property. The Ministry of Administration and Local Self-Governance is responsible for carrying out administrative control of the operations of local self-governance units.

The Rules on Internal Controls and Internal Control Procedures within the Ministry of Finance defines the elements of the internal control model and control procedures concerning the administrative activities and accounting system.

4.3.1. Financial management and control

What may be concluded from the above is that provisions governing the FMC system in the RS public system are spread across a number of statutes. The provisions of the Budgetary System Act, Treasury Act, Budget Execution Act, Republican Administration Act,

concerning FMC, are not incompatible as regards defining the accountability for certain financial systems and controls. However, the said provisions are not a base sufficient enough to understand and apply the principles of management, managerial processes, overall managerial accountability, responsibility delegating, control standards, control procedure purposes, and other FMC criteria as required by EC regulations.

There are no statutes or required structures to set up a comprehensive PFMC in the RS. Although there is an understanding of significant control procedures that are applied in the majority of public institutions and financial systems, the internal control systems for significant systems and institutions has not been established yet. Control procedures and findings of the conducted control procedures are not transparent or available to higher organisational levels.

Preliminary controls that are applied in certain systems and institutions, as well as ex post controls (inspections) are not interdependent and do not constitute a chain within which they would easily relate to each other in respect of the same system or institution. There is no coordination of planning or carrying out managerial and control activities.

Although notable progress in terms of the legislative framework and bylaws has been observed, particularly following the adoption of the Rules on Internal Controls and Internal Control Procedures, the implementation of the Rules itself has not been observed not only because of the assumption that all budgetary users need additional capacities but also because of the fact that the Rules do not constitute a sufficient base for setting up or functioning of the internal control system.

The control procedures mainly refer to the control of budget execution relative to the planned amounts and accounting controls, and do not include the issues of efficiency and effectiveness of the executed budgets.

Given the fact that PIFC predominantly rests on controls through treasury systems in the RS public institutions, which primarily implies reconciliation with cash flows produced upon the budget approval, the absence of responsibility delegating and public expenditure managing in a manner that will enable the attainment of the organisation's goals and an efficient and effective use of resources are a flaw of the current system of management and controls in terms of the requisite EU principles of management and control standards.

The existing treasury systems with good financial controls and special authority to access the treasury system, as well as the compulsory approval procedure do not guarantee the quality of public expenditures or an added value for the money consumed.

The current legislation do not require the budgetary users to prepare annual reports on the FMC efficiency and effectiveness, which would be a basis for monitoring the FMC system development and consolidated reporting to the RS Government.

4.3.2. Internal audit

The RS Public Sector Internal Audit Act was adopted in February 2008.

The RS Public Sector Internal Audit Act having been adopted, a legislative framework was created for setting up internal audit units within the RS public sector institutions, which met the statutory criteria as to the size of their annual budget, total staff and value of annual transactions.

Units for internal audit of RS institutions are established as autonomous bodies that are accountable to the institution's manager. The functional autonomy, internal audit activities, reporting, follow-up reviews and quality assurance are provided for by the RS Public Sector Internal Audit Act. So far, approximately thirty internal audit units have been established within the RS public sector institutions. Although certain ministries, municipalities and extrabudgetary funds, as well as other republican administrations and agencies, have recruited internal auditors under the Internal Audit Act, the process of setting up internal audit units has not been completed in each institution.

The MoF is obligated to adopt rules on additional criteria for setting up internal audit units. The Rules will enable establishing an adequate structure of the RS public sector internal audit units in such a way that the internal audit functions covers those institutions that are not bound by law to set up such an internal audit unit.

The Internal Audit Act and Rules on Additional Criteria for Setting up Internal Audit Units should enable setting up a unit with an IA function in approximately 950 (as reported) public sector institutions.

The internal auditors currently employed have mainly been trained through training programmes of the RS Association of Internal Auditors, which operates within the RS Association of Accountants and Auditors. The activities of these internal auditors are mainly focused on creating the necessary control environment for carrying out the internal audit function, notably drafting rules, understanding the institutional system, establishing the required structure of units, producing strategic and annual plans, etc. Audit activities of the internal audit units as established mostly include audit of the compliance of individual systems of a given institution with the applicable regulations.

In terms of the work of those internal auditors that meet the competence criteria, it will be necessary to define and adopt relevant bylaws and IA standards in accordance with the internationally recognised IA practices. An additional training programme for the IA function in the public sector institutions and training according to the adopted programme would significantly improve FMC and ensure that the statutory management and control models are applied.

Public enterprises in RS have introduced the IA function under the Public Enterprises Act.

4.3.3. Central Harmonisation Unit (CHU)

Pursuant to the Internal Audit Act, a central unit for the harmonisation and coordination of the FMC system and internal audit will be set up within the RS Ministry of Finance. According to the Rules on the Organisation and Staff Specification of the Ministry of Finance, the CHU will be organised in three departments:

The FMC Department is responsible for drafting regulations in the FMC area, monitoring the application of the adopted regulations and reporting on the status and progress of the FMC system. Through the IFC Strategy project document, the Department will adopt training programmes for the staff responsible for the FMC system and ensure the implementation of the adopted training programme. The training programmes will identify the areas of training that will be trusted to outsourced institutions as well as parts of the programme to be implemented by the CHU.

A task of the CHU's Internal Audit Department is to define standards and methodology for carrying out the IA function in RS public sector institutions; monitor the application of adopted regulations; report on the state and progress of the IA function; propose measures to mend any weaknesses in the IA functioning; as well as to propose programmes for the training of internal auditors and implementation of such programmes in practice.

The Information and Communication Department will identify all important information that arises from the implementation of this project, as well as its timely communication through the RS public administration system. The identified information and established system for communicating with interested parties will ensure prerequisites for storing important data and their use with a view to efficient coordinating the development and monitoring of the FMC system and IA function.

The CHU will coordinate the setting up and development of the relevant structure of IA units by proposing the necessary regulations, monitoring their application and reporting on corrective actions to be deployed in order to ensure an optimal structure of IA units. The CHU will coordinate the work of internal auditors through harmonised IA rules, work methodology, standards and code of ethics, training programmes, certification of internal auditors and monitoring of annual reports of IA units.

No CHU staff will be involved in the performance of tasks of any IA unit.

The RS Government has appointed the CHU manager. The actual staffing of the CHU is currently ongoing.

5. PIFC development in the Republic of Srpska

PIFC establishing and development in the RS will evolve on the basis of policies developed by the EC, RS PIFC Strategy and best practices of the states that have joined the EU in applying the said EC concept.

This implies that the RS will adopt the statutes that will serve as a prerequisite for setting up the missing structures and bodies within the RS institutions, which will be responsible for developing and implementing their respective FMC systems and IA functions. In addition to the missing statutes, structures and bodies that would deal with the internal financial control, a definition and adoption of lower-level regulations, be it for the FMC, managerial accountability or IA function, would enable further improvement of the control environment in the RS public sector and managing public funds in line with the sound FMC principles.

A particular emphasis is placed on the need to develop relevant training programmes for the staff to be hired to introduce certain FMC models and IA functions into the public sector institutions, as well as examination programmes and certification of the staff that has successfully completed the demanding training programmes. Since there is no single control environment model that would be shared by the administrations countries acceding to the EU, good understanding of internationally recognised management and control principles, best practices of EU Member States, weaknesses of the current IFC system and reform processes currently implemented in the related financial systems constitute grounds for setting up, implementing and developing an efficient IFC system.

The principles of managerial accountability related to the integrity, ethical values and policy of staff competence will be a significant basis for introducing responsible, efficient and effective spending of public funds, which needs to include regular annual reporting on sound FMC developed in each institution.

The structure of PIFC units as set up in the RS, IA regulations, IA methodology, adopted standards, codes of ethics, training programmes and certification of internal auditors, resting on the best practices, will enable internal audit to provide reasonable assurance of the effectiveness of the established models of risk assessment, controls and management in the RS public sector institutions.

The CHU is a structure within the Ministry of Finance that will be responsible for defining and adopting aligned regulations for introducing an FMC system and IA function. The CHU will coordinate the setting up of the FMC system and IA function in such a way that each institution establishes an efficient FMC system and that competent internal auditors provide reasonable assurance that the system will be both adequate and efficient in a given time period.

Networking the CHU with related institutions and bodies of other candidate or member states would enable an exchange of information that is requisite for setting up and developing FMC and IA in accordance with internationally recognised standards and best practices.

The same approach to FMC setting up and developing would apply to the structures designed to manage and control the use of EU funds.

The provisional time frame for the implementation of the action plan arising from the RS PIFC Strategy is five (5) to seven (7) years.

An initial assessment of costs of the required PIFC system itself is not possible since a number of conditions as regards the data on the costs of the FMC system to be set up and resulting benefits need to be met.

The best guarantee that the control costs will not exceed the benefits this process will ensure will be an effort to coordinate the management and IA systems in such a way that they constitute a comprehensive system that will exclude any possibility of unnecessary or potential overlapping of managerial and control procedures in individual systems and institutions, and forecast an interim period for acquiring the necessary knowledge and skills by the current staff engaged to work on IA and FMC issues.

The costs of introducing the IFC in the RS public sector will be significantly affected by the aspects of assistance to be provided by the EU through a project document that will be adopted on the basis of the activities and goals as contained in this document.

The IFC costs may also be affected by events that may present a potential risk for successful PIFC establishing, such as: insufficient commitment to changes in the RS public sector, inability to recruit competent staff (including the CHU) and inadequate training.

Annual reports on the implementation of the Action Plan of the PIFC Strategy will be submitted to the RS Government along with reports on deviations from the planned activities and reasons for any failure to implement them.

5.1. Development of managerial accountability

The managerial accountability in RS institutions will be defined through the FMC System Act and supplemented by relevant rules to introduce additional criteria as regards managerial accountability in individual financial systems and institutions in the RS public sector. The said Act will also define the responsibilities of the institutions' manager for establishing and operations of the relevant FMC system.

Since it is not possible for the managers to carry out all of the managerial functions and activities on their own, regulations will provide for a possibility to delegate their responsibilities. It is for this reason that it is necessary to incorporate certain provisions to enable such delegation of responsibilities. Such delegating must be accompanied by introducing obligations, reporting on the tasks accomplished as well as a possibility to withdraw any responsibility already delegated. Any delegating of this kind will not remove the ultimate responsibility of the organisation's manager. Training programmes for the FMC and IA areas, subject to compulsory preparation and implementation by the RS Ministry of Finance, will also define the training of manager in the area of managerial accountability.

A definition of the managerial accountability principle and relevant training of managers will be a prerequisite for creating a control environment for the management and control system based on the attainment of the organisation's defined goals along with an efficient and effective use of resources, lawful and correct operations and reliable and timely information.

5.2. Development of the FMC system

The development of the FMC system in the RS, based on the international standards and best practices of EU institutions and Member States, will commence with the adoption of the PIFC Strategy and enactment of the RS Public Sector Internal Audit Bill. The development of the FMC system will continue with defining and adopting statutes on the FMC system, based on which other necessary FMC bylaws will be prepared. Following the drafting of initial regulations governing the FMC setting up, organisational changes would be initiated, where structures will be introduced in respect of the staff authorised and responsible for individual financial systems and institutions in accordance with the rules the MoF is currently preparing. The established structures will be responsible for developing a relevant FMC model in accordance with the prescribed criteria and framework FMC models.

Control activities to be introduced should include clear policies and procedures for each of the key processes and keep the significant risks at an acceptable level. The control activities will include ex ante, ongoing and ex post control activities, which will include the following:

- Granting authorisations and approvals,
- Segregation of duties and responsibilities for key activities;
- Verification of transactions and events prior to and upon their execution,
- Regular reconciliation of the records with significant documentation,
- A review of processes and activities in terms of the application of the current regulations, policies, procedures and other requirements,
- A review of critical points of the performance of every member of the staff (supervision),
- Control of access to assets and records,
- IT controls, etc.

The Action Plan of the PIFC Strategy will enable a gradual introduction of an efficient FMC system, which will ensure a systemic approach and full coverage of the RS institutions depending on the level of development and application of certain important financial systems and subsystems.

The development of the FMC system will be based on the adopted methodology for assessing the current situation in the area of financial management and control of important processes and/or institutions as compared to the goals and activities listed in this document. The methodology to assess the current situation will be defined and adopted through a plan for the implementation of the IFC Strategy for each important system to be observed in accordance with the plan of activities.

In order to successfully implement the FMC system, it is necessary to develop, adopt and implement training programmes for managers, who will be responsible for setting up a relevant FMC system. The training programme should include managerial processes related to strategic planning, strategic risk assessment, internal control system, HR management policies, annual reporting on operational activities, delegating responsibility and authority for the FMC system and annual reporting on the FMC system. The programme should cover the highest level of managerial accountability or staff in the RS institutions, which will be delegated the said managerial accountability.

At its initial stage, the training will be conducted by foreign experts and CHU staff, whereas later on it will be possible to involve outsourced institutions (universities and professional expert associations) and trained trainers. The development of managerial accountability and FMC in the RS public sector is a difficult task that implies certain risk since it is about introducing activities that demand changing the mind-set and understanding one's responsibilities. Since this project has already been launched through the process of preparing the BFP, multi-annual planning of expenditure framework, fiscal forecasts and projections as well as recommendation from the SAI reports, it would not be justified to postpone further activities as regards establishing a comprehensive FMC in the RS public sector institutions.

5.3. *Development of internal audit*

The IA development in the RS public sector (excluding public enterprises) started upon the enactment of the RS Public Sector Internal Audit Act in 2008.

Internal auditors are recruited to work in the RS public sector institutions according to the criteria for establishing IA units as prescribed in the IA Act. A comprehensive, decentralised structure of IA units in the RS public sector will be established through additional criteria for setting up IA units by the RS MoF's CHU.

Since the adopted EU standards define IA as a component element of PIFC, the IA function in the RS public sector institutions will be further developed as part of a comprehensive PIFC system.

In order to avoid any possibility in the initial period for internal auditors to be required to carry out the financial management function along with setting up a control system in their respective institutions, the IFC implementation plan will ensure successful establishing of the IA function with the FMC system development. This particularly refers to recruiting internal auditors to assess the FMC system.

The internal auditors will be free to choose the type of audit according to the goal as set to be achieved, strategic plan prepared on the basis of a risk assessment and annual plan of activities. This implies a review of all functions, processes and systems, including the FMC system established by the management. The internal auditors will report and suggest improvements of the FMC system and monitor correcting any observed irregularities.

The methodology of work and guidelines for carrying out IA activities, performance standards and code of ethics for internal auditors will be developed in parallel to establishing the FMC system. All of the above documents will be based on internationally recognised standards and best practices as regards the IA function. Through relevant training of internal auditors and pilot projects related to carrying out internal audits based on the assessment of the established management and control system, the efficiency and applicability of the adopted work methodologies and competence of internal auditors would be verified.

Due to the fact that the training of RS internal auditors is provided by the professional organisation *RS Association of Accountants and Auditors (AAA)*, the training programme for internal auditors to be adopted by the CHU will include the existing AAA's training programme. So far, some 200 internal auditors have completed the AAA training programme. The AAA's training programme combined with additional knowledge and skills from the programme to be approved by the CHU will be a condition to acquire a certificate of the RS MoF in accordance with the Internal Audit Act.

The EC technical assistance concerning the implementation of the IFC policy and Action Plan of the PIFC Strategy will be aimed at training of internal auditors according to the adopted training programme or RS public sector internal auditors. Any initial training of a number of internal auditors to be funded from grants or donor funds of the Member States would be identified following the adoption of the rules to define additional criteria for setting up IA units and recruitment criteria for internal auditors, and would include at least the current internal auditors employed in the RS public sector.

According to the Internal Audit Act, IA units are subject to an external review of the quality control of their work every five years, which will be conducted by an independent organisation or person in accordance with the Internal Audit Act.

5.4. Central Harmonisation Unit (CHU)

Based on the adopted RS Public Sector Internal Audit, the Rules on the Organisation and Staff Specification of the Ministry of Finance, a CHU has been established within the MoF. In early 2009, the RS Government appointed the CHU manager and the staff recruitment is expected to continue in accordance with the Rules on the Organisation and Staff Specification for the CHU.

The CHU has been organised in such way that it independently carries out the tasks defined in the respective statutes. The CHU consists of the following organisational parts:

- Department of establishing and monitoring the application of FMC regulations,
- Department of establishing and monitoring the application of IA function regulations, and
- Department of information and communication.

The CHU organisation of work, as above, should enable responsible and timely performance of tasks. These tasks will include the following:

- Drafting the CHU rules,
- Drafting FMC statutes and bylaws for FMC,
- Preparing and adopting the principles and framework control standards based on international standards and best practices,
- Drafting the Rules on additional criteria for setting up an efficient IA structure in the RS public sector,
- Drafting and adopting the framework rules on the work of internal auditors,
- Drafting and adopting a code of ethics for internal auditors based on international standards,
- Drafting and adopting the methodology and guidelines for the work of internal auditors,
- Drafting and adopting the framework rules on recruitment requirements and knowledge and skills of internal auditors,
- Defining a training programme and organising training of the management and staff responsible for FMC,
- Defining a training programme and organising training of internal auditors,
- Coordinating the establishment and development of the FMC system and IA function.
- Monitoring the application of regulations governing the FMC area through analyses of annual reports on the FMC system submitted by the RS institutions,
- Monitoring the application of regulations governing the IA area through analyses of annual reports on IA submitted by the RS institutions,
- Preparing consolidated annual reports on activities related to establishing and developing of the FMC system,
- Preparing consolidated annual reports on establishing and developing the IA function in the RS public sector,
- Drafting other regulations necessary for establishing and developing the FMC system,
- Networking with CHUs of other countries with a view to exchanging best practices.

As for the consolidated reports, the RS CHU will have to prepare one consolidated report on FMC and one consolidated report PIFC in the RS. The CHU consolidated reports will aggregate all annual reports of all RS institutions affected by the FMC and IA regulations. The CHU annual reports will be subject to the MoF's approval and adopted by the RS Government.

The CHU will define a methodology for an internal assessment of the effectiveness of the CHU performance. The methodology will be based on internationally recognised assessment standards and best practices of EU Member States. The CHU annual reports will be published on the RS MoF's web page. An external assessment of the CHU performance will be conducted once in five years through a SIGMA peer review or by EC auditors, which will be defined in the Rules on the work of the CHU coordinating body.

To achieve successful development and implementation of the regulations governing the CHU, ranging from the CHU rules of work to drafting respective statutes, methodologies, procedures and reports, development and implementation of training programmes for FMC, IA, including the CHU staff, EC expert support will be ensured through a project that will support establishing PIFC in the RS.

It is necessary to ensure an exchange of experiences with CHUs of EU Member States that have established and efficiently carry out their PIFC function in accordance with EU requirements. It is necessary to define the missing statutes pertinent to financial management, internal control and internal audit on the basis of relevant regulations and good practices of EU Member States along with their necessary adaptation to the circumstances delineating the current FMC system in the RS institutions.

5.5. Management and control of IPA assistance and EU funds

The Republic of Srpska will set up and develop all of the required structures and procedures for assuming the functions of management, execution and control of the IPA and EU funds in accordance with the required decentralised management model.

NIPAC. The National IPA Coordinator for the Republic of Srpska with a relevant service. The National Coordinator will be appointed by the RS Government and responsible for coordinating programming at the RS level, priority setting, distribution of funds under the programme, monitoring and evaluation for projects implemented at the RS level. S/he will also be responsible for the vertical coordination with IPA coordinators at other levels of governance in BiH.

CAO. The Competent Accreditation Officer will be the RS Minister of Finance, who will be appointed by the RS Government. He will be responsible for issuing, monitoring and suspension of accreditation of the National Fund and National Authorising Officer for the Republic of Srpska.

The National Fund, headed by the **National Authorising Officer (NAO),** will be structures to channel the EU funds for the Republic of Srpska and coordinate the financial management of EU assistance. The National Fund will be placed in the Department of the

Treasury of the Republic of Srpska, whereas the Assistant Minister for the RS Treasury will act as the National Authorising Officer on behalf of the Republic of Srpska.

CFCU. Central Finance and Contracting Unit at the level of the Republic of Srpska. In organisational terms, this unit will be placed with the MoF's Department of Public Investments and be responsible for coordinating the operations of the implementing agency (or operational structures of individual ministries and municipalities) or persons responsible for individual project components. Within the competent ministries, towns and municipalities of the Republic of Srpska, relevant operational structures will be set up, which will be responsible for implementing one or more programmes for the implementation of sectoral policies.

The MoF's Internal Audit Unit will be responsible for verifying the efficiency of the management and control system that have been set up to manage certain programmes, legality and regularity of transactions under IPA projects, as well as other auditing activities as required in financial agreements.

The Supreme Audit Institution of the Republic of Srpska will conduct an external audit of the efficiency and effectiveness of programmes implemented within the RS institutions, as well as any other audits as required by financial agreements with the EC.

According to the above structure, the Rules on the Organisation and Staffing Specification for the RS institutions will be amended.

5.6. Identification of controls / procedures related to significant irregularities and fraud

One of the aims of developing an internal control system in the public sector of the Republic of Srpska is to prevent and identify in a timely manner significant irregularities and potential fraud. To that end, it is necessary that the institutions report on the observed irregularities and measures to prevent them, monitor and undertake corrective actions as regards EU funds and RS budgetary allocations alike.

The RS Public Sector Internal Audit Act lays down an obligation of internal auditors to notify the manager of the IA unit in case of any irregularity and/or fraud. The IA unit managers are bound to notify the organisation's manager and prosecutor's office in case they suspect an irregularity **and/or** fraud.

The MoF will set up a structure to record irregularities in consuming the domestic budget allocations and EU grants and funds. Written procedures for actions to address the reported irregularities or potential fraud or suspicion of fraud will create a relevant control environment for efficient reporting and acting upon the reported irregularities in the RS public sector.

6. The Action Plan for Implementing the PIFC Strategy

The Action Plan has been prepared on the basis of the information available as regards the technical assistance to be provided by the EC to establish the PIFC in the Republic of Srpska.

Any changes of the development needs and activities to set up an efficient IFC system in the RS are provided for in the draft ToR prepared by the EC. Such changes may be subject to final negotiations between the end-user (RS MoF) and selected consultant, and may be defined in the initial period of two months following the signing of the agreement with the selected consultant.

Action Plan

No.	Development needs	Indicators	Deadline
1.	Central Harmonisation Unit	Permanent CHU staff	1st half 2010
2.	PIFC Strategy	PIFC Strategy adopted	1st half 2010
3.	Project agreement	Project agreement and financial agreement signed	1st half 2010
4.	CHU Rules of procedure	CHU Rules of procedure adopted	1st half 2010
5.	Cooperation of the CHU with responsible personnel of ministries, republican administrations, agencies, funds, towns and municipalities	Presentations on IFC importance held in ministries, republican administrations, agencies, municipalities, funds, etc.	By the end of 2010
6.	Methodology to assess the current system of management and controls of significant systems and institutions	Methodology to assess the current system of management and controls adopted	On a continuing basis from 2010 to 2012
7.	Provisions governing the FMC system and managerial accountability	Provisions governing the FMC system and managerial accountability	By the end of 2010
8.	Principles of management and control standards of international professional institutions	Principles of management and control standards of international professional institutions adopted (INTOSAI, COSO, etc.)	On a continuing basis from 2010 to 2012
9.	Best FMC and IA practices	Networking with CHUs of EU Member States and translation and updating of standards, guidelines and modus operandi	On a continuing basis from 2010 to 2012 and onwards
10.	Training programme and rules on requirements for FMC staff	Training programme and rules on requirements for FMC staff (with managerial accountability)	On a continuing basis from 2010 to 2012 and onwards
11.	Training of FMC staff and a pilot project to set up an FMC system	Managers and FMC staff trained and carrying out their duties in line with the required knowledge and skills	The process will commence in 2011 after the necessary requirements related to the established capacities have been met and evolve on a continuing basis

12.	Additional criteria for setting up IA units	Rules on Additional criteria for setting up IA units	By the end of 2010
13.	Rules on the work of IA units	Framework rules on the work of IA units adopted	By the end of 2010
14.	Standards for the work of and code of ethics for internal auditors	Standards and code of ethics for internal auditors adopted as based on internationally recognised standards	By the end of 2010
15.	IA methodology	IA methodology adopted	On a continuing basis from 2010 to the end of 2012
16.	Training programmes and rules on IA recruitment	Training programme for internal auditors adopted Rules on IA recruitment adopted	On a continuing basis from 2010 to 2012
17.	IA and CHU staff training, including pilot audit	IAs trained carry out IA functions according to the adopted IA standards, code of ethics and methodology	The training process will commence in 2010 with the training of the current IAs and will be organised a continuing basis as IA units and recruitment evolve
18.	Standards of annual reporting on FMC and CHU	Initial annual FMC and IA reports Initial consolidated CHU report	On a continuing basis from 2010 to 2012
19.	Standards of annual reporting by IA units and CHU	Initial annual reports by IA units developed Initial consolidated IA report by developed by the CHU	On a continuing basis from 2011 to 2012